

Stock Market Response to Economic Policy Uncertainty: Moderating Effect of COVID-19 Pandemic Sentiment

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Abstract: This study examines the dynamic relationship between Economic Policy Uncertainty (EPU) and stock market liquidity, with a particular focus on the moderating role of the COVID-19 pandemic sentiment. Using high-frequency stock market data from Brazil, India, and the USA, we employ wavelet coherence analysis to assess the co-movement between EPU and stock liquidity under varying pandemic sentiment levels derived from Google search volume intensity (SVI). Our findings reveal that heightened policy uncertainty exacerbates market illiquidity, particularly during periods of high pandemic sentiment. Additionally, we uncover a feedback loop where illiquidity often precedes EPU in the short term, while EPU occasionally drives illiquidity. Overall, the study's insights underscore the critical role of market sentiment in shaping policy responses to financial crises.

Keywords: Economic Policy Uncertainty, Stock Liquidity, Pandemic Sentiment, COVID 19, Wavelet Analysis

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