

The Impact of Geopolitical Risks and the Oil Price Fluctuations on the Kuwaiti Financial Market

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Abstract : The aim of this paper is to identify whether oil price volatility or geopolitical risks can predict future financial stress periods or economic recessions in Kuwait. We construct the first Financial Stress Index for Kuwait (FSIK) that includes informative vulnerable indicators of the main financial sectors: the banking sector, the equities market, and the foreign exchange market. The study covers the period from 2000 to 2020, so it includes the two recent most devastating world economic crises with oil price fluctuation: the Covid-19 pandemic crisis and Ukraine-Russia War. All data are taken by the central bank of Kuwait, the World Bank, IMF, DataStream, and from Federal Reserve System St Louis. The variables are computed as the percentage growth rate, then standardized and aggregated into one index using the variance equal weights method, the most frequently used in the literature. The graphical FSIK analysis provides detailed information (by dates) to policymakers on how internal financial stability depends on internal policy and events such as government elections or resignation. It also shows how monetary authorities or internal policymakers' decisions to relieve personal loans or increase/decrease the public budget trigger internal financial instability. The empirical analysis under vector autoregression (VAR) models shows the dynamic causal relationship between the oil price fluctuation and the Kuwaiti economy, which relies heavily on the oil price. Similarly, using vector autoregression (VAR) models to assess the impact of the global geopolitical risks on Kuwaiti financial stability, results reveal whether Kuwait is confronted with or sheltered from geopolitical risks. The Financial Stress Index serves as a guide for macroprudential regulators in order to understand the weakness of the overall Kuwaiti financial market and economy regardless of the Kuwaiti dinar strength and exchange rate stability. It helps policymakers predict future stress periods and, thus, address alternative cushions to confront future possible financial threats.

Keywords : Kuwait, financial stress index, causality test, VAR, oil price, geopolitical risks

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