IMPACT OF PUBLIC TRUST IN U.S. FINANCIAL INSTITUTIONS ON GLOBAL STOCK MARKET RETURNS

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ABSTRACT:

Public trust in financial institutions is crucial for determining the value of securities. This study examines how new macroeconomic indicators that capture public trust in U.S. financial institutions impact stock markets in North America, Latin America, Europe, Asia, the Gulf Cooperation Council (GCC), Africa, and major emerging economies. We employ five distinct indicators that measure public trust levels in commercial banks, mutual funds, stock markets, large corporations, and overall financial trust, and investigate their relative impact on 21 international stock market indexes. The results suggest that three out of the five financial trust indicators significantly impact U.S. and international stock market returns, with varying degrees of strength. Specifically, the financial trust index, public trust in large corporations, and public trust in commercial banks significantly affect global markets, while trust in stock markets and mutual funds are insignificant. The financial trust index has the maximum impact and affects stock markets in economies with strong trade links to the U.S., such as Canada, the U.K., China, and Mexico. Similarly, public trust in large corporations significantly impacts stock markets in manufacturing countries like Canada, China, the U.K., Germany, France, Spain, and GCC economies. On the other hand, public trust in commercial banks affects the stock markets of economies with strong financial services industries, such as China, the U.K., Switzerland, Germany, Hong Kong, and South Korea. These findings suggest that financial trust is a critical factor in valuing securities in international markets, making it an additional risk factor that is priced in global markets. Understanding these dynamics can enhance market stability, improve investor confidence, and foster sustainable global economic growth.

***Keywords**: Public Trust, Financial Institution, Global Stock Markets*

1. INTRODUCTION

The U.S. economy and its financial markets have long been considered the cornerstone of global economic stability and growth. There exists strong empirical evidence on the impact of the U.S. macroeconomic variables, federal reserve policies, stock market returns, and volatilities on both advanced and emerging stock markets worldwide (IMF, 2017; Kose, 2010; Bernanke, 2013; Bekaert and Harvey, 1995; Bekaert et al., 2014; Froot and Ramadorai, 2005; Reinhart and Rogoff, 2009; Bruno and Shin, 2015; Gopinath, 2020; Forbes and Rigobon, 2002). However, little is investigated on the international transmission of behavioral factors such as public trust in the U.S. financial institutions on international stock market returns. Trust in financial institutions is a critical factor that affects investor confidence, risk assessment, and decision-making processes. When trust is high, investors are more likely to engage in market activities, fostering liquidity and stability. Conversely, a decline in trust can lead to increased volatility and risk aversion, impacting market returns globally.

In this study, we expand upon the existing linkages between the U.S. and the global stock markets and examine the international transmission of the financial trust variables and empirically investigate how it is priced in stock markets worldwide. Specifically, the objective is to investigate the explanatory power of a new macroeconomic indicator, *financial trust* in forecasting movements of 21 international stock market indexes. By examining this relationship, we can better understand how perceptions of stability and reliability within the U.S. financial system reverberate across global stock markets. We include five distinct categories of financial trust indicators (public trusts in commercial banks, mutual funds, financial markets, large corporations, and the overall financial trust index variable) and examine their relative impact on North