

Chapter 5

Herding in Crisis: Financial Contagion and Collective Panic During Economic Turmoil

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ABSTRACT

This study investigates the impact of media coverage intensity, market volatility, investor sentiment, institutional investor activity, and regulatory announcements on market stability, incorporating the moderating effect of social network influence and the mediating effect of financial contagion. Using panel data regression and structural equation modeling, the research aims to provide a nuanced understanding of the dynamics influencing market stability. The findings reveal that media coverage intensity, investor sentiment, and regulatory announcements positively impact market stability, while market volatility negatively impacts it. Institutional investor activity also contributes positively to market stability. Furthermore, social network influence moderates these relationships, either amplifying or mitigating the impacts, and financial contagion mediates the effects, weakening the positive impacts.

INTRODUCTION

The occurrence of herding in financial markets has attracted substantial scholarly and practical interest, particularly during times of economic upheaval. Herding is the inclination of investors to imitate the acts of others instead of relying on their own information or analysis. This conduct has the potential to intensify market volatility

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and result in financial contagion, which is the transfer of distress from one market or asset to others, potentially causing widespread economic instability.

This study aims to comprehend the underlying mechanisms that lead to herding behaviour and its consequent influence on the stability of the market. In times of crises, multiple factors can amplify the tendency for individuals to engage in herding behaviour, which in turn can have an impact on market results. Media attention intensity is a significant factor. The media has a vital role in influencing how the public perceives things and how investors feel, particularly in times of uncertainty. Extensive media attention can magnify apprehensions and uncertainties, resulting in a shared state of terror among investors. Due to the quick dissemination of information, frequently with a bias towards bad news, investors may react impulsively, basing their actions on the apparent majority opinion.

Herding behaviour is influenced by market volatility, which is an important independent variable. Elevated levels of volatility generally indicate ambiguity and peril, forcing investors to seek the security of the majority. During times of market instability, making decisions as an individual becomes more difficult, and the perception that there is safety in following the crowd can lead investors to imitate the activities of others (Xia & Madni, 2024). This conduct not only exacerbates the level of unpredictability but also weakens the stability of the market. Investor sentiment, which refers to the mood or attitude of investors towards market conditions, has a substantial impact on herding behaviour. Positive emotion can result in excitement and excessive confidence, prompting investors to collectively invest in assets that are overvalued. In contrast, a pessimistic sentiment can trigger a large-scale selling and a state of panic. Market fluctuations can be amplified and financial systems destabilised by the combined actions driven by shared feeling.

Understanding herding during crises is crucial, and institutional investor activity plays a significant role in this regard. Institutional investors, including hedge funds, mutual funds, and pension funds, frequently exert substantial market impact as a result of their substantial trading volumes. Their actions have the potential to trigger a series of interconnected responses among retail investors and other players in the market. When institutional investors initiate the sale of assets, it might serve as an indication of imminent danger, prompting others to do the same and thereby hastening the decline of the market.

Regulatory pronouncements have the potential to either reduce or intensify herding behaviour. In times of crisis, prompt and efficient regulatory measures can offer assurance and stability. Nevertheless, vague or postponed notifications might exacerbate ambiguity and instigate panic. Investors may perceive these signs as indications of fundamental issues, leading to herd behaviour as they hastily take measures to safeguard their investments. The variable being measured in this study, market stability, is affected by the independent variables described earlier.

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