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Thai Financial Markets and Political Change

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Abstract

This paper examines both short-run and long-run dynamics of return, volatility, liquidity and liquidity risk of returns on the Stock Exchange of Thailand (SET) index and USD/THB over the period of 1 January 1996 to 31 December 2011 to evaluate the effect of the Thai 2006 *coup d'états* and its interim military and civilian governments on financial markets. Heterogeneous reactions in the currency and stock markets in both short-run and long-run analyses are detected. The immediate reaction to the coup is more evident in the stock market with a reduction in stock return, a short-lived spike in return volatility and volume with an immediate reversal, and a drop in liquidity risk. However, the long-run impact is stronger in the currency market, where we find an increase in bid-ask spread but a drop in liquidity risk. Finally, the Coup reduces liquidity risk in the stock market in the long-run.

Keywords: Foreign Exchange Market, Stock Market, Liquidity, Realized Volatility, Realized Skewness, Bid-Ask Spreads, Political Risk.
JEL Codes: F31; G01; G15.

1 Introduction

Concepts and theories associated with capitalism, democracy and globalisation mostly originate from developed countries (or the West) such as the United States and Europe. The West has influenced the setup of the global financial system and has perpetuated the belief that the economy can only operate well under a democratic environment. Further, the advancement in technology and the globalisation of markets have made today's world «smaller» where there are essentially no constraints on where investors are able to invest or where institutions can raise capital from. The globalisation of markets has seen many developing countries, where their political system may not operate under a democratic environment, adapt the financial concepts and theories from the West. The financial

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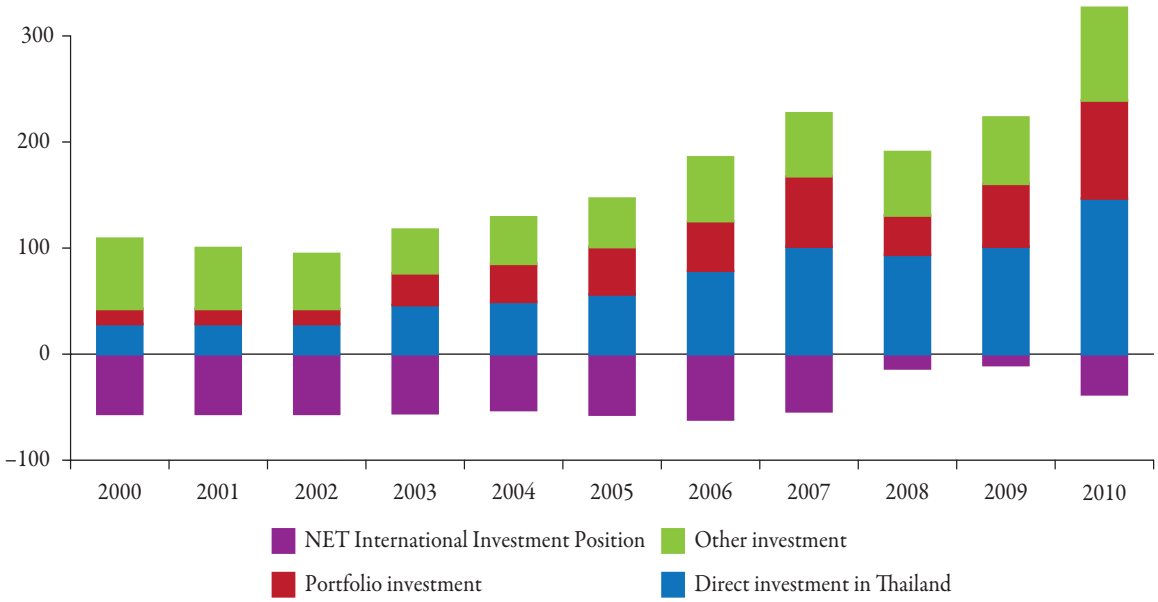

Figure 1: Thailand's net international investment position and some of its components from 2000-2010. Data is collected from Bank of Thailand. The unit for vertical axis is in billion US dollar. Data is downloaded from http://www.bot.or.th/English/Statistics/EconomicAndFinancial/ExternalSector/Pages/StatInternationalInvestmentPosition.aspx.

systems (such as their stock exchange, futures exchange and foreign exchange market) of these developing countries are generally modelled on those in the West.

Thailand is one of these developing countries that have and continue to rely on external funds from foreign investors to develop its economy as shown in Figure 1[1]. While Thailand, a constitutional monarchy, has modelled herself on the West by liberalising its financial system and allowing foreign investors to access the Thai market, Thailand has a political system that does not operate under a full democratic environment. The democratic system has been weak even though the Thais have had parliamentary democratic system since 1932. Over the past 80 years, the country was ruled by a succession of military leaders installed after *coup d'états*, the most recent in 2006. This paper asks whether the 2006 *coup d'états* has any effect on the Thai financial market. More specifically, has the Thai 2006 *coup d'états* and its interim military and civilian governments negatively affected the performance of the Thai equity markets and her currency (USD/THB)? Has the events in 2006 increased the volatility in the Thai stock and FX markets? Is the liquidity in Thai stock and FX markets negatively affected? Finally, has the 2006 events increased the liquidity risk in the Thai stock and FX markets?

Due to the unavailability of high-frequency data prior to 1996, this paper focuses only on the most recent 2006 *coup d'états* in Thailand, which is a significant political event that continues to have a lasting effect on the Thai society until the present day. Prior to the 2006 *coup d'états*, Thaksin Shinawatra, who was the Thai Prime Minister from 2001

[1] Figure 1 plots historical statistics of Thailand's net international investment position and some of its components such as foreign direct investments, portfolio investments and other investments. The negative net international investment position indicates that Thailand relies on external fund flows. Further there is an increasing trend in the three components of external fund flows.

to 2006, faced allegations of corruption, authoritarianism, treason, conflicts of interest, acting non-diplomatically, muzzling of the press, tax evasion, lèse majesté, selling assets of Thai companies to international investors for his own benefit, and concealing his wealth during his office. His claimed authoritarianism and misuse of power made it impossible for all Thais to be fairly treated. This led to the formation of the People's Alliance for Democracy (PAD), also known as the yellow shirt group. The yellow shirt group actively protested and revealed evidence against Mr Thaksin Shinawatra to the public. Eventually, the Military stepped in, leading to the 2006 *coup d'états* on 19 September 2006, and the establishment of the interim governments. In an exclusive interview with the editors of the Nation Group, General Sonthi Boonyaratglin explains why he staged the 2006 *coup d'états* as follows[2]:

> I'd like to say two things about the military coup. First, I received calls for the coup from many people. Second, soldiers are obliged to protect national security, safeguard the nation and uphold loyalty to the monarchy. The military cannot tolerate any leaders who lack or have limited loyalty to the King. Under the previous government, widespread corruption was evident. The administration was plagued by irregularities. Independent organisations failed to function; the administrative mechanisms as per the 1997 Constitution were stalled. In politics, the government was in charge of caretaker duties. There was no functioning legislative body, and the judiciary could not function. There appeared to be no way out. This was before factoring in the social divisions. The country could not survive under the circumstances, and the coup was deemed necessary. The armed forces' aim is to reform politics and introduce sustainable solutions. The administrative system should be rectified in line with true democratic rule. We want to place emphasis on having the King as Head of State. People across the country, including those in rural areas, have thanked the armed forces for staging the coup. Many even told us we were late in intervening. I understand the coup may have tainted the country's image internationally. But I believe a little interruption is acceptable in order to enable everyone to move forward once again.

Between 19 September to 1 October 2006, Thailand was placed under an interim military government led by General Sonthi Boonyaratglin. On 1 October 2006, the interim civilian government was formed and headed by Interim Prime Minister General Surayud Chulanont. Soon after, the red shirt group, formally known as United Front for Democracy against Dictatorship (UDD), was formed and staged protests for Mr Thaksin Shinawatra. Since then, the nation has been divided into these two political groups. Hence, it is very important to examine whether this political event has any long-lasting impact on the Thai financial system. Given the Thai financial system was adapted from the West and the Western belief in having a democratic environment, the 2006 *coup d'états* and the installation of the interim civilian government provide a perfect setting to test whether beliefs, concepts and theories from the West can be applied to the Thai economy.

One of these beliefs is that events such as the *coup d'états* represent political uncertainty and instability, which can have an adverse effect on a country's economy. For example, Leigh, Wolfers and Zitzewitz (2003) study what financial markets think of war in Iraq and find that the war lowers the value of US equities by around 15 percent. Similarly, two days after the 2006 *coup d'états*, an analyst from Morgan Stanley suggested that the 2006

[2] «Exclusive Interview: Kingdom "would not have survived without coup"», *The Nation*, October 26, 2006.

military coup is not just a cyclical event but signals the weakness in the future government and the likelihood of the devaluation of Thai assets (Xie, 2006). Similar sentiments[3] on the Thai economy were reflected in the media coverage after the 2006 *coup d'états*. These sentiments were based on the standard Western belief that *coup d'états* represents political risk and likely to induce a flight to quality in investment flow. However, these anecdotes have not been empirically tested.

The research on political risk and return can be dated back as far as the 18th century. Chydenius (1765) in his book called *The Nation Gain*, advocates that democracy, equality, and a respect for human rights were the only way towards progress and happiness for the whole of society. He also explores the relationship between economy and society, and is the first to lay out the principles for liberalism, capitalism, and modern democracy. Soon after that, Smith (1776) published another book on political economy, called *The Wealth of Nations*, which became a foundation of modern economies. Smith (1776) implies that politics and economy are linked and can influence each other. Numerous researchers have attempted to empirically test whether politics have any impact on financial markets, especially on the equity market. A number of studies such as Niederhoffer, Gibbs and Bullock (1970) and Herbst and Slinkman (1984) document that politics causes stock prices to move. Bernhard and Leblang (2002) also study the effect of democratic political events on currency markets via the spot-forward exchange rate relation and document more often exchange risk premia during political processes. An unpulished work by Lim (2003) also examines political risk and exchange rate using a Markov switching model for 25 countries and found contemporaneous political risk is important for developed countries' currency markets while both lagged and contemporaneous political events help determine developing countries' exchange rate. However, many researchers question whether these findings can be generalised to all countries given that politics at both the domestic and international level are multifaceted in nature. For example, Bekaert and Harvey (2002) find that politics in emerging markets play a more significant role and appear to be less stable than those in developed markets.

In the US, Santa-Clara and Valkanov (2003) document higher equity returns but lower risk when the US President is from the Democrat Party than from the Republican Party. They call this the «Presidential Puzzle». However, the generalisation of this Presidential Puzzle is limited since many countries have more than two political parties in their political system. Vuchelen (2003) also suggests that testing the Presidential Puzzle in other countries can be difficult, especially in countries that have more than two political parties with a Coalition-based political system. In these countries, government is usually formed by a coalition of more than one party. When parties in the coalition disagree and withdraw from the government, a new election may be called. For these countries, the study of political risk and return usually focuses on the effects of political events on equity returns. Thailand falls into this category. For example, on May 10 2011, Prime Minister Abhisit Vejjajiva dissolved the parliament as a result of a disagreement among coalition parties that formed his government. Hence, it is natural to examine the impact

[3] For example, ratings agency Standard and Poor's said the coup risks paralyzing policymaking and undermining the investment climate (*The Economic Times*, 2006).

of political events such as the 2006 *coup d'états* and the interim civilian government on the Thai stock and currency markets.

Using the 5-minute returns on the Stock Exchange of Thailand (SET) index and USD/THB exchange rate from 1 January 1996 to 31 December 2011, we analyse both the short-run and long-run effects of the 2006 *coup d'états* and its interim military and civilian governments[4]. Overall, we find that investors react heterogeneously between stock and currency markets in both short-run and long-run. More specifically, we find the immediate reaction to the coup is more evident in the stock market with a reduction in stock return, a short-lived spike in return volatility and volume with an immediate reversal, and a drop in liquidity risk. While we do not find any short-run impact on return volatility of the USD/THB, we do find the THB strengthened against the US dollar (reduction in the return on USD/THB), a drop in bid-ask spread and increase in liquidity risk. However, the long-run impact is stronger in the currency market, where we find an increase in bid-ask spread but a drop in liquidity risk. Finally, the 2006 coup also reduces liquidity risk in the stock market in the long run. In summary, we find the expected initial adverse reaction (short run results) to the coup, however, the effects were transient and the short run effects were quickly reversed (long run result). Our findings are contrary to the media coverage of fundamental and long run adverse effects for the Thai political economy. These results also suggest that Western beliefs may not necessary apply in the Thai setting even though the Thai financial system is modelled on those from the West. Our findings are also consistent with Thyne and Powell (2014) who provide recent evidence that coups increase democracy, especially in least likely democratic environments. Further, our findings imply that the political situation in Thailand is quite unique – what is viewed as bad by an outsider may not be necessarily perceived to be bad by the Thais (*The Nation*, 2006). Consistent with the statement by General Sonthi Boonyaratglin in his exclusive interview with *The Nation*, Schmidt (2007) note that «The bloodless coup did increase Thailand's short-term economic uncertainty, but in some ways it also increased Thailand's stability for the midterm». Hence, we find only a fleeting adverse effect on both the stock and currency markets.

Our findings provide social and economic contributions to many groups of people such as investors, academic and policy makers. For example, foreign investors with long-term investment horizon may benefit from leaving funds in Thai financial markets rather than withdrawing them whenever there is a Coup. Important lessons can also be learnt for policy makers. Policy makers may not need to impose unnecessary regulation/restrictions to prevent fund flow from short-lived panics during the Coups periods. Finally, our findings open many future research venues for academics. For example, future research could examine the behavioural explanation of political events on financial markets with different political regimes or how culture differences can play a role in political risk on financial markets.

The remainder of this paper is organised as follows. Section 2 reviews the related literature. Section 3 describes the data and modelling framework. Section 4 summarises the empirical results and Section 5 concludes.

[4] We use the term «the 2006 coup», «the coup», and «the 2006 *coup d'états* and its interim military and civilian governments» interchangeable in this paper.

2 Background and Review of Literature

2.1 Evolution of Thai Politics[5]

On 10 December 1932, when the very first Thai constitution was singed, Thailand transformed from an *Absolute Monarchy* to a *Constitutional Monarchy* political system, whereby a monarch is the head of state and the prime minister is the head of government. Since then, Thailand has gone through several peaks and troughs in her search of full democracy. The milestones in the Thai political development can be summarised into 4 episodes as follows.

The first episode is from 1932 to 1972, also known as «Bureaucratic Polity» period, when civil servants and technocrats play a dominant role in running the country. During this episode, only a handful of elite technocrats influence the country's policies. Any political tensions are confined among these elite technocrats, rather than the people. Among civil servants, the military is the most powerful group and plays important role in the developing country's economy and stability during these 40 years period.

The second episode is from 1973 to 1976, also known as «Blooming of Democracy» period, when students play key role in running the country. As a result of economic development by the military in the first episode, more people become educated. Students from major universities and colleges seek for a real democracy for the country and become a real force for pressuring technocrats to allow people more freedom and democracy. Eventually, student-led uprisings occurred in October 1973 and liberated the country from military government. During these 3 years period, there was freedom of speech, many politicians and governments were criticised, protests were staged everywhere and revolutionary and socialist movements became more apparent. The episode was ended by the right-wing military and conservative politicians like Samak Sundaravej in a massacre, resulting in many students were killed.

The third episode is from 1977 to 1992, also known as «Semi Democracy» period, when civil servants and businessmen play an important role in running the country. This episode is a result of unsatisfactory of the blooming democracy period and the compromise between military group and politicians. The key feature of this period is the balance of power and benefits between military and businessmen. Due to the success in economic development and growth, businessmen become more powerful. This led to tension among businessmen, civil servants and military towards the end of this period.

The current episode is from 1992 until today, also known as «Political Reform» period, when businessmen and people play a dominant role in running the country. This episode started from the Black May uprising in 1992, one of the key milestones in Thai political reform, led to more reform with the 1997 constitution, «The People's Constitution». This constitution was designed to create checks and balance of powers between strengthened government, separately elected senators and anti-corruption institutes. In addition, the Administrative courts, Constitutional Courts and election-control

[5] This Section summarises and translates a Thai article. Provided by the Office of the Election Commission of Thailand, accessed 16 May 2014 <www2.ect.go.th/modules/m_files_store/download.php?>.

committee were also established to strengthen the checks and balance of politics. The Black May uprising in 1992 is the very first of the recent uprisings, led by Thai middle class or white collar people in search of more freedom and fairness. The Black May uprising in 1992 is also shown to the world the importance of Thai Royal family. The King demanded that Genreal Suchida Kraprayoon and Chamlong Srimuang to put an end to their confrontation and work together through parliamentary processes and stop the unrest in 1992. Although the King of Thailand, King Bhumibol Adulyadej, has little direct power under the constitution, he is a symbol of national identity and unity and much loved by Thais. The current Thai constitution is the 2007 Constitution, designed to be tighter in its control of corruptions and conflicts of interests while decreasing the authority of the government, was promulgated in 2006 after an army-led coup. The rulings by the Constitutional Court under the Constitutional of the Kingdom of Thailand B.E. 2550 (2007) are final and unappealable[6]. The recent well-known rulings by the Constitutional Court are the 2007 dissolution of the Thai Rak Thai political party and the 2014 removal of the Prime Minister Yingluck Shinawatra from office.

2.2 Review of Literature

As noted previously, the belief that politics and economy are linked is not new, and can be dated back to the 18th century. Hence, numerous researchers have attempted to empirically test whether politics have any impact on financial markets, especially on the equity market. For example, Errunza (1983) reports that political risk is an important factor in international portfolio investment decisions particularly in emerging markets. Existing studies from event studies also show that political risk has some important implications for stock prices. For example, Chan and Wei (1996) investigate the impact of political news on stock market volatility in Hong Kong and find that political news increases stock market volatility. Bittlingmayer (1998) studies political events in Germany during the period of 1880 to 1940 and provides evidence that major political events, such as World War I, have significant impacts on stock prices and stock volatility. Aggarwal, Inclan and Leal (1999) also investigate the effect of political events on 16 stock markets' volatility from 1985 to 1995. They find that country-specific political events such as the Marcos-Aquino conflict in the Philippines saw an increase in volatility. Furthermore, Kim and Mei (2001) document that stock market returns and volatility are sensitive to political news announcements and the level of political development in Hong Kong. They also find an asymmetric effect between bad and good political news. Chan, Chui and Kwok (2001) also show political news has a distinct impact on market activities in Hong Kong when compared with the economic news. Further, Chen, Bin and Chen (2005) document a significant abnormal price performance on the Taiwanese stock market in reaction to the political events. Examining the political risk in Turkey, Mehdian, Nas and Perry (2008) find that the Turkish stock prices systematically drop below their fundamental values during the period of the unexpected political events in Turkey.

[6] More details can be accessed via http://www.constitutionalcourt.or.th/.

When considering political risk and foreign exchange, many prior studies, however, primarily focus on the effect of political risk on the Foreign Direct Investment (FDI). For example, Mahajan (1990) and Hashmi and Guvenli (1992) show political risk has an impact on the operation and profitability of foreign-owned entities. Similarly, Jun and Singh (1996) and Harms (2002) find political risk plays a significant role in FDI. In addition, Nordal (2001) and Click (2005) find that political risk is a significant determinant in the valuation of investment projects as well as the return on asset (ROA) of firms with FDI.

Existing literature also examines the relation between foreign exchange rates and politics in various aspects. For example, Jaramillo, Steiner and Salazar (1999) examine how political economy shapes the exchange rate policy in Colombia while Freiden, Leblang and Valev (2010) show how political economy plays an important role in shaping the exchange rate policies of 21 transition economies. Similarly, Bodea (2010) examines the effect of political economy on exchange rate policies for the post-communist countries. Larson and Madura (2001) study the overreaction and underreaction phenomenon to the economic and political events in the foreign exchange market and document some evidence that political events are associated with a stronger tendency toward overreaction than economic events. Bachman (1992) examine the effect of political risk on the forward exchange bias for the case of elections and find politics provides useful information for foreign exchange traders that economists should not ignore. Cody (1989) examines the effect of French President Mitterand's May 1981 imposition of exchange controls on the dollar/franc exchange rates and finds that exchange rate risk dominates political risk during the vast majority of sample period. Stokis and Kapopoulos (2003) examine the impact of Greek elections on its exchange rate dynamics and find the electoral cycle impacts the exchange rate volatility. Finally, Bailey and Chung (1995) examine and document the impact of exchange rate fluctuations and political risks on the risk premiums of cross-sectional equity returns in Mexico. While much research has been done, this paper fills the gap in the existing literature by studying the impact of political events in both the stock and currency markets in an emerging market.

3 Data and Modelling Framework

3.1 Data and Key Variables of Interests

The dataset used in this study consists of the tick-by-tick bid-ask quotes for the USD/THB and SET index level and its daily trading volume. The USD/THB is an FX quotation of how much 1 US dollar is worth in Thai Baht. In this case, the USD is the commodity currency whereas the THB is the term currency. Our sample period is from 1 January 1996 to 31 December 2011. Data are extracted from the Thomson Reuters Tick History database provided by the Securities Industry Research Centre of Asia-Pacific (SIRCA). As the aim of our paper is to study whether the Thai 2006 *coup d'états* and its interim military and civilian governments has any effect on return, volatility, liquidity

and liquidity risk in the Thai stock and currency markets, we construct four key variables of interest for both the stock and currency market as follows:

Return: The daily return is defined as follows:

$$Return_t = \sum_{d=1}^{D} r_{d,t} \tag{1}$$

where $r_{d,t}$ denotes the dth five-minute return during day t and D denotes the total number of five-minute return intervals during any trading day. The $r_{d,t}$ on the SET index is computed based on the price level of the SET index at a five-minute interval. However, the $r_{d,t}$ for the USD/THB is calculated from the mid-point between bid and ask quotes for the USD/THB at a five-minute interval.

Volatility: We measure volatility using intra-day data based on Andersen *et al.* (2003). The daily realised volatility (RV) is defined as follows:

$$RV_t = \sum_{d=1}^{D} r_{d,t}^2 \tag{2}$$

Liquidity (LIQ): For the SET index, we do not have data on the bid-ask spread. Hence, we measure liquidity of the SET index using the daily trading volume, directly extracted from the Thomson Reuters Tick History database provided by the Securities Industry Research Centre of Asia-Pacific (SIRCA). Hence, the higher the trading volume (LIQ) in the SET index, the more liquid is the Thai market. However, for the USD/THB, we use the daily average of the bid-ask spread as our proxy for liquidity.

$$LIQ_t = \frac{\sum_{d=1}^{D} S_{d,t}}{D} \tag{3}$$

where $s_{d,t}$ denotes the dth 5-minute bid-ask spread during day t and D denotes the total number of 5-minute intervals during trading day t. Hence, the higher the bid-ask spread (LIQ), the less liquid the Thai currency market.

Liquidity risk (LIQRISK): We measure liquidity risk based on the volatility of our liquidity measures. Hence, for the SET index, the LIQRISK is defined as follows:

$$LIQRISK_t = \frac{\sum_{d=1}^{D} (v_{d,t}^2 - \bar{v}_t)}{D-1} \tag{4}$$

where $v_{d,t}$ denotes the dth 5-minute trading volume during day t and $\bar{v}_t$ denotes the daily average of the trading volume taken at five-minute intervals during day t. However, for the USD/THB, we define the LIQRISK on the USD/THB market as the realized volatility of liquidity as follows:

$$LIQRISK_t = \sum_{d=1}^{D} s_{d,t}^2 \tag{5}$$

In addition, due to concerns with the non-zero value of the average spread, we also use the daily standard deviation of the spread as an alternative proxy for the volatility of the spread[7]:

$$LIQRISK_t = \frac{\sum_{d=1}^{D} (s_{d,t}^2 - \bar{s}_t)}{D-1} \tag{6}$$

3.2 Modelling Framework

To test whether the Thai 2006 *coup d'états* has any short run effect on return, volatility, liquidity and liquidity risk in the Thai stock and currency markets, we conduct the following preliminary analyses. First, we compare the daily average return of the event date, day 0 (19 September 2006, when the Military coup occurs) with the daily average returns 5, 10, 20, 40 and 60 days prior to day 0. Second, we compare the daily average return between 60, 40, 20, 10 and 5 days pre- and post-Military coup.

Next, we formally investigate both short-run and long-run impacts of the Thai 2006 *coup d'états* and its interim military and civilian governments on return, volatility, liquidity and liquidity risk in the Thai stock and currency markets via the following regression analysis:

$$y_{it} = \alpha_{it} + \sum_{e=1}^{n} \beta_e X_{it,e} + u_{it} \tag{7}$$

where y_{it}, the dependent variable, is the four key variables of interests discussed in Section 3.1, u_{it} is normally distributed with zero mean and variance of one. $X_{it,e}$ are independent and control variables.

Our key independent variables include *SR5*, *SR10*, *SR20*, *SR40*, *SR60*, *Politic, Local_net_ratio and FC_net_ratio*. The *SR5*, *SR10*, *SR20*, *SR40*, and *SR60* are dummy variables designed to capture short-run impact of Thai 2006 *coup d'états* and set to one for the following windows [0,5], [6,10], [11,20], [21,40] and [41,60], respectively, with day zero as 19 September 2006. The *Politic* is a dummy variable designed to capture the long-term impact of the Thai 2006 *coup d'états* and equal to 1 from 19 December 2006 to 28 January 2008. The *FC_net_ratio* is the percentage of Thai baht amount of net stock market purchases by foreign investors relative to all trading activity on day *t*. The variable captures the net flow in trading activities of foreign investors on the Thai stock market[8].

The control variables include lagged variables of the dependent variables, time period dummy variables that capture the various financial crisis and foreign exchange regime, time between quotes and downside risk. Following Yiu, Ho and Choi (2010), we use the Asian currency crisis dummy variable, *ASIA*, to denote the period 2 July 1997 to 31 December 1998. Other time period dummy variables denoting the various financial crises are adopted from Fry, Hsiao and Tang (2010). The Russian crisis dummy variable, *RUSSIA*, denotes

[7] Results using this measure are available upon request. Overall, results are qualitatively similar to our main proxy.

[8] An alternative measure is the percentage of Thai baht amount of net stock market purchases by local investors relative to trading activity on the stock market on day *t, i.e., Local_net_ratio*. The main results are robust to replacing the *FC_net _ratio* with this alternative measure.

observations from the period 17 August 1998 to 31 December 1998. In late 1998, we saw the fall out of the large hedge fund in the US, Long-term Capital Management (LTCM). The dummy variable, *LTCM*, denotes observations from the period 23 September 1998 to 15 October 1998. The dummy variable, *BRAZIL*, denotes observations from the Brazilian crisis that occurred between 7 January 1999 and 25 February 1999. The US market crash in the early 2000 (28 February 2000 to 7 June 2000) associated with the technology stocks, also known as the «dotcom» crisis, is captured by the dummy variable, *DOTCOM*. The dummy variable, *ARGENTINA*, captures the Argentine crisis that occurred between 11 October 2001 and 3 March 2005. The last time period dummy variable, *GFC*, captures the effect of the recent global financial crisis that occurred between 26 July 2007 and 30 July 2010.

To control for the different foreign exchange regime on the USD/THB during our sample period, we also include a dummy variable, *TIGHT*, set equal to one when the USD/THB is operated under the fixed FX regime. Control variables associated with trading activities are listed as follows. In the currency market, we include *Quote*, which is the total number of quotes per day (proxy for trading volume) and *Quoter*, which is the total number of quoters per day (proxy for competition). In both stock and currency markets, we include TBT, which is the daily average of time difference between two consecutive quotes on the USD/THB or the daily average of time difference between two prices for SET Index. STDTBT is the daily average of standard deviation of time difference between two consecutive quotes on the USD/THB or the daily average of standard deviation of time difference between two prices for SET Index.

Finally, to control for downside risk, we follow Chen *et al.* (2001), and Hutson, Kearney and Lynch (2008) and compute the daily realized skewness for day t in both the currency and stock markets as follows:

$$RSKW_t = -\frac{D(D-1)^{3/2}\left(\sum_{d=1}^{D} r_{d,t}^3\right)}{(D-1)(D-2)\left(\sum_{d=1}^{D} r_{d,t}^2\right)^{3/2}} \tag{8}$$

This daily realized skewness is the negative of the third moment of returns divided by the cubed standard deviation of returns to standardize for differences in variances. We include the negative sign to facilitate ease of interpretation. To be more specific, an increase in the daily skewness corresponds to a stock or currency market having a more left-skewed distribution (Chen *et al.*, 2001). Therefore, this formula allows us to focus on the importance of the downside risk in analysing return, volatility, liquidity and the volatility of liquidity.

4 Empirical Results

4.1 Descriptive Statistics

Panels A, B and C of Table 1 report descriptive statistics for all continuous variables in the USD/THB market for the full sample, political event sample and non-political event

Table 1: Descriptive Statistics for USD/THB

	Return	*RV*	*LIQ*	*LIQRISK*	*TBT*	*Quote*	*Quoter*	*RSKW*	*STDTBT*
Panel A: Full Sample									
Mean	0.0001	0.034	0.07	165.93	7,157.70	3,753.79	26.94	−0.07	12,531.48
Maximum	0.1878	9.533	1.90	293,168.20	433,747.00	31,979.00	51.00	17.06	722,163.80
Minimum	−0.1103	0.000	0.00	0.00	0.99	5.00	0.00	−17.04	0.00
Std. Dev.	0.0076	0.399	0.09	5,698.75	26,632.81	2,941.88	12.67	1.82	28,485.18
Skewness	3.28	21.42	6.20	40.36	6.02	0.73	−1.02	0.23	9.47
Kurtosis	114.53	486.1	74.9	1,766.27	45.82	4.51	2.81	32.86	158.69
Observations	5,009	5,009	5,009	5,009	5,009	4,990	4,990	4,620	5,009
Panel B:19 September 2006 to 28 January 2008									
Mean	−0.0004	0.1367	0.15	22.55	1064.07	5,012.60	21.41	−0.04	7,109.28
Maximum	0.1095	1.8996	0.51	1,022.50	19,880.52	31,979.00	37.00	3.98	311,892.10
Minimum	−0.1103	0.0000	0.00	0.00	219.23	3,703.00	0.00	−4.20	268.21
Std. Dev.	0.0119	0.2224	0.09	110.49	2,442.13	1,779.84	10.78	0.89	1,7898.22
Skewness	0.24	4.30	0.88	8.16	6.30	9.44	−1.18	−0.91	12.29
Kurtosis	40.19	28.66	4.47	68.52	43.44	131.76	2.82	16.20	200.28
Observations	426	426	426	426	426	426	426	385	426
Panel C: 1 January 1996 to 18 September 2006 and 29 January 2008 to 31 December 2011									
Mean	0.0001	0.0252	0.07	179.26	7724.11	3,636.29	27.46	−0.07	13,035.49
Maximum	0.1878	9.5325	1.90	293,168.20	433,747.00	15,926.00	51.00	17.06	722,163.80
Minimum	−0.0697	0.0000	0.00	0.00	0.99	5.00	0.00	−17.04	0.00
Std. Dev.	0.0071	0.4108	0.09	5,957.50	27,765.56	3,000.97	12.71	1.88	29,225.73
Skewness	4.38	21.51	7.19	38.60	5.75	0.64	−1.06	0.24	9.29
Kurtosis	137.19	476.74	91.52	1,616.00	41.92	2.78	2.86	31.29	153.46
Observations	4,583	4,583	4,583	4,583	4,583	4,564	4,564	4,235	4,583

Note: This table reports summary statistics of key variables examined in this study. Data is collected from Thomson Reuter via SIRCA from 1 January 1996 to 31 December 2012. *Return* is the average daily return of USD/THB. Realised volatility (*RV*) is the daily average of realized volatility of the 5-minute return on the USD/THB. *LIQ* is the daily trading volume of the USD/THB. *LIQRISK* is the standard deviation of trading volume of the USD/THB. *TBT* is the daily average of time difference between two prices for the USD/THB. Realised skewness (*RSKW*) is the daily average of realized skweness of the 5 minute return on the USD/THB. Panel A reports summary statistics for the full sample period. Panel B reports summary statistics for the period with 2006 Thai coup and the interim civilian government. Panel C reports summary statistics for the period with the civilian government formed by election.

sample, respectively. We define the political event sample from 19 September 2006 to 28 January 2008 – the period that covered the Thai 2006 *coup d'états* and its interim military and civilian governments. Overall, during the Thai 2006 *coup d'états* and its interim military and civilian governments, the return on the USD/THB is negative and is more volatile. On the other hand, we see a decrease in the liquidity and the liquidity risk in the USD/THB when compared to the non-event and full sample periods. The daily average return on the USD/THB is 0.01% per day for the full sample and non-political event sample while the daily average return is –0.04% per day during the 2006 *coup d'états*. Contrary to expectations, the Thai baht strengthened against the US dollar during the political event in comparison to the non-political and full samples. The USD/THB is less volatile for the full sample and non-political event sample with the volatility of 3.5% per day and 2.5% per day, respectively. The volatility of the USD/THB during the Thai 2006 *coup d'états* and its interim military and civilian governments period is substantially higher at 14% per day.

Panels A, B and C of Table 2 report the descriptive statistics for all continuous variables in the SET index for the full sample, political event sample and non-political event sample, respectively. Overall, we find investors in the stock market react differently to those in the currency market. That is, during the Thai 2006 *coup d'états* and its interim military and civilian governments, the return on the SET index and the liquidity measures

Table 2: Descriptive Statistics for SET Index

	Return	*RV*	*LIQ*	*LIQRISK*	*TBT*	*RSKW*	*STDTBT*
Panel A: Full Sample							
Mean	−0.00007	0.00020	1,946,832	770,096.30	317.09	−0.59	5,044.99
Median	−0.00015	0.00010	1,579,746	656,101.50	279.74	−0.45	3,495.92
Maximum	0.11350	0.01317	22,633,899	5,544,965.00	1,710.92	16.18	28,328.42
Minimum	−0.16063	0.00000	17.00	147,947.10	68.85	−16.89	411.60
Std. Dev.	0.01745	0.00046	1,932,106.00	458,057.20	253.73	4.83	4,212.24
Skewness	0.07406	12.99175	1.71	2.37	1.85	0.10	1.86
Kurtosis	9.32022	264.96260	9.42	14.60	6.38	4.02	5.99
Observations	3,874	3,874	3,874	1,521	3,874	3,873	3,874
Panel B: 19 September 2006 to 28 January 2008							
Mean	0.00016	0.00017	2,583,201	559,886.60	417.87	−0.58	5,897.73
Median	−0.00020	0.00007	2,258,587	477,517.50	281.44	−0.55	3,505.10
Maximum	0.10577	0.01006	7,719,615	2,166,600.00	1,421.15	13.80	23,328.50
Minimum	−0.16063	0.00002	785,638	147,947.10	275.90	−13.83	3,455.29
Std. Dev.	0.01597	0.00062	1,278,107	311,454.90	263.05	4.82	4,603.75
Skewness	−2.16934	13.42653	1.65	1.97	1.65	0.27	1.65
Kurtosis	38.06740	203.85650	6.03	7.73	4.49	4.11	4.49
Observations	334	334	334	334	334	334	334
Panel C: 1 January 1996 to 18 September 2006 and 29 January 2008 to 31 December 2011							
Mean	−0.00010	0.00020	1,886,790	829,245.40	307.58	−0.59	4,964.54
Median	−0.00015	0.00011	1,375,184	712,871.90	279.61	−0.43	3,493.58
Maximum	0.11350	0.01317	22,633,899	5,544,965.00	1,710.92	16.18	28,328.42
Minimum	−0.11090	0.00000	17	168,336.50	68.85	−16.89	411.60
Std. Dev.	0.01759	0.00044	1,972,260	475,102.60	250.79	4.84	4,165.10
Skewness	0.23261	12.58218	1.77	2.38	1.90	0.08	1.88
Kurtosis	7.46844	267.28340	9.52	14.62	6.69	4.01	6.17
Observations	3,540	3,540	3,540	1,187	3,540	3,539	3,540

Note: This table reports summary statistics of key variables examined in this study. Data is collected from Thomson Reuter via SIRCA from 1 January 1996 to 31 December 2011. *Return* is the average daily return of SET Index. Realised volatility (*RV*) is the daily average of realized volatility of the 5-minute return on the SET Index. *LIQ* is the daily trading volume of the SET Index. *LIQRISK* is the standard deviation of trading volume of the SET Index. *TBT* is the daily average of time difference between two prices for SET Index. Realised skewness (*RSKW*) is the daily average of realized skweness of the 5 minute return on the SET Index. Panel A reports summary statistics for the full sample period. Panel B reports summary statistics for the period with 2006 Thai coup and the interim civilian government. Panel C reports summary statistics for the period with the civilian government formed by election.

are higher. The return and the liquidity are also less volatile when compared to the non-event and full sample periods. The daily average return on the SET is −0.01% per day for the full sample and non-political event sample while the daily average return on the SET is 0.02% per day during the political event. The SET is more volatile for the full sample and non-political event sample with the volatility of 0.02% per day for both samples and the volatility of the SET during the political event is slightly lower at 0.017% per day.

4.2 Preliminary Analyses

Panel A of Table 3 reports the changes in the average daily return, realized volatility, liquidity and liquidity risk of the Thai currency (measured by USD/THB) between various pre and post windows. Consistent with results in Figure 1, our event study results show that the Thai 2006 *coup d'états* significantly affect the return and volatility of the USD/THB in the short run. That is, on the Military coup date, the Thai baht strengthens against the US dollar (a reduction in return) in comparison to the USD/THB 60, 40, 20, 10 and 5 days before the event.

Similarly, the USD/THB is more volatile on the Military coup date in comparison to the return volatility on the USD/THB 60, 40, 20, 10 and 5 days before the event. However, the Thai 2006 *coup d'états* does not significantly affect the liquidity and liquidity risk in the USD/THB market. Using wider windows, to measure the effect of the coup on the USD/THB market, we do not find significant differences in the measures for the pre and post periods centred on the 2006 *coup d'états* date[9].

Panel B of Table 3 reports the changes in the average daily return, realized volatility, liquidity and liquidity risk measured using the SET Index. The event study results from Panels A and B shows the initial reaction (day 0) on the currency and stock markets are heterogeneous. There is little effect evident on the stock market. We find the Thai 2006 *coup d'états* statistically affects the return and liquidity risk on the SET index only when comparing the day 0 reaction to the 5-day window prior to event. That is, the daily return and the liquidity risk of the SET index on the Military coup date are statistically lower than the same metrics measured over the five day period before the coup. The analysis using wider windows pre and post the coup shows stronger impact on the liquidity and liquidity risk of the SET index. The liquidity and liquidity risk are both significantly higher during the 5, 40 and 60 days after the coup date.

4.3 Short-run and Long-run Dynamics

We formally test the short-run and long-run effects of the Thai 2006 coup and Interim Civilian Government on the Thai stock and currency markets by estimating model 7 using regression analysis for each of our four key variables of interests. Overall, we find investors react heterogeneously in the currency and stock markets in both our short-run and long-run analyses. The immediate reaction to the coup is more evident in the stock market with a reduction in stock return, a short-lived spike in return volatility and volume with an immediate reversal, and a drop in liquidity risk. We find no short-run impact on return volatility of the USD/THB, but we do the THB strengthen against the US (reduction in the return on USD/THB), a drop in bid-ask spread and increase in liquidity risk. However, the long-run impact is stronger in the currency market, where we find an increase in the bid-ask spread but a drop in liquidity risk. Finally, the Coup reduces liquidity risk in the stock market in the long-run. We discuss these results in more detail in the following Sections.

4.3.1 *The Effect of the 2006 Coup on the USD/THB Market*

For the currency market, after controlling for factors that are found to be significant in the previous literature[10], we find that the 2006 coup and Interim Civilian Government have a short-run impact up to 20 trading days after the coup on return, 60 trading days on

[9] The five windows include (0.5), (0.10), (0.20), (0.40) and (0.60).

[10] We do not discuss results on any significant control variables as they are not our main focus. Further, we also control for 3 dissolution dates occurred during our sample. Our main results reported in Tables 4 and 5 are robust to the inclusion of dissolution dates dummies. Results are available upon request.

Table 3: Event Study

Event Window	Return		RV		LIQ		LIQRISK	
	Diff	t-stat	Diff	t-stat	Diff	t-stat	Diff	t-stat
				Panel A: USD/THB				
(−60,−1) vs 0	−0.01402	(−6.42)	−0.00083	(−14.14)	0.074829	(0.46)	0.001698	(0.23)
(−40,−1) vs 0	−0.01414	(−6.31)	−0.00084	(−28.33)	0.000514	(0.37)	−0.00084	(0.00)
(−20,−1) vs 0	−0.01426	(−7.40)	−0.00084	(−27.90)	−0.06045	(−0.11)	−0.00171	(−0.62)
(−10,−1) vs 0	−0.01393	(−7.30)	−0.00084	(−35.02)	−0.0532	(−0.44)	−0.00081	(−0.51)
(−5,−1) vs 0	−0.01487	(−6.52)	−0.00083	(−25.18)	−0.05094	(0.03)	−0.00204	(−0.47)
(−60,−1) vs (0,5)	0.001473	(0.92)	−0.00055	(−1.19)	−1.42227	(−1.00)	−0.04157	(−1.48)
(−60,−1) vs (0,10)	0.000356	(0.41)	−0.00027	(−1.12)	−0.67694	(−0.94)	−0.01995	(−1.30)
(−60,−1) vs (0,20)	0.000104	(0.18)	−0.00034	(−1.41)	−0.93712	(−1.29)	−0.01816	(−1.47)
(−60,−1) vs (0,40)	0.000415	(0.94)	−0.00134	(−1.28)	−2.91888	(−1.17)	−0.02142	(−1.37)
(−60,−1) vs (0,60)	0.00035	(0.91)	−0.00097	(−1.38)	−2.14709	(−0.06)	−0.01701	(−1.28)
				Panel B: SET Index				
(−60,−1) vs 0	0.005866	(0.63)	3.45E-05	(0.52)	−169,341	(−1.33)	−1,357,275	(−0.72)
(−40,−1) vs 0	0.005454	(0.71)	1.87E-05	(0.38)	−98,186.7	(−1.07)	−1,023,810	(−0.46)
(−20,−1) vs 0	0.004726	(0.59)	1.12E-05	(0.35)	−106,212	(−0.88)	−1,018,342	(−0.43)
(−10,−1) vs 0	0.005064	(0.62)	2.3E-05	(0.57)	24,628.32	(−0.30)	−370,718	(0.09)
(−5,−1) vs 0	0.010436	(1.65)	2.35E-05	(0.71)	242,413.5	(0.94)	621,788.2	(1.74)
(−60,−1) vs (0,5)	0.003869	(0.74)	−0.00038	(−1.01)	−1,965,477	(−2.19)	−412,744	(−1.96)
(−60,−1) vs (0,10)	0.003238	(1.08)	−0.00017	(−0.92)	−891,669	(−1.57)	−170,445	(−1.30)
(−60,−1) vs (0,20)	−9.4E-07	(0.00)	−7.1E-05	(−0.74)	−445,283	(−1.37)	−78,293.2	(−1.06)
(−60,−1) vs (0,40)	7.24E-05	(0.04)	−1.9E-05	(−0.39)	−760,664	(−3.17)	−163,491	(−2.86)
(−60,−1) vs (0,60)	0.000486	(0.32)	−1.1E-06	(−0.03)	−136,782	(−3.21)	−639,388	(−2.91)

Note: This table reports the difference between event windows for average daily return (Return), realized volatility (RV), liquidity (LIQ) and liquidity risk (LIQRISK) and their t-statistics. Panels A and B report the results for the USD/THB and the SET index, respectively. The difference is computed based on window on left hand side of the pair minus window on the right hand side of the pair, for example (−60, −1) vs 0 is the daily average return from day −60 to −1 minus return on day 0. The event date or day 0 is 19 September 2006, when Thai coup occurs.

liquidity and liquidity risk but no short-run impact on volatility. More specifically, there is a hump shape in USD/THB return, with a 0.15% drop in return for 5 trading days after the Coup, revert back to zero from days 6-10 after the Coup and then drop again to 0.23% from days 11-20 after the Coup. This implies that the Thai baht strengthen against the US dollar within the five trading days after the 2006 Coup and between days 11-20 after the Coup. We also find that the Thai baht strengthen when foreign investors have a net purchase in the Thai stock market as evidence by the negative coefficient on *FC_net_ratio* (Coeff = −0.0054, t-stat = −2.59). This result is intuitive as the purchase (sale) of Thai stocks by foreign investors is likely to require the conversion of the US dollar (Thai baht) into the Thai baht (US Dollar). When we interact our short-term political risk dummies with the trading activities in the Thai stock market by foreign investors, we find that the net purchases in the Thai stock by foreign investors further strengthen the Thai baht 5 days and 21-40 days after the Coup. However, between days 6-20 after the Coup, the net purchases in the Thai stock market by foreign investors weaken the Thai baht, an unexpected result. This implies *FC_net_ratio* does not capture all trading activities in the currency market and ignores other foreign investments and trade flows in Thai economy. In summary, it appears that the Coup does not adversely affect the Thai baht and that the participants in the currency market do not view the coup adversely. Our findings are also consistent with Schimdt (2007), who document that foreign investors were pouring money into Thailand before, during and after the 2006 Coup, resulting in the strengthened Thai baht.

The relationship between short-run dummy variables and bid-ask spread (*LIQ*) in the USD/THB market is even more complex. Contrary to the expectation that political risk should drive spread up during the period of high risk (see Galati, 2001), we find significant negative coefficients for almost all short-run dummies, except SR20 (see Table 4 and Table 5). A closer examination of the interaction term between these short-run dummy variables and trading activities in the Thai stock market reveals that the net purchases in the Thai stock market by foreign investors from days 41-60 after the Coup further reduces the currency bid-ask spread. However, the long-run dummy, Politic, revert the short-run impact by increasing the currency bid-ask spread back to the original level. Again, these results highlight that the uniqueness of the Thai market that does not follow the Western view. As noted by Schimdt (2007) while the US government suspended $24 million in military aid to Thailand, the Chinese government provided a special assistance of $49 million worth of military aid to Thailand, resulting in an inflow of foreign money to Thailand. Further, he also documents that Thai exporters ran up the country's largest-ever monthly trade surplus at US $1.4 billion on the month of the 2006 Coup. These foreign inflows increase the liquidity in the currency market as shown in the drop in bid-ask spread.

In contrast to the liquidity story, the short-run impact of the coup on realised volatility of spread (*LIQRISK*), which last up to 60 days after the Coup, increases the liquidity risk in the currency market. Further, the net purchases in the Thai stock market by foreign investors 6-10 days after the Coup further increase the liquidity risk in the currency market. However, the long-run dummy, Politic, reverses the short-run impact by decreasing the currency liquidity risk down, even lower than when the Coup starts. Hence, these results reinstate that the Thai currency market is not affected by the political risk as defined by the Western view.

4.3.2 *The Effect of the 2006 Coup on the SET Index*

Controlling for factors that found to be significant in the previous literature[11], we find the strength and length of the short-run effect of the 2006 coup varies across return, volatility, liquidity and liquidity risk. In general, the net purchases in the stock market by local investors adversely affect the returns on the SET index. We also find the 2006 coup decreases the SET return for days 1-5 post the coup. However, the buying activities in the Thai stock market by local (foreign) investors significantly increase (decrease) the SET return for days 1-60 after the coup and make the overall return in the SET becomes positive. Further, there is no long run impact of the Coup. Consistent with the findings from the analysis on the USD/THB, the Thai stock market is not adversely affected by the Coup.

The effect of the 2006 Coup on the stock market return volatility is immediate but short-lived and lasted only five trading days after the Coup. There are signs of panic in the market as evidenced by the increase in volatility during the five days after the Coup.

[11] We do not discuss significance of any control variables as they are not the key focus of our papers.

Table 4: The Effect of 2006 Coup and Interim Civilian Government on the USD/THB

	Return		*RV*		*LIQ*		*LIQRISK*	
	Coeff	t-stat	Coeff	t-stat	Coeff	t-stat	Coeff	t-stat
C	0.0014	(1.20)	−0.2751	(−2.49)	0.0330	(3.83)	−6.29E03	(−3.50)
SR5	−0.0015	(−3.20)	0.0342	(1.82)	−0.0082	(−4.02)	1.31E03	(3.40)
SR10	0.0004	(1.54)	0.0479	(1.94)	−0.0104	(−4.50)	1.79E03	(3.53)
SR20	−0.0023	(−3.21)	0.0525	(1.83)	−0.0057	(−1.19)	1.74E03	(2.89)
SR40	0.0000	(−0.17)	0.0212	(1.30)	−0.0050	(−2.51)	8.40E02	(2.60)
SR60	−0.0012	(−1.35)	0.0364	(1.88)	−0.0076	(−3.81)	1.26E03	(3.32)
POLITIC	−0.0010	(−1.17)	0.0411	(0.50)	0.0382	(4.28)	−7.49E03	(−3.60)
Fc_net_ratio	−0.0054	(−2.59)	0.0707	(0.82)	0.0300	(2.77)	−5.87E03	(−3.01)
*Fc_net_ratio*Sr5*	−0.0277	(−7.84)	−0.2145	(−2.10)	−0.0033	(−0.26)	2.67E03	(1.75)
*Fc_net_ratio*Sr10*	0.0088	(3.84)	−0.2123	(−1.82)	−0.0217	(−1.95)	4.33E03	(2.36)
*Fc_net_ratio*Sr20*	0.0256	(3.16)	−0.1453	(−1.12)	−0.0362	(−0.97)	1.79E03	(0.59)
*Fc_net_ratio*Sr40*	−0.0300	(−3.80)	0.1381	(0.48)	−0.0783	(−1.72)	1.02E04	(1.31)
*Fc_net_ratio*Sr60*	−0.0220	(−1.34)	−0.0833	(−0.94)	−0.0369	(−2.69)	4.75E03	(2.44)
*Fc_net_ratio*politic*	−0.0075	(−1.03)	−0.4724	(−1.82)	0.0057	(0.19)	−7.06E02	(−0.19)
ASIA	0.0022	(1.78)	−0.2448	(−1.52)	0.0830	(5.62)	−1.41E04	(−3.79)
ARGENTINA	−0.0003	(−1.38)	0.0345	(1.99)	−0.0015	(−0.50)	1.34E03	(3.46)
BRAZIL	0.0005	(0.73)	−0.0307	(−1.38)	0.0083	(2.29)	−1.59E03	(−2.92)
DOTCOM	0.0001	(0.28)	0.0118	(0.97)	−0.0006	(−0.31)	6.17E02	(2.22)
LTCM	−0.0039	(−2.29)	−0.0267	(−1.15)	0.0038	(0.70)	−7.17E02	(−0.91)
RUSSIA	−0.0035	(−2.54)	0.1924	(1.53)	−0.0632	(−5.26)	1.10E04	(3.71)
GFC	0.0001	(0.37)	0.1068	(2.71)	0.0078	(3.88)	−1.46E03	(−2.78)
Quote	2.4E-08	(0.46)	7.1E-06	(2.05)	−5.8E-07	(−2.29)	0.1990	(3.61)
Quoter	−5.2E-05	(−1.70)	0.0051	(2.37)	−0.0003	(−1.29)	4.40E01	(1.90)
AVGTBT	1.5E-07	(1.24)	1.1E-06	(0.47)	4.3E-07	(0.90)	−0.0940	(−1.56)
STDTBT	−1.2E-09	(−0.10)	2.2E-07	(0.72)	−3.2E-08	(−0.82)	0.0048	(1.03)
TIGHT	−0.0003	(−0.84)	0.0719	(1.65)	−0.0184	(−4.63)	3.81E03	(3.80)
AVGSPREAD	0.0015	(0.26)	1.3138	(1.50)	–	–	7.80E04	(3.88)
RV	–	–	–	–	–	–	1.50E03	(1.07)
RSKW	–	–	0.0002	(0.11)	–	–	−1.20E01	(−0.29)
Return(−1)	−0.1932	(−3.81)	–	–	–	–	–	–
RV(−1)	–	–	−0.0114	(−1.42)	–	–	–	–
RV(−2)	–	–	−0.0119	(−1.42)	–	–	–	–
RV(−3)	–	–	−0.0050	(−0.44)	–	–	–	–
RV(−4)	–	–	0.1622	(1.18)	–	–	–	–
AVGSPREAD(−1)	–	–	–	–	0.2300	(2.77)	–	–
AVGSPREAD(−2)	–	–	–	–	0.1237	(1.56)	–	–
AVGSPREAD(−3)	–	–	–	–	0.0944	(3.92)	–	–
AVGSPREAD(−4)	–	–	–	–	0.0745	(3.47)	–	–
REALISEDSPREAD(−1)	–	–	–	–	–	–	0.0596	(0.84)
REALISEDSPREAD(−2)	–	–	–	–	–	–	−0.0619	(−0.88)
Adjusted R-squared	0.0351	–	0.0822	–	0.5535	–	0.6167	–

Note: This table reports result for model 7. Data is collected from Thomson Reuter via SIRCA from 1 January 1996 to 31 December 2012. *Return* is the average daily return of USD/THB. Realised volatility (*RV*) is the daily average of realized volatility of the 5-minute return on the USD/THB. *LIQ* is the daily average bid and ask spread on the USD/THB. *LIQRISK* is the realized volatility of spread as defined in Section 3.1. The *SR5*, *SR10*, *SR20*, *SR40*, and *SR60* are dummy variables designed to capture short-run impact of Thai 2006 *coup d'états* and set to one 5, 10, 20, 40 and 60 trading days after 19 September 2006, respectively. *SR5* is 1 from 20-27 September 2006 and 0 otherwise.*SR10* is 1 from 28 September 2006 to 4 October 2006 and 0 otherwise. *SR20* is 1 from 5-18 October 2006 and 0 otherwise. *SR40* is 1 from 19 October 2006 to 16 November 2006 and 0 otherwise. *SR60* is from 17 November 2006 to 18 December 2006 and 0 otherwise. The *Fc_net_ratio* is the percentage of net amount of stocks (in Thai baht) purchased by foreign investors relative to all investor types. Other control variables are as described in Section 3.

The heightened volatility gradually diminishes during the period [6, 60] after the Coup. In addition, the net purchases in the Thai stock market by local (foreign) investors further reduce (increase) the volatility. Again, this is inconsistent with the Western view on political risk as the Coup does not adversely affect the Thai stock market at all.

Consistent with the findings for the realised volatility, the effect of the Coup on the stock market liquidity is immediate but short-lived, lasting only five trading days after the Coup. There is an increase in the trading volume during the five days after the Coup.

Table 5: The Effect of 2006 Coup and Interim Civilian Government on the SET Index

	Return		*RV*		*LIQ*		*LIQRISK*	
	Coeff	t-stat	Coeff	t-stat	Coeff	t-stat	Coeff	t-stat
C	0.00157	(2.20)	8.30E-05	(3.34)	3.57E+05	(9.60)	1.60E+05	(5.85)
SR5	−0.00291	(−2.34)	1.31E-04	(1.71)	2.36E+05	(0.87)	−2.45E+04	(−0.69)
SR10	−0.00145	(−0.58)	−8.56E-05	(−3.80)	−4.46E+05	(−2.59)	−2.12E+05	(−3.57)
SR20	0.00172	(0.30)	−7.62E-05	(−2.63)	1.97E+05	(2.37)	−6.82E+04	(−3.39)
SR40	−0.00004	(−0.03)	−1.02E-04	(−3.66)	2.63E+05	(2.97)	5.16E+04	(1.51)
SR60	0.00046	(0.58)	−9.24E-05	(−4.51)	1.11E+04	(0.17)	−6.30E+04	(−2.60)
POLITIC	−0.00055	(−0.66)	−1.14E-05	(−0.29)	−8.72E+03	(−0.20)	−4.55E+04	(−2.71)
Fc_net_ratio	0.06670	(11.86)	9.83E-05	(1.04)	5.86E+05	(4.76)	4.11E+05	(4.43)
*Fc_net_ratio*Sr5*	−0.14825	(−14.36)	7.92E-03	(9.65)	1.73E+07	(6.31)	3.26E+06	(8.47)
*Fc_net_ratio*Sr10*	−0.05850	(−2.53)	−5.04E-05	(−0.28)	−8.09E+06	(−4.28)	−2.21E+06	(−3.89)
*Fc_net_ratio*Sr20*	−0.03542	(−0.53)	−2.01E-04	(−0.80)	−2.25E+06	(−1.66)	5.26E+04	(0.21)
*Fc_net_ratio*Sr40*	−0.04339	(−2.99)	2.43E-05	(0.11)	−2.92E+05	(−0.13)	−6.96E+05	(−1.36)
*Fc_net_ratio*Sr60*	−0.01164	(−1.24)	4.02E-05	(0.33)	−5.49E+05	(−0.41)	−4.55E+05	(−1.32)
*Fc_net_ratio*Politic*	0.01104	(0.65)	−1.54E-03	(−1.27)	1.37E+05	(0.22)	−1.72E+05	(−1.02)
ASIA	−0.00677	(−3.99)	1.05E-04	(2.26)	−3.21E+05	(−7.38)	–	–
ARGENTINA	0.00124	(1.85)	−4.59E-05	(−2.57)	−1.02E+04	(−0.34)	–	–
BRAZIL	−0.00334	(−1.45)	9.45E-05	(1.85)	−2.81E+05	(−5.62)	–	–
DOTCOM	0.00089	(0.46)	1.02E-04	(2.13)	−2.53E+05	(−5.91)	–	–
LTCM	0.01420	(3.41)	4.80E-06	(0.05)	−2.99E+04	(−1.29)	–	–
RUSSIA	0.00811	(2.69)	1.06E-04	(1.44)	2.85E+04	(0.99)	–	–
GFC	0.00157	(1.97)	−9.60E-06	(−0.25)	1.44E+05	(3.38)	−1.40E+04	(−0.97)
AVGTBT	2.1E-06	(0.43)	−9.60E-08	(−0.73)	−7.12E+01	(−0.38)	−31.73965	(−0.33)
STDTBT	−3.6E-07	(−1.25)	8.93E-09	(1.14)	−1.76E+01	(−1.61)	−4.46E+00	(−0.76)
TIGHT	−0.00279	(−2.56)	−2.12E-05	(−0.89)	−2.62E+05	(−8.02)	–	–
RV	–	–	–	–	1.37E+08	(2.16)	1.41E+08	(5.37)
RSKW	–	–	1.57E-06	(0.43)	−1.97E+04	(−6.08)	−5.26E+03	(−3.32)
VOLUME	−7.0E-11	(−0.43)	8.53E-12	(1.06)	–	–	–	–
Return(−1)	−0.04189	(−1.26)			–	–	–	–
RV(−1)	–	–	2.86E-01	(4.61)	–	–	–	–
RV(−2)	–	–	6.88E-02	(1.40)	–	–	–	–
RV(−3)	–	–	4.53E-02	(1.48)	–	–	–	–
RV(−4)	–	–	3.86E-02	(1.24)	–	–	–	–
STDTOTVOL(−1)	–	–	–	–	–	–	0.5268803	(14.17)
STDTOTVOL(−2)	–	–	–	–	–	–	0.1144897	(3.29)
STDTOTVOL(−3)	–	–	–	–	–	–	0.0344942	(0.88)
STDTOTVOL(−4)	–	–	–	–	–	–	0.057762	(1.77)
STDTOTVOL(−5)	–	–	–	–	–	–	0.086239	(1.37)
STDTOTVOL(−6)	–	–	–	–	–	–	−0.000255	(−0.01)
Adjusted R-squared	0.11781	–	0.158157	–	0.8515705	–	0.6449793	–

Note: This table reports result for model 7. Data is collected from Thomson Reuter via SIRCA from 1 January 1996 to 31 December 2012. *Return* is the average daily return of SET Index. Realised volatility (*RV*) is the daily average of realized volatility of the 5-minute return on the SET Index. *LIQ* is the daily trading volume of the SET Index. *LIQRISK* is the standard deviation of trading volume of the SET Index. The *SR5*, *SR10*, *SR20*, *SR40*, and *SR60* are dummy variables designed to capture short-run impact of Thai 2006 *coup d'états* and set to one 5, 10, 20, 40 and 60 trading days after 19 September 2006, respectively. *SR5* is 1 from 20-27 September 2006 and 0 otherwise. *SR10* is 1 from 28 September 2006 to 4 October 2006 and 0 otherwise. *SR20* is 1 from 5-18 October 2006 and 0 otherwise. *SR40* is 1 from 19 October 2006 to 16 November 2006 and 0 otherwise. *SR60* is from 17 November 2006 to 18 December 2006 and 0 otherwise. The *Fc_net_ratio* is the percentage of net amount of stocks (in Thai baht) purchased by foreign investors relative to all investor types. Other control variables are as described in Section 3.

From days 6 to 10 after the Coup, trading volume drops more than the increase seen during the first five days after the coup. Then, the trading volume picks up again from days 11 to 40. In addition, the net purchases in the Thai stock market by local (foreign) investors further reduce (increase) the stock market liquidity. Surprisingly, this result is consistent with the Western view that political risk, which bring uncertainty, causes investors to withdraw from the market, resulting in lower trading volume.

Finally, the liquidity risk in Thai stock market reduces 11-20 and 41-60 days after the Coup and continues to reduce throughout the Interim Civilian government. Interacting

the political risk dummies with trading activities by foreign investors, we find that net purchases in the stock market by local (foreign) investors reduces (increases) liquidity risk 1-5 trading days after the Coup and revert 3-third back from day 6-10 after the Coup. Again, consistent with the return and volatility story, the Thai stock market is not adversely affected by the Coup, contrary to Western belief.

Overall, these findings are also consistent with a remark by Charoensin-o-larn (2007) that the movement in SET index reflects that foreign investors are not concerned with the Coup or the new constitutions. Charoensin-o-larn (2007) also note that the neo-royalists, the old elite, the armed forces, the middle class, and a substantial portion of urban intellectuals view the 2006 coup as a legitimate «last resort» to solve the political conflicts while the lower-income class mostly oppose the 2006 coup. As investing in stock market requires initial capital, access to the capital market and knowledge about financial market, it is more likely that proponents of the coup are relatively active in the Thai stock market. Given that the Thai stock market is dominated by local retail investors (see Phansatan *et al.*, 2011), it is not surprising that we find the SET index is not adversely affected by the 2006 Coup.

5 Conclusion

This paper studies whether the Thai 2006 *coup d'états* and its interim military and civilian governments has any effect on the Thai stock and currency markets in both the short-run and long-run. We contribute to the literature on political economy by testing whether Western beliefs and theories can be applied to Thailand. Thailand has a unique political setting in that, unlike other unstable political emerging markets, the Thai political system is a democracy under the Monarchy, which is loved by the majority of Thais. It is well-known that Thais love and respect their current King due to his life-long work towards improving Thais' standard of living. Like most emerging markets, the Thai financial system is based on those in the Western countries. This provides a perfect setting to test our key research questions.

Specifically, we examine the effect of political risk on both short-run and long-run dynamics of return, volatility, liquidity and liquidity risk of returns on the Stock Exchange of Thailand (SET) index and the USD/THB exchange rate. We find investors react heterogeneously between currency and stock markets in both short-run and long-run analyses. This is likely due to the different compositions in the two markets where domestic retail investors are more dominant in the stock market and less so in the currency market. Phansatan *et al.* (2011) report that the major traders on the Thai stock market are individual domestic traders, with their activity accounting for 80% of the trading volume and 70% of the trading value. On the other hand, Tsuyuguchi and Wooldridge (2008) report that data from the BIS Triennial Central Bank Survey indicate that the turnover of Asian currencies rose sharply between 2004 and 2007, financial institutions became more important customers, and the participation of non-residents increased.

In the short run analyses, the Thai 2006 *coup d'états* is shown to strengthen the Thai Baht against the US dollar, have no impact on the return volatility, reduce the bid-ask

spread and liquidity risk in the currency market. Although, in the long run, the Coup brings the currency bid-ask spread back to the original level, it reduces the liquidity risk. For the stock market, we find Thai 2006 *coup d'états* and its interim military and civilian governments increase stock return but reduce volatility and liquidity risk though it also reduces trading volume. It appears that the Western beliefs and theories do not fully apply to the Thai financial market. There is no statistical evidence that Thai 2006 *coup d'états* has adversely affected the Thai stock and currency markets. The findings imply that the political situation in Thailand is unique – what is viewed as bad by outsiders is not necessary bad for Thais (*The Nation*, 2006). As Kivimaki (2007) discusses, «Focus on the consolidating mechanism of democracy can have confused Thai specialists of the potential of non-democratic tendencies taking over. The Thai coup of 2006 reminds us that expertise in an area requires an approach where the actual developments can be related to the possible developments that could take place. A specialist of Thailand cannot really understand this complex country unless she or he is able to see the potentials it has for a fundamental change». Consistent with Schmidt (2007), our findings indicate that investors are not concerned with the Thai government but more so with the monarchy or King Rama IX who is much loved by Thais, and that a change in the monarchy is more likely to have a dramatic impact on the Thai financial market. Hence, we conclude that the Thai 2006 *coup d'états* and its interim military and civilian governments does not have a fundamental adverse effect on the Thai financial market as claimed by some financial commentary or media coverage.

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