

The Effect of Political Stability and Macroeconomic Indicators on FDI

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ABSTRACT

This study investigates the impact of political stability and key macroeconomic indicators on foreign direct investment (FDI) across five countries representing both developing and developed economies, using annual data spanning from 2008 to 2023. The research aims to understand how variations in political and economic environments influence the inflow and performance of FDI, a critical driver of economic growth and international integration. In this analysis, macroeconomic factors are captured through interest rates, inflation rates, and GDP per capita, while capital market performance is reflected in stock market index returns and total market values. Political risk is assessed through a political stability index, serving as a proxy for institutional reliability and governance of quality. The dependent variables comprise FDI measured as a percentage of GDP and as GDP values in U.S. dollars, enabling a comprehensive evaluation of FDI performance relative to economic size and output. To test the formulated hypotheses and address potential endogeneity issues, the study employs the Generalized Method of Moments (GMM) estimation technique within a multiple regression framework. The findings reveal a statistically significant relationship between political stability and FDI inflows, demonstrating that higher political risk negatively affects both FDI as a share of GDP and its absolute value in U.S. dollars. This implies that countries with stable political environments are more likely to attract sustained and higher levels of foreign investment. The results underscore the importance of political and institutional factors in shaping investment dynamics alongside macroeconomic fundamentals. Consequently, policymakers are encouraged to strengthen governance and ensure macroeconomic consistency to enhance their countries' attractiveness to foreign investors and promote long-term economic growth.

KEYWORDS

Political Stability, Economic Indicators, FDI, PSI, Countries, GMM

1- INTRODUCTION

A key feature of globalization has been the liberalization and expansion of global foreign direct investment (FDI) flows, which serve as a vital source of capital inflows for many economies (Anyanwu, 2017). However, following the most severe post–World War II recession, the global economic environment has faced persistent uncertainty, characterized by slowing trade, reduced capital flows, and declining commodity prices—trends that have disproportionately affected developing countries (World Bank, 2015; Oner, 2015). Between 2014 and 2015, energy prices dropped by approximately 45%, and non-energy commodities by 14%, largely due to oversupply and weakening demand in emerging markets such as China (World Bank, 2015). These developments led to revenue and employment losses in commodity-exporting nations, exacerbating exchange rate instability and poverty levels (World Bank, 2015).

Recognizing these challenges, the **United Nations Sustainable Development Goals (SDGs, 2015)** emphasized the need to increase FDI to support sustained economic growth, particularly in developing nations where savings rates and official development assistance remain low. Consequently, FDI became a critical mechanism for capital mobilization and growth (Ai Ngoc Nihan Le et al., 2023).

Given its importance, understanding the determinants of FDI—especially political risk—has become essential. Political instability, policy shifts, and regime changes create uncertainty for investors, often deterring cross-border investment (Giambona et al., 2017). According to **The Management of Political Risk** (Giambona, Graham, & Harvey, 2017), nearly half of firms avoid FDI in politically unstable environments. Therefore, this study aims to examine the political risk factors influencing FDI across countries, building on previous research that links political stability with investment behavior and market performance (Abdelrhim et al., 2024; Gokhan, 2022; Souffargi & Boubaker, 2024).

2- RESEARCH AIM

The aim of this research is to identify the impact of political risk and economic indicators on foreign direct investment. Also, identify the direct of the relation between them using FDI percentage% of GDP, FDI in USD, interest rate%, inflation rate%, market return%, total value of stocks, GDP per capita and political stability index in the time period of (2008 -2023).

3- RESEARCH GAP

After reviewing we can conclude that no paper examined the political risk effect on FDI of country Germany and Morocco. And no paper captured the time period of 2008 to 2023. And no paper used the variables total value for stocks and political stability index PSI.

4- RESEARCH PROBLEM

Foreign Direct Investment (FDI) plays a crucial role in promoting economic growth and development, especially in emerging economies. However, FDI inflows are often influenced by a country's political stability and macroeconomic conditions, such as inflation, GDP growth, and exchange rates. In many developing countries, fluctuations in these factors create uncertainty for foreign investors, potentially reducing investment inflows. Despite the recognized importance of political and economic stability in attracting FDI, empirical evidence remains mixed and context-specific. Therefore, it is essential to investigate how political stability and key macroeconomic indicators jointly affect

FDI inflows, particularly in economies that experience periodic political or economic instability. Since FDI is important for developing countries, it is important to examine factors that affect it. We have to identify how does the political stability affect it. So, our aim is to answer those research questions:

Is political risk really affect FDI?

How does political risk affect foreign direct investment (FDI)?

5- RESEARCH IMPORTANCE

The FDI is a really valuable asset for countries that are still developing. But the problem is most foreign investors are hesitant to invest in less developed countries because of the political risk. We study the relation to know how can a developing country attract funds. It is crucial for development.

6- RESEARCH VARIABLES

Our research will include some independent variable and 2 dependent variables. The research will cover time period from 2008 to 2023. It will include 5 countries (Egypt, Saudi Arabia, Morocco, USA and Germany).

6.1 Independent Variables XS

X1: Interest rate

X2: Inflation rate

X3: GDP per capita

X4: Market return

X5: Stock Market value

X6: Political stability index

6.2 Dependent Variables Y

Y1: FDI percentage of GDP%

Y2: Foreign direct investment.

7- RESEARCH HYPOTHESIS

The hypothesis that are developed are as follow:

H1: There is significant impact of the Political risk on FDI

7.1 Data & Methodology

The data collected are from 3 known websites: trading economies, macro trends and world bank. the period of study is from 2008 to 2023. The independent variables are political stability related variables like interest rate and inflation rate and the dependent variables are FDI and FDI percentage of GDP.

8- LITERATURE REVIEW

According to **Abler Nader, Abdelrhim Mansour, Farouh Mahmoud** (2025), examined the impact of political stability on market price performance across countries from four continents: Europe, the Americas, Asia, and Africa. The sample includes ten countries from each continent, selected based on World Bank classifications, for the period 2008-2022. Testing hypotheses has been conducted using GMM technique, where Z-moments are projected into the column space of instrumental variables. The results indicate that political stability alone has a minimal impact on market prices in Europe and Africa, but its significance increases when combined with GDP per capita and FDI. In the Americas and Asia, political stability shows a more obvious impact, especially when combined with other economic factors.

Furthermore, **Wafaa Souffargi and Adel Boubaker** (2024), Studied the Impact of Political Uncertainty on Stock Market Returns: The Case of Post-Revolution Tunisia: The impact of the main political events is supported by parametric and non-parametric tests with an event-driven approach as well as regression analysis. The popular uprising has a destructive effect on stock market returns. The Democratic transition positively affects the market. The results of our study are of direct interest to financial authorities and decision-makers who wish to assess the role of political uncertainty in triggering or exacerbating stock price movements and contribute to a better understanding of investor behavior.

Moreover, **Zhiying Mai, Hassan Mujtaba Nawaz Saleem, Muhammad Kamran** (2023), Studied The relationship between political instability and stock market performance: An analysis of the MSCI index in the case of Pakistan: The stock market is a barometer of the economy, reflecting the overall state and direction of economic development. It is influenced by various factors, including social, environmental, and political factors. It is important to study the impact of political instability on stock market performance, especially in emerging economies. Therefore, this study aims to examine the relationship between political instability and stock market performance in Pakistan. To achieve this objective, historical data from 1996 to 2021 were used. Regression analysis was employed, and a two-way robustness analysis was conducted to ensure the accuracy of the results using generalized multivariate model (GMM) methods with GDP as the other endogenous variable. Our results demonstrate that political stability has a significant positive impact on stock market performance, while political instability negatively impacts stock market performance.

However, **Siska Elmira, Duraipandi Oyyappan** (2023), examined the effect of systematic risk, which includes the exchange rate, rates of interest, inflation, and the stock market capitalization in Indonesia linked with political stability as moderating variable. This study is based on secondary data from the first quarter of 2000 until the last quarter of 2020. A quantitative research design with a descriptive approach was employed in this study. The regression results confirmed that systematic risk, which consists of the USD exchange rate against the rupiah, interest rates, and inflation level has a negative impact on stock market development in Indonesia.

In addition, **Ai Ngoc Nihan Le, Ha Pham, Dung Thi Noge Pham and Khoa Dang Duong** (2023), studied Recently the report that Foreign Direct Investment (FDI) is the primary driver of economic growth because it transfers the latest technologies from developed to developing countries (Chenaf- Nicet and Rougier, 2016). Kurecic and Kokotovic (2017) argue that political stability does not significantly affect FDI because investors take political risks for granted. Sabir et al. (2019) indicate that political stability positively affects foreign direct investment. Prior studies indicate that trade openness helps the country access a broader market, creating resources for import and export, causing investors to expect much revenue in the host country. Therefore, trade openness greatly influences foreign direct investment (Djulius, 2017).

Also, **Gokhan konat** (2022), Studied that all types of capital imports related to open capital accounts in emerging and developing economies are equally undesirable and have difficulties as they are becoming more and more open. Short-term loans and portfolio investments show a sudden reversal in case of a change in the economic environment or just the investor's perception, causing possible financial and economic crises. Therefore, it is often recommended that these economies try to attract foreign direct investment (FDI) is firstly and be cautious when accepting other sources of financing.

Besides, **Abdullah Mohammad, Chowdhury Mohammad, Karmaker Uttam, Fuszder Md Habibur, Shahriar Md Asif** (2022), examined the role of political stability in a firm's financial performance in Bangladesh. By considering 139 listed companies from the Dhaka Stock Exchange over the period of 2011 to 2020, we applied a dynamic generalized method of moments (GMM), dynamic quantile regression and dynamic threshold regression. The empirical evidence of this study shows a significant positive impact of political stability on Bangladeshi firms' financial performances.

Furthermore, **Keshavarz Hadi, Rezaei Mohammad** (2022), investigated the effect of political, economic, and financial risk with capital markets has not been done. Therefore, this study seeks to answer the question of whether political, economic, and financial risks affect stock risk and return? This study tries to examine the effect of political, economic, and financial risks on stock risk and return. Theoretical Framework: Economic risk is a tool for assessing a country's economic strengths and weaknesses. Financial risk is a tool to assess a country's ability to pay its costs. Financial risk is a measure of a country's ability to formally finance, trade, and trade liabilities. Political risk is often defined as the undesirable risk of political events Their results show that the growth rate of GDP has a significant negative effect on the volatility of stock returns. Inflation, money growth rate, and exchange rate volatility have a positive and significant effect on different regimes.

However, **Darsono, Andi, Nugroho, Aditya, and Prasetyo, Bambang**, (2022), investigated the influence of political stability on stock market returns and volatility in Indonesia. The study analyzed daily stock market data from January 2010 to December 2020, employing GARCH and EGARCH models to assess volatility patterns. The results indicated that periods of political stability were associated with higher stock market returns and lower volatility, while political instability led to increased market fluctuations.

Similarly, **Pavel Jeutang and Kwabena Kesse**, (2021), Studied a novel measure of political risk that confirms some of the findings documented in the Foreign Direct Investments (FDI) literature. Particularly, we confirm the positive relationship between political stability and its components on FDI inflows, and the moderating effect of natural resources on this relationship. The proposed political risk measure contains relevant, unique and incremental information not observed in the literature. For example, although this measure is highly correlated with the political risk rating of the International Country Risk Guide (ICRG), it contains unique information that explains FDI inflows beyond what is explained by the ICRG rating. A link to the database for our political risk rating for 150 countries covering 2000 to 2015 has been provided.

Likewise, **Kunjal, Khurshed, Mensah, Isaac, and Premaratne, Gayan** (2021), analyzed the impact of political, economic, and financial risks on the volatility of exchange-traded funds (ETFs) in South Africa. The study employed a GARCH-MIDAS model to assess the influence of these risks on ETF market volatility using data spanning from 2000 to 2018. The results demonstrated that political risk, as a proxy for political stability, had a significant effect on market volatility, highlighting the critical role of a stable political environment in ensuring market stability.

However, **Salisu, Afees A., Ebuh, Godwin U., and Usman, Nura A.** (2021), explored the effect of geopolitical risks on stock market volatility in emerging markets. Utilizing the GARCH-MIDAS approach, the study examined data from multiple emerging economies over the period from 2005 to 2019. The findings revealed that heightened geopolitical risks, indicative of political instability, significantly increased stock market volatility, underscoring the importance of political stability for market performance.

Moreover, **Ahmed & Salim** (2021), studied the impact of political stability on stock market performance in emerging economies. The study focused on the stock markets of Egypt, Turkey, and South Africa using monthly data from January 2005 to December 2020. The authors used the GARCH and EGARCH models to analyze the volatility of stock returns in relation to political events. The findings suggest that higher political stability leads to increased investor confidence, resulting in better stock market performance. On the other hand, political unrest was associated with high market volatility and reduced returns.

Likely, **Abdelkader Nassour, saliha meftah, Sajid Hussain Mirani** (2020), Studied the impact of Political risk on Foreign Direct Investment inflows in three selected MENA countries (Algeria Turkey and Arabia-Saudi) during the period (1984-2017) using the Panel Data model. The Hausman Test confirms that the random effects model is a more appropriate technique for this model to explain the effect of Political Risk on FDI inflows. The results of our study show that: Democratic Accountability and Investment Profile, Law Order have a significant positive impact on FDI inflow. Besides that, another interesting finding of the research is the significant negative relationship between the Military in Politics and FDI.

However, **Omar & Youssef** (2020), explored how political events influence the stock market in Middle Eastern economies, focusing on data from Saudi Arabia, Jordan, and Lebanon. Using GARCH models, they analyzed the weekly stock index performance from 2008 to 2019. The study found that political stability is positively associated with market growth and reduced volatility, whereas political uncertainty often led to market crashes or sharp declines in investor activity.

Additionally, **Hassan and Liu**, (2019), investigated the relationship between political stability and stock market performance in Asian markets. The study analyzed daily stock return data from China, India, and Indonesia over the period from 2010 to 2018. The authors employed the EGARCH model to measure the effect of political risk on market volatility. Their results showed that political instability significantly increases stock market fluctuations and reduces investor trust, especially in countries with less transparent political systems.

As well as, **Syed Shahbaz Hussain, Saeed Ahmed Sabir and Muhammad Saeed as Mio** (2017), Studied of the Impact of Political Stability, Government Effectiveness and Control of Corruption on Stock Markets in South Asia: the relationship between political stability, government effectiveness and corruption on stock market Performance using the panel VECM model for South Asian countries from 1989 to 2015. In order to Determine, the directional relationship, the Granger Causality test is being employed. Policy Recommendation for the South Asian nations could be condensed i.e. control on corruption, enhance Government effectiveness, keep away from frequencies of violence and political instability that send wrong Flags to universal investors, and keep up sound regulation quality. Study findings suggest a strong positive Relationship between control of corruption, government effectiveness, political stability and stock market Performance.

Likewise, **Meo Mohammed**, (2017), studied the relationship between political stability, government effectiveness and corruption on stock market performance using the panel VECM model for South Asian countries from 1989-2015. Study findings suggest a strong positive relationship between control of corruption, government effectiveness, political stability and stock market performance.

Correspondingly, **Irshad Hira** (2017), investigated the relationship of political instability with the stock prices. Results of the study indicated the negative relationship of stock prices with political instability. Moreover, results of suggest that instable political system ultimately leads decline in stock prices.

Equally important, **Radu Madalina** (2015), examined the influence of political stability on economic growth in Romania. They used statistical and econometric approach (correlation and multivariate regression). The result of this study say that political stability is so important thing and it affect economic growth of the country and stable political environment is a key for building and improving and it's so important thing that help country to develop.

9- VARIABLES BREAKDOWN

9.1 Interest Rate

Interest rate is the cost of borrowing money or return on investments from bonds. They are determined based on many factors like the supply and demand for credit, inflation expectations, and monetary policy decisions made by central banks. Interest rate changes can have a big impact on investors willingness to borrow or lend funds. If an investor sees that the borrowing rate is high he will not be willing to borrow any cash and might post pone future investments, interest rate is important thing that central bank need to keep view on it, when there is an inflation they will increase interest so that people cost of borrowing will be high so they can control the inflation, when there is a recession central bank can decrease the interest rate so that people can borrow money and use it to develop.

Table 1: Interest Rate

Variable Name	Interest Rate
Definition	The cost of lending or borrowing money
Factors affecting it	1-The supply and demand for credit 2-Inflation expectations 3- monetary policy
Equation	$S.I. = P \times T \times R / 100$ Simple interest rate =principal X Time X rate of interest annually

The higher the principle the higher the interest rate. Investors who pay more principle are rewarded with more interest. But not everyone is able to or willing to pay high amount of principle all at once. For foreigner's investors a higher interest rate is more attractive than a low interest rate investment.

9.2 Inflation Rate

Inflation is the rate of increase in prices over a given period of time. And it massively affects the buying power of consumers. Inflation rate is a massive problem for many organizations because it controls the amount of goods and service that can be bought with the amount of capital available.

Table 2: Inflation Rate

Variable Name	Inflation Rate
Definition	The rate of increase in prices over a given period
Factors affecting it	Law monetary policy Pressures on the supply or demand side People's expectations
Equation	Total Inflation Rate = (Target Year CPI – Base Year CPI) ÷ Base Year CPI) x 100

9.3 GDP per Capita

GDP per capita is the total value of production of goods and service per individual in the country. It is mainly measured by dividing the real GDP by the population. GDP per capita is an important indicator of economic performance and a useful unit when making cross-country comparisons of average living standards and economic wellbeing. However, GDP per capita is not a measure of personal income. It is really helpful in identifying investments opportunities. A higher GDP per capita means a better market, which makes it a good destination for investment in luxury goods, and high ends service.

Table 3: GDP per Capita

Variable Name	GDP per Capita
Definition	It is the total value of economic output per individual in a country
Factors affecting it	GDP Inflation rate Interest rate
Equation	GDP PER CAPITA = GDP/ POPULATION

9.4 Market Return

Market return is the overall profit gained from a specific market or a broad market index. It is a very useful tool in identifying how well the market is doing.

Table 4: Market Return

Variable Name	Market Return
Definition	It is essentially a measure of how much an investment in stocks has grown over time
Factors affecting it	Return on assets, ROA Return on equity Firm age
Measurement	$\text{New stock price} - \text{old stock price} / \text{old} \times 100$

9.5 Stock Market Value

Total Value can be understood as the total increase of the stock prices over time. It tells how effective is the country in creating wealth for its stock holders.

Table 5: Stock Market Value

Variable Name	Stock Market Value
Definition	It is the increase in stock value over time
Factors affecting it	Number of sales Price per stock Company's effectiveness
Measurement	$\text{Stock market value} = \text{selling price} \times \text{quantity sold}$

A higher total value indicates a strong market performance and low indicate bad market performance. It's a sign for return to stock holders from the investments and a higher total value means a more attractive invest to both foreigners and domestic.

2.2.6- Political Stability Index:
It is a numerical measure that says if the country is politically stable or not, it gives -2.5 as a weak sign and politically instable country, while 2.5 gives a sign that this country is strong and politically stable.

9.6 Political Stability Index

Table 6: Political Stability Index

Variable Name	Political Stability Index
Definition	Is a bench mark for identifying political stability
Factors affecting it	Ruling system Economic condition Micro and macro-economic

A higher political stability index means it is stable country and low risk and people will be willing to invest in it while a low index says that country has a bad stability and sign to weakness. It is Based on many measurements. Political stability index is a benchmark to assist in identifying the stability of the economy. There is no one simple equation to measure political stability index. Political stability helps us identify many things like political violence risk, government stability and social unrest.

9.6.1 Political Stability Index Measurement

Political stability index = $(W_v \times V) + (W_{ge} \times GE) + (W_{rl} \times RL) + (W_{cr} \times CR) + (W_{sr} \times SR)$ W_v = weight of violence (0.3)

V = score of violence in a country

W_{ge} = weight of government effectiveness (0.2)

GE = government effectiveness score in a country W_{rl} = weight of rule of law (0.2)

RL = score of rule of law

W_{cr} = weight control of corruption (0.2) CR = control of corruption score

W_{sr} = weight of social unrest (0.1)

SR = score of social unrest

9.6.2 Political Stability Index Charts

Figure 1: Saudi Arabia PSI



Figure 2: Egypt PSI



Figure 3: USA PSI

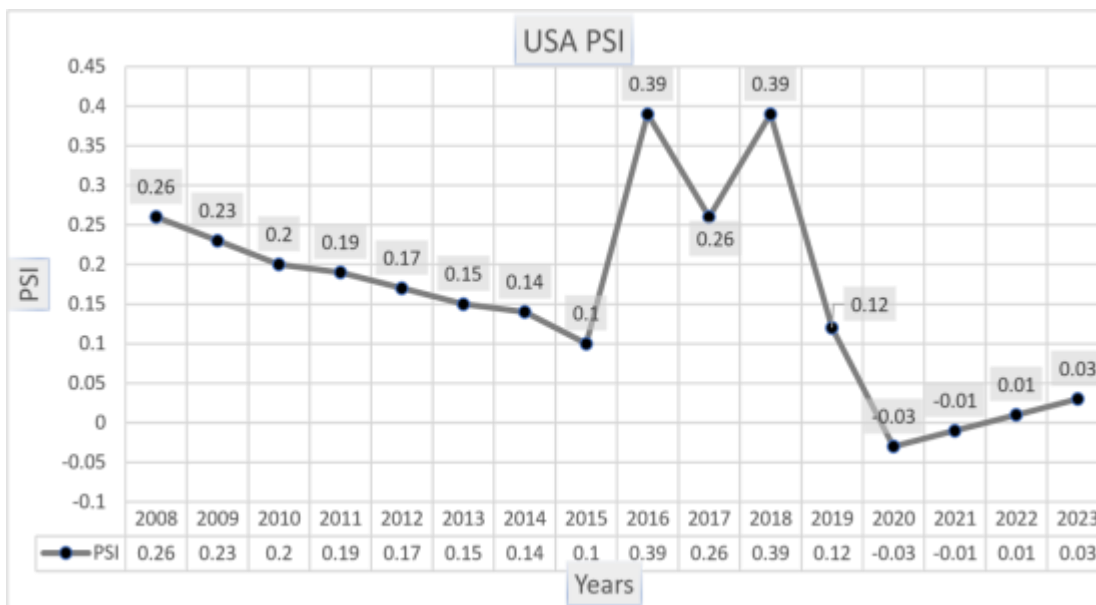


Figure 4: Morocco PSI



Figure 5: Germany PSI

9.7 Dependent Variables

9.7.1 FDI % of GDP

It's the percentage of the foreign investors compared with the percentage of the GDP of your country. it is important because it help us identify how attractive a country is for foreign investors. The higher the FDI percentage of GDP the more attractive it will be for foreign investors. It reflects good political stability.

Table 7: FDI% of GDP

Variable Name	FDI% of GDP
Definition	Amount of foreign money that come to the country divided by GDP
Factors affecting it	1- Economic stability, example: - a- Revolutions - b- Wars - c- Political stability index if it is weak or strong
Measurement	$(\text{FDI} / \text{GDP}) \times 100$

9.7.2 FDI

It is the Total cash flow that come from outside either from foreign investors or other countries. It is important because it identifies how much foreign currencies enter a specific country.

Table 8: FDI

Variable Name	FDI
Definition	Cash that comes from foreigners
Factors affecting it	1- Micro economic 2- Macro-economic 3- Pandemic diseases like corona virus
Measurement	Net inflows = inflows – outflows from foreign investors

A high FDI means that the country gets a lot of cash from outside so it is something good and it will help. while a low FDI will be a bad sign because it means that the country is not getting any foreign aid of funds and this funds can help countries to get foreign currencies and use it to develop country. A high FDI means a country is successfully attracting foreign funds. Attracting foreign funds is necessary specially for developing countries which are in shortage of funds needed for their investments. The more the inflows of foreign funds are compared to outflows that means the country has more of a surplus. So, the higher the better.

10- RESEARCH VARIABLES**Table 9: Research Variables**

Variable	Type	Sign	Measure type	Source
FDI as % of GDP	Dependent	Y1-FDG	Economic	Macrotrends
FDI in \$ (Ln)	Dependent	Y2-FD\$	Economic	Macrotrends
Interest Rate%	Independent	X1-IR	Economic	Trading Economics
Inflation Rate%	Independent	X2-IF	Economic	Macrotrends
GDP-Per-Capita	Independent	X3-GPC	Economic	Macrotrends
Stock Market Return%	Independent	X4-SMR	Capital Market	Trading economies
Stock Market Value in \$ (ln)	Independent	X5-SMV	Capital Market	Trading Economics
Political Stability Index	Independent	X6-PSI	Index	World bank

10.1 Descriptive Statistics**Table 10: Descriptive Statistics**

Variable	Y1-FDG	Y2-FD\$	X1-IR	X2-IF	X3-GPC	X4-SMR	X5-SMV	X6-PSI
Mean	0.018351	23.54978	0.037669	0.045599	26884.56	0.051750	25.07339	-0.228750
Median	0.017500	22.99161	0.022500	0.022850	22924.00	0.064192	24.45457	-0.320000
Maximum	0.058300	26.96048	0.192500	0.338800	81695.19	0.668500	29.06372	0.790000
Minimum	-0.002000	19.89396	0.000000	-0.020900	1942.000	-0.362800	21.80846	-1.640000
Std. Dev.	0.010642	1.962026	0.045686	0.059385	23406.26	0.181998	2.077976	0.649388
Skewness	0.742582	0.268985	1.810822	2.766324	0.419274	0.474904	0.203706	-0.220912
Kurtosis	4.482488	1.805892	5.692247	12.42146	1.852364	4.329885	1.740104	2.416610
Jarque-Bera	14.67827	5.717682	67.88166	397.9138	6.734104	8.902427	5.844412	1.785173
Probability	0.000650	0.057335	0.000000	0.000000	0.034491	0.011664	0.053815	0.409595
Sum	1.468100	1883.983	3.013500	3.647900	2150765.	4.139996	2005.871	-18.30000
Sum Sq. Dev.	0.008947	304.1142	0.164892	0.278603	4.33E+10	2.616736	341.1208	33.31468
Observations	80	80	80	80	80	80	80	80

In this descriptive statistics table, we can see that PSI (X6) has the lowest mean of -0.228750 with a standard deviation of 0.649388 and minimum of -1.640000 and maximum of 0.790000 compared to the GDP per capita, which has the highest mean of 26884.56 with a standard deviation of 23406.26, and a maximum of 81695.19 and minimum of 1942.000.

10.2 Correlation between Independent Variables

Table 11: Correlation between Independent Variables

Variable	X1-IR	X2-IF	X3-GPC	X4-SMR	X5-SMV	X6-PSI
X1-IR	1.000000	0.867042	-0.528171	0.192261	-0.349616	-0.717526
X2-IF	0.867042	1.000000	-0.359117	0.230901	-0.182376	-0.519824
X3-GPC	-0.528171	-0.359117	1.000000	0.075998	0.498617	0.748461
X4-SMR	0.192261	0.230901	0.075998	1.000000	0.005407	-0.068661
X5-SMV	-0.349616	-0.182376	0.498617	0.005407	1.000000	0.586651
X6-PSI	-0.717526	-0.519824	0.748461	-0.068661	0.586651	1.000000

In this table, we can conclude that the 2 variables with the highest correlation are inflation rate and interest rate with a percentage of 86 percent which is the highest between all Independent variables. The variables GDP per capita and political stability index also has a massive correlation of 74 percent.

10.3 Testing of Hypotheses

The following hypotheses were developed as follows:

H1: There is significant impact of the Political risk on FDI

The equation is as follows: $y_2 = \text{PSI}x_6 + \text{SMV}x_4 + \text{IR}x_1 + \text{GPC}x_3 + \text{IF}x_2 + \text{SMR}x_4$

Model 1: Y1-FDG**Table 12: Model 1: Y1-FDG**

Variables	Coefficient	Prob.
X1 – IR	0.094585	0.1349
X2- IF	0.020653	0.6047
X3-GPC	-1.50E-07	0.0443
X4-SMR	0.004273	0.5050
X5-SMV	-0.001108	0.1036
X6-PSI	0.012486	0.0005
C	0.048295	0.0059
R-squared	0.210062	

On the table above (table model 1), it states the correlation of dependent variable (FDI % OF GDP) to independent variables the political stability index and economic indicators. It can conclude that the correlation is insignificant since the R squared percentage is really low. A percentage of 21% shows low effect. It means that political risk has a minimal effect on FDI percentage of GDP

In addition, in the table above we can note that there are only 2 significant correlation variables, which are Psi and GDP per capita. The rest is insignificant which explains why the R squared has such low percentage.

Model 2: Y2-FD\$**Table 13: Model 2: Y2-FD\$**

Variables	Coefficient	Prob.
X1-IR	8.132454	0.1325
X2-IF	2.641086	0.4390
X3-GPC	7.71E-05	0.0000
X4-SMR	0.278279	0.6112
X5-SMV	-0.198510	0.0009
X6-PSI	0.766590	0.0105
C	26.18834	0.0000
R- squared	0.830368	

On the table above, it states the correlation between dependent variable FDI in USD and independent variables political stability index and economic indicators. It can be concluded that political risk has a significant impact on FDI in USD. That is because the R squared has a massive percentage of 83%. It means the impact is massive. There are 4 variables with a significant effect, which explains the high R squared percentage.

Model 1: Y1-FDG (Excluding X2-IF and X4-SMR)**Table 14: Model 1: Y1-FDG (Excluding X2-IF and X4-SMR)**

Variables	Coefficient	Prob.
X1- IR	0.126511	0.0005
X3-GPC	-1.38E-07	0.0557
X5-SMV	-0.001060	0.1135
X6-PSI	0.012636	0.0003
C	0.046770	0.0066
R- squared	0.201485	

In table above, we excluded 2 variables, which are inflation rate and market, return %. Since they are insignificant, but the results were nearly the same as the table before. With the correlation power of 20%. It did not change much from the 21% of before. However, there was still more variables in this case which was significant than the previous case that we did not disinclined in.

Model 2: Y2-FD\$ (Excluding X2-IF and X4-SMR)

Table 15: Model 2: Y2-FD\$ (Excluding X2-IF and X4-SMR)

Variables	Coefficient	Prob.
X1- IR	11.90766	0.0001
X3-GPC	7.80E-05	0.0000
X5-SMV	-0.192614	0.0011
X6-PSI	0.791893	0.0072
C	26.01570	0.0000
R- squared	0.828160	

In the table above, we excluded the inflation rate and stock market return to see the effect without them. The correlation didn't change much with the R squared being 82% to what it was 83% in the previous table. In this case all the variables were significant showing a strong correlation.

The Results Equation

$$Y2 = \text{PSI} \times 6 + \text{SMV} \times 5 + \text{GDC} \times 6 + \text{IR} \times 1$$

Table 16: Results

Results Summary	R- Squared and Significance Level
Y1 to (IR, GPC,SMV,PSI)	0.20, insignificant
Y2 to (IR, GPC,SMV,PSI)	0.82, significant

11- CONCLUSION

We can conclude that the political stability massively affects the FDI. Political stability identifies the ease a country can get its hands on FDI. In addition, political stability affects many macroeconomic indicators like GDP per capita. Those economic indicators have an effect on the FDI as well.

We can answer the research questions with the answer of yes there is a relationship between political risk and foreign direct investment. Moreover, the higher the political stability the easier the country will be able to get the funds needed. FDI is necessary for countries to evolve and grow and countries must try to maintain their political system in order for foreign investors to feel safe investing their hard-earned money in your country.

Political stability has a big correlation with FDI and it has a high percentage of R squared. From the variables, collected 4 of them showed high correlation which are (PSI, SMV, GDC and IR).and inflation rate and market return showed insignificant effect.

The results indicated that political stability had a minimal effect on FDI as a percentage of GDP, with an R-squared value of only 21%, where only the Political Stability Index (PSI) and GDP per capita showed significant correlations. However, when analyzing FDI in USD, political stability demonstrated a strong impact, with an R-squared value of 83%. Four variables were found to be significant, confirming a strong relationship between political stability and FDI levels. Excluding the inflation rate and stock market return had little effect, as the explanatory power remained high ($R^2 = 82\%$), reinforcing the robustness of the model.

12- RECOMMENDATIONS

We can recommend that countries try to maintain their political stability index in a certain level to prevent the risk of not getting enough FDI and not have enough capital to finance their activities. Political stability cannot be ignored since investors look at it before deciding to invest.

It is also recommended that countries should try to attract more FDI since it helps especially less developed countries to grow. Political risk is a big issue that developing countries must consider in order to attract funds.

And it is recommended for foreign investors to carefully look at the political position of the country before investing in it. Political stability has a massive and significant effect on the performance of the firms, which will affect the return the investor might get.

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