

Chapter 4

Economic Effects in Islamic Stock Development of the European Countries: Policy Recommendations for Ethical Behaviors

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ABSTRACT

The purpose of this chapter is to understand whether economic growth and inflation rate have an effect on the development of Islamic stock market. Within this context, quarterly data of 13 European countries for the periods between 2002:2 and 2016:3 are analyzed with Dumitrescu Hurlin panel causality test. It is concluded that inflation rate and economic growth have a significant effect on the development of Islamic stock market. Because economic growth affects private investment in the country, it has an important impact on the development of Islamic stock exchange. Additionally, inflation rate is accepted as the main cause of Islamic stock market development because it increases uncertainty in the market. Hence, it can be said that countries should focus on the policies to decrease high inflation rates and increase economic growth. With the help of these kind of actions, it will be possible to improve Islamic stock market in the country. Because companies, which are included in Islamic stock market, have to obey ethical rules, it will improve the performance of the economies as well.

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INTRODUCTION

Stock exchange refers to the place where marketable securities can be traded according to legal rules (Kraus and Stoll, 1972). As it can be understood from this definition, it plays a very significant role for the economies of the countries. First of all, companies can reach the resources they need much easily with the help of stock exchange (Galaz et. al., 2015). Owing to this situation, it helps to increase private investment in a country. In addition to this aspect, investors can have a dividend income for the stocks they purchased (Narayan and Ahmed, 2014). As a result, it can be said that stock exchange contributes the economic development of a country (Levine and Zervos, 1998).

Because of the aspects emphasized above, it can be seen that stock exchange development should be provided for economic stability (Panetta, 2002). Within this scope, stock exchange index is considered an important indicator that shows the performance of stock exchange. It calculates the price movements of the stocks in the market as a whole (Laboissiere et. al., 2015). When this index increases, it means that the trade volume in this market goes up as well. This information will attract new investors to come into the stock market. The main reason is that investors generally follow the values of stock exchange indexes in order to have a view of the general performance of the stock exchange.

It was accepted that there are some macroeconomic factors that affect the performance of stock exchange. First of all, there is a negative relationship between interest rate and stock exchange value since higher interest rates have a decreasing effect on the investment of the companies (Andries et. al., 2014). Moreover, exchange rate volatility also causes decreases in the value of stock exchange because investors do not prefer to make investment in such a risky environment (Chkili and Nguyen, 2014). Additionally, current account deficit, unemployment and political instability are other problems that affect stock exchange volume negatively due to the similar reason (Akbalık and Özkan, 2017), (García-Izquierdo et. al., 2015).

Furthermore, inflation and economic growth are also very significant factors that have an important impact on the development of stock exchange. Higher inflation rate leads to increase in input prices. Because it affects the investment of the companies negatively, it can be said that it has a decreasing effect on stock exchange value (Iqbal, 2017). In addition to the inflation rate, economic growth plays a critical role with respect to the performance of stock exchange market. Because economic growth shows the improvement in the economy, it has a positive relationship with stock exchange development (Ngare et. al., 2014).

Islamic stock exchange is a new topic in the literature that has an increasing popularity. It contains the stocks of the companies whose operations are not against with Islamic rules (Sakti and Harun, 2015). In other words, the companies that trades related to gambling, alcohol, interest and pork products cannot be included in this stock exchange. Therefore, it can be said that Islamic stock exchange has an important power to attract the attention of the investors that give importance to the religious rules. Furthermore, this index also provides a suitable and effective investment environment to non-Muslim investors (Hussin et. al., 2012), (Karim et. al., 2012).

Business ethic refers to the rules and policies which regulate the financial market (Yizheng, 2005). Therefore, it can be said that it is also an essential topic for the stability of financial markets because it provides security in this market (Hawley, 1991). Since investors prefer to make investment to the market they can trust, business ethic rules have a positive impact on economic development of the country. Otherwise, investors will be reluctant to increase their investments, and this leads to financial problems for this country (Abdul Rahman et. al., 2010), (el Alaoui et. al., 2015).

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