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Thesis Title: Impact of Terrorism on Consumer Sentiment and Inflation Rates in Pakistan: A City-Level Analysis

Abstract:

This study estimates the impact of terrorism on consumer sentiment and inflation rates at city level in Pakistan. Tagged as one of the most dangerous places of the world, Pakistan is the epicenter of terrorism since the events of 9/11. As this continuous wave of terrorism is largely originated and financed by external forces, dealing with this problem has remained an uphill task for the government so far. Apart from tangible financial losses and civilian casualties, there is an equally important but unnoticed and intangible impact of terrorism on consumer sentiment in Pakistan. Consumer sentiment is an important indicator as it triggers economic activity and in case of Pakistan, consumer sentiment measured by Diffusion Index is used as a policy input in formulation of monetary policy. Using city fixed effects model on balanced panel data of 59 cities and 6 time periods (bi-monthly), the study estimates that whenever there is a terrorist incident in a city, irrespective of the intensity of the attack; sentiment of the consumers in the targeted city turns pessimistic (diffusion index decreases) relative to those cities which do not face an attack. The coefficient of terrorism is equal to one-half standard deviation of the diffusion index (consumer sentiment) and is consistent in all specifications. Reverse causality test indicates that occurrence of terrorist activity is exogenous i.e. current and past sentiment do not impact or promote terrorism. Additionally, and importantly, this study also estimates the impact of terrorism on city-level inflation rates to capture the influence of terrorism on actual economic activity and purchasing power of consumers. This estimation is done using city-fixed effects model on panel data of 40 cities and 18 time periods (monthly). Results indicate that overall inflation, food inflation as well as non-food inflation rates relatively rises in the cities that face an attack. While the coefficient of terrorism is approximately equal to one-half standard deviation of overall and food inflation rates respectively, it is equal to one-third of standard deviation of non-food inflation rate. In case of inflation, intensity of an attack also influences the inflation rates at the affected cities. More intense an attack, more likely the inflation rate to go up. Reverse causality reveals that terrorism is exogenous and high inflation rates do not lead to or promote terrorism. Since the impact of terrorism is more significant at the affected cities, there is a need for a region-specific (city-specific) counter-terrorism policy instead of a generic national policy.