Chapter 7

Evaluating Microeconomic Factors, Financial Crisis, and Stock Price Dynamics:
Evidence From MENA Region

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ABSTRACT

The purpose of this chapter is to examine the impact of microeconomic factors and the global financial crisis (GFC) on stock prices in the Middle East and North Africa (MENA) region. The study employs panel data techniques covering a sample of 277 firms listed in seven MENA countries for the period 2000-2015. The empirical model consists of eight microeconomic (firm-specific) variables and a dummy variable to capture the impact of global financial crisis. The results suggest that microeconomic factors play a vital role in determining stock prices in the MENA region. More specifically, factors such as return on equity, book value per share, dividend per share, earnings per share, and price-earnings ratio positively influence stock prices, while dividend yield and gearing have negative impact on stock prices. In addition, firm size posits a positive and statistically significant relationship with stock prices. However, the GFC seems to be insignificant determinant of stock prices in the case of MENA countries in the sample studied. This chapter provides several practical implications.

INTRODUCTION

The current geopolitical tensions coinciding with the long standing 2007 global financial crisis has had excruciating repercussions on the economic and financial conditions of the global community especially on stocks, oil and share prices in the first quarter of 2018. This wave of uncertainty hit the emerging markets as well. It is here that the issue of stock market integration surfaces because a highly integrated stock markets pre-supposes similar prices as well as parity in risk premiums. On the other hand, studies by Granger and Morgenstern (1970), Agmon (1973), and Hilliard (1979) purports that share price interdependency is more intense within a county than among countries. Jiang et al. (2017) discuss various market integration theories, the information spillover effect offers an ideal rationale for the same. The spillover effect hypothesis argues that "since the opening times of stock market are different in different countries and regions, the information of the stock market will, in turn, reflect on their assets price, which leads to the correlation between different stock markets" (Jiang et al., 2017, p. 3). The same conclusion was found by Awartani et al. (2013) who studied the directional spillovers from the U.S. and the Saudi Market to Equities in the Gulf Cooperation Council Countries. Dornbusch et al. (2000) assigns these cross-market linkages which is an outcome of a particular shock in a specific economy to a concept called the Contagion effect. They further discusses two root causes of contagion in emerging markets (see also Masson,1998 and Wolf, 1999) the first being the result of interdependence due to financial linkages and the second being the result of investors withdrawing funds many other markets (also known as the irrational phenomena) due to financial panics, loss of confidence and increased risk aversion.

Acording to Verrecchia (2001), it is the financial reporting systems that provide firms' vital information to the capital market and when investors generally trade stocks on the basis of aforesaid information, the stock prices converge to their fundamental values. Additionally, such information is considered value relevant if they reflect on stock price movements. However, current realms of uncertainty mandates investors to comprehend some indisputable analytical tools which will aid them in making sound, rational and judicious investment decisions over and above deciphering their relationship with stock prices (hereafter SP). That said, a few relevant models embraced by the investing community serve as possible explanations for SP fluctuations. The most fundamental approach employed is inarguably the Gordon (1962) growth model where investors base stock prices on the discounted present value of future expected dividend payments. Also, Ross's (1976) Arbitrage Pricing Theory offers two dimensions namely macroeconomic forces and internal forces for investors to base their decisions related to assessing the SP. While the former relates to changes in governmental regulations, business cycle volatilities, changes in investor's attitude, fluctuating market conditions, natural calamities and contingencies like strikes, lock outs etc., the latter focuses on internal forces in a company such as financial statements, as determinants of SP.

Needless to say, investor purchasing behaviour is apparently preceded by several supporting theories. To begin with, the efficient market hypothesis propounded by Fama (1991) explicitly assigns a strong connection between accounting information and SP, as such information seamlessly diffuses into the market (Chambers, 1974) and reflects in the form of demand fluctuations thereby affecting the SP. However, Debondt (1991) advocates the concept of 'mean reversion' where in stock prices mean reverting in the long run suggests a low stock price being followed by a relatively higher return, thus encouraging groups such pension funds to invest in equity markets after an apparent stock market slump (see also Vlaar, 2005). This acts as a forerunner to the overreaction hypothesis proposed by De Bondt and Thaler (1985, 1987) that investors tend to overreact to extreme price variations due to the ingrained nature of overweighing current information over prior ones. Alternatively, Spierdidijk and Bikker (2012) in their

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