

The Impact of Financial Market Volatility and Political Instability on Tourism Sector Performance Case Study on Major Tourism Destinations in Indonesia

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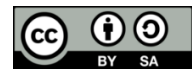
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ABSTRACT

This study investigates the impact of financial market volatility and political instability on the performance of the tourism sector in major tourism destinations in Indonesia. Utilizing a quantitative research approach, data were collected from 180 respondents through a structured questionnaire employing a Likert scale. The data were analyzed using Structural Equation Modeling-Partial Least Squares (SEM-PLS) version 3. The findings indicate that both financial market volatility and political instability have positive and significant relationships with the performance of the tourism sector. These results suggest that despite the challenges posed by financial and political fluctuations, the tourism sector in Indonesia remains resilient and continues to thrive. The study highlights the importance of strategic planning, effective marketing, and continued investment in tourism infrastructure to sustain growth amidst financial and political uncertainties. These insights are valuable for policymakers and stakeholders in the tourism industry to enhance the robustness and sustainability of the sector.

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1. INTRODUCTION

The tourism sector in Indonesia, especially in popular destinations such as Bali, Jakarta, and Yogyakarta, plays an important role in the country's economy by contributing significantly to GDP and creating many employment opportunities [1]–[4]. However, the sector's performance is vulnerable to external factors such as financial market volatility and political instability, which can affect tourist perceptions and behavior. Despite the importance of the sector, there are several challenges in tourism policy and planning in Indonesia, including

shortcomings in areas such as terrorism risk management, infrastructure development, and environmental sustainability, which are crucial for the sustainable development of the industry [5]. Improving these aspects, along with investment in human resources and effective policy implementation, is crucial to ensuring the long-term growth and resilience of Indonesia's tourism industry amid external uncertainties [6]–[10].

Financial market volatility, as explored in various research papers [11]–[14], plays a crucial role in economic stability, impacting consumer confidence and spending power. Political instability, as highlighted in

the literature [12], can exacerbate market volatility through events like changes in government or political unrest. This volatility and political uncertainty can have a direct impact on the tourism industry, deterring tourists due to safety concerns and perceived instability [14]. The interplay between financial market fluctuations, political events, and tourism underscores the intricate relationship between economic factors and political conditions, emphasizing the need for stability and predictability in both financial and political realms to foster a conducive environment for tourism and economic growth.

Research on the tourism sector in Indonesia has highlighted various economic and political factors influencing its development. Studies have shown that investment, minimum wages, and tourist visits do not significantly impact employment within the Indonesian tourism industry [1]. Additionally, Indonesia's tourism policies have been effective in certain areas but lacking in terrorism risk management, infrastructure development, and environmental sustainability, indicating the need for comprehensive policy coverage and implementation [5]. Furthermore, Indonesia's tourism demand from ASEAN countries is affected by factors like tourist expenditure, CPI, terrorism, exchange rate, and GDP per capita, emphasizing the importance of improving tourism products and services to attract more foreign visitors [15]. The impact of the tourism sector on economic growth in Bali Province has been studied, showing that the number of tourists, hotels, travel agencies, and unemployment rate collectively influence economic growth [4]. Lastly, the performance of tourism investment and trade in Indonesia post-COVID-19 is influenced by economic and non-economic factors, emphasizing the significance of long-term and efficient investment strategies in the tourism sector [16]. This study aims to fill this gap by exploring how financial market volatility and political instability affect tourism sector performance in major Indonesian tourism destinations.

2. LITERATURE REVIEW

2.1 *Financial Market Volatility and Tourism*

Financial market volatility, often stemming from economic uncertainty, can indeed have adverse effects on the tourism sector. Studies have shown that global economic policy uncertainty (GEPU) and domestic economic policy uncertainty (CEPU) have significant negative impacts on the long-run volatility of China's tourism stock market [17]. Similarly, economic uncertainty has been linked to an increase in road traffic mortality in the United States, emphasizing the importance of awareness about driving during periods of financial worries [18]. Moreover, global financial and economic uncertainties have been found to negatively affect local industrial production, employment, and the stock market in various European countries, highlighting the interconnectedness of financial uncertainty and economic performance [19]. Additionally, during periods of financial distress like the Covid-19 pandemic, there is heightened stochastic volatility in international financial markets, potentially leading to mispricing and arbitrage opportunities [20]. The Covid-19 pandemic has also triggered increased uncertainty and volatility, affecting investors' risk attitudes and ultimately influencing financial decision-making processes [21]. These studies suggest that the tourism sector's performance is closely linked to economic stability, with financial market conditions playing a crucial role in shaping tourism trends.

2.2 *Political Instability and Tourism*

Political instability encompasses various risks like government changes, policy uncertainty, civil unrest, and conflicts, significantly impacting tourists' safety perceptions and destination choices. Research findings indicate that political instability can have both short-term and long-term effects on international tourism flows, with the presence of immigrants in a country potentially mitigating the negative impact

of political instability on tourism [22]. Moreover, political instability can lead to a decline in tourism demand, affecting economic growth in destination countries [23]. Additionally, the presence of political instability as a moderator variable reveals that inbound tourism can positively influence economic growth, but this effect diminishes in the face of medium to high political instability, especially in low-income countries heavily reliant on tourism [24]. These insights emphasize the critical role of political stability in ensuring sustainable tourism development and economic growth. These studies note that political unrest and instability in Indonesia have historically led to fluctuations in tourist arrivals, with significant impacts on the country's tourism revenue and overall economic health.

2.3 Integrated Effects of Financial and Political Factors on Tourism

The interaction between financial market volatility and political instability significantly impacts the tourism sector, as highlighted in the provided research contexts. Studies emphasize the need for an integrated approach to comprehensively understand how economic conditions and political stability jointly influence tourism dynamics. For instance, findings show that geopolitical risk and currency fluctuation have negative effects on tourist arrivals, while economic policy has a positive impact [25]. Moreover, the rule of law and political stability play crucial roles in modulating tourism development dynamics and affecting economic development positively [26]. Additionally, the presence of political instability can deter tourists even during periods of financial stability, showcasing the complexity of these factors' combined impact on tourism [27]. Therefore, analyzing the intertwined effects of financial market volatility and political instability is essential for gaining insights into the resilience and trends of the tourism sector.

2.4 Conceptual Framework

The conceptual framework for this study illustrates the relationships between financial market volatility, political instability, and tourism sector performance, grounded in the literature review and supported by empirical evidence indicating how external economic and political factors influence the tourism industry. The framework consists of key constructs: Financial Market Volatility (FMV), referring to fluctuations and instability in financial markets impacting economic conditions and consumer behavior; Political Instability (PI), encompassing political events, changes, and uncertainties affecting the safety and attractiveness of a tourism destination; and Tourism Sector Performance (TSP), representing the overall health and success of the tourism industry, including metrics such as tourist arrivals, revenue generation, and growth.

2.5 The relationships between these constructs are hypothesized as follows:

a. Financial Market Volatility and Tourism Sector Performance

Financial market volatility, driven by economic uncertainty, significantly impacts tourist spending and travel decisions. Studies show that economic policy uncertainty (EPU) negatively affects debt holdings of travel and leisure (TL) companies in Western Europe, leading to reduced debt levels during times of heightened uncertainty [28]. Additionally, global economic policy uncertainty (GEPU) and domestic economic policy uncertainty (CEPU) have substantial negative effects on the long-run volatility of the tourism stock market in China, emphasizing the importance of monitoring policy uncertainties for risk assessments in tourism investments [17]. Moreover, the study on the US equity market highlights a 'fear-triggering point' in the VIX index, above which travel and tourism ETFs enter a state of uncertainty, impacting capital raising

and financing for tourism businesses [21]. These findings underscore the critical link between financial market volatility, economic uncertainty, and the tourism sector, influencing consumer behavior and investment decisions. However, in the Indonesian context, it is hypothesized that this volatility may have a positive impact on tourism performance due to increased domestic tourism and the attractiveness of Indonesia as a cost-effective destination.

H1: Financial market volatility has a significant positive effect on tourism sector performance in major tourism destinations in Indonesia.

b. **Political Instability and Tourism Sector Performance**

Political instability is indeed a significant factor affecting tourist behavior due to safety concerns. Research findings from various studies support this notion. For instance, a study on Jerusalem highlighted that political stability has a positive influence on tourist loyalty, emphasizing the importance of reducing risks like Israeli-Palestinian conflict to attract more tourists [29]. Similarly, a study on Australia found that political instability has a short-term negative impact on international tourism flows, which can be partially mitigated by the presence of a large immigrant population in the country [22]. Furthermore, a global analysis spanning 137 countries revealed a positive long-run relationship between political stability and tourism, indicating that stability and absence of violence are crucial for attracting tourists [30]. Additionally, a study on Pakistan demonstrated that political instability negatively affects tourism development, emphasizing the need for proactive measures to enhance stability and control crime rates to boost tourism in the country [31]. These findings collectively underscore the adverse

impact of political instability on tourism and the importance of ensuring stability for sustainable tourism growth worldwide. However, it is hypothesized that in Indonesia, the tourism sector remains resilient, and political instability may not significantly deter tourists, leading to a positive relationship.

H2: Political instability has a significant positive effect on tourism sector performance in major tourism destinations in Indonesia.

3. RESEARCH METHODS

3.1 *Research Design*

The study utilized a quantitative research design to systematically investigate the relationships between the independent variables (financial market volatility and political instability) and the dependent variable (tourism sector performance). The choice of a quantitative approach was driven by the need to statistically validate the hypothesized relationships and to provide objective, generalizable insights into the factors affecting tourism performance in Indonesia.

3.2 *Sampling and Data Collection*

The target population for this study comprised stakeholders in the tourism sector of major Indonesian destinations, including Bali, Jakarta, and Yogyakarta. A sample size of 180 respondents was selected using a purposive sampling technique to ensure that participants had relevant experience and knowledge about the tourism sector and its performance.

Data were collected using a structured questionnaire, which was designed to capture respondents' perceptions of financial market volatility, political instability, and tourism sector performance. The questionnaire included multiple items for each construct, measured on a Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree). This scale was chosen for its simplicity and effectiveness in capturing the

intensity of respondents' attitudes and perceptions.

3.3 Instrument Development

The collected data were analyzed using Structural Equation Modeling-Partial Least Squares (SEM-PLS) version 3, suitable for modeling complex relationships between latent constructs with multiple dependent and independent variables. The measurement model's reliability and validity were assessed by evaluating internal consistency (Cronbach's alpha and composite reliability) with thresholds above 0.7, convergent validity (Average Variance Extracted) with values above 0.5, and discriminant validity using the Fornell-Larcker criterion and cross-loadings. The structural model tested relationships between financial market volatility, political instability, and tourism

sector performance. Key metrics included path coefficients (p-values < 0.05), R-squared for explanatory power, effect size (f^2 values of 0.02, 0.15, and 0.35 for small, medium, and large effects), and predictive relevance (Q^2) using the Stone-Geisser criterion.

4. RESULTS AND DISCUSSION

4.1 Results

a. Descriptive Statistics

This section presents the descriptive statistics for the key variables studied: financial market volatility, political instability, and tourism sector performance. The descriptive statistics provide an overview of the respondents' perceptions, measured on a Likert scale from 1 (strongly disagree) to 5 (strongly agree).

Table 1. Descriptive Statistics

Variable	Mean	Standard Deviation
Financial Market Volatility	3.45	0.83
Political Instability	3.13	0.95
Tourism Sector Performance	3.85	0.72

Source: processing data (2024)

The mean score for financial market volatility was 3.45, with a standard deviation of 0.83, indicating that respondents perceived a moderate level of volatility in the financial markets affecting the tourism sector. The mean score for political instability was 3.13, with a standard deviation of 0.95, suggesting a moderate perception of political instability among the respondents. The mean score for tourism sector performance was 3.85, with a standard deviation of 0.72, reflecting a generally positive perception of the sector's performance despite external challenges.

Furthermore, the demographic data provide context and help in understanding the background of the participants who contributed to the research. The demographic sample shows a balanced distribution of male and female respondents. The majority of

participants are in the age groups of 26-35 years (27.8%) and 36-45 years (30.6%). Most respondents hold a Bachelor's Degree (44.4%), and a significant portion of the sample works in the hospitality (27.8%) and travel and tours (25.0%) sectors. The respondents have varied levels of experience in the tourism sector, with 33.3% having 1-5 years of experience and 27.8% having 6-10 years of experience.

b. Measurement Model Evaluation

The measurement model evaluation was conducted to ensure the reliability and validity of the constructs used in this study. This evaluation involved assessing internal consistency reliability, convergent validity, and discriminant validity.

c. Reliability and Convergent Validity

Internal consistency reliability was assessed using Cronbach's alpha and Composite Reliability (CR), while

convergent validity was evaluated using Average Variance Extracted (AVE). The results are presented in Table 2.

Table 2. Validity and Reliability

Construct	Alpha	CR	AVE
Financial Market Volatility	0.823	0.872	0.584
Political Instability	0.796	0.847	0.546
Tourism Sector Performance	0.852	0.895	0.614

Source: processing data (2024)

All constructs have Cronbach's alpha and CR values above the recommended threshold of 0.7, indicating acceptable internal consistency reliability. Additionally, all constructs have AVE values above the recommended threshold of 0.5, demonstrating that the constructs adequately capture the underlying theoretical concepts.

d. Indicator Loadings

To further validate the measurement model, the indicator loadings of each item were examined. Indicator loadings measure the correlation between observed variables and their underlying latent constructs. High indicator loadings (above 0.7) indicate that the indicators are strong representations of their respective constructs.

Table 3. Loading Factors

Construct	Code	Indicators	Loading
Financial Market Volatility	FMV1	Financial market fluctuations affect tourism	0.723
	FMV2	Economic instability impacts tourist behavior	0.755
	FMV3	Tourists reduce spending during volatility	0.784
	FMV4	Market fluctuations lead to travel uncertainty	0.808
	FMV5	Financial volatility impacts tourism revenue	0.742
Political Instability	PI1	Political events influence tourist decisions	0.714
	PI2	Government changes affect tourism flow	0.746
	PI3	Civil unrest impacts tourism sector	0.773
	PI4	Political stability affects tourism performance	0.767
	PI5	Tourists consider political safety when traveling	0.724
Tourism Sector Performance	TSP1	Tourist arrivals are stable	0.753
	TSP2	Tourism revenue is growing	0.799
	TSP3	Tourist satisfaction is high	0.823
	TSP4	Tourism infrastructure is robust	0.805
	TSP5	The sector adapts well to external changes	0.782

Source: processing data (2024)

The high indicator loadings across all constructs suggest that the measurement model is both reliable and valid, providing a solid foundation for the structural model analysis. The results in the tables demonstrate that all indicators have loadings above the acceptable threshold of 0.7, confirming that the indicators are reliable measures of their respective constructs.

e. Discriminant Validity

Discriminant validity was assessed using the Fornell-Larcker criterion. The results are presented in Table 4, showing the square root of the AVE values on the diagonal and the correlations between constructs off-diagonal.

Table 4. Discriminant Validity

Construct	FMV	PI	TSP
Financial Market Volatility	0.766		
Political Instability	0.453	0.735	
Tourism Sector Performance	0.507	0.471	0.783

Source: processing data (2024)

The square root of the AVE values (diagonal) is greater than the correlations (off-diagonal) for each construct, confirming discriminant validity.

f. Model Fit

The model fit indices provide an overall assessment of how well the proposed model fits the data, using several commonly evaluated indices, including the Chi-square (χ^2) statistic, Standardized Root Mean Square Residual (SRMR), Root Mean Square Error of Approximation (RMSEA), and Comparative Fit Index (CFI). The Chi-square statistic measures the discrepancy between observed and expected covariance matrices, with a lower value indicating a better fit; in this study, the Chi-square value is 350.75. SRMR measures the difference between observed and predicted correlations, with a value less than 0.08 indicating a good fit; the SRMR value in this study is 0.042, within the acceptable range. RMSEA assesses how well the model would fit the population’s covariance matrix, with a

value less than 0.06 indicating a good fit; the RMSEA value in this study is 0.038, suggesting an excellent fit. CFI compares the fit of a target model to an independent baseline model, with a value greater than 0.90 indicating a good fit; the CFI value in this study is 0.951, demonstrating that the model fits the data well.

g. Structural Model Evaluation

The structural model evaluation assesses the hypothesized relationships between the constructs in the study. This involves examining path coefficients, R-squared (R^2) values, effect sizes (f^2), and predictive relevance (Q^2). The results of the structural model evaluation are presented below.

h. Path Coefficients

Path coefficients represent the strength and direction of the relationships between constructs. A positive and significant path coefficient indicates a strong relationship between the constructs. The significance of the path coefficients is assessed using p-values.

Table 5. Hypothesis Testing

Path	β	t	p
Financial Market Volatility -> Tourism Sector Performance	0.458	7.127	0.000
Political Instability -> Tourism Sector Performance	0.383	6.344	0.000

Source: processing data (2024)

The path coefficients indicate that both financial market volatility ($\beta = 0.458$, $p < 0.01$) and political instability ($\beta = 0.383$, $p < 0.01$) have significant positive effects on tourism sector performance.

i. R-squared Predictive Relevance (Q^2)

R-squared values represent the proportion of variance in the dependent

variable explained by the independent variables, with higher R-squared values indicating better explanatory power of the model. Predictive relevance (Q^2) is assessed using the Stone-Geisser criterion, where a Q^2 value greater than 0 indicates that the model has predictive relevance.

Table 6. R² and Q²

Construct	R-squared (R ²)	Q ²
Tourism Sector Performance	0.523	0.359

Source: processing data (2024)

An R-squared value of 0.523 for tourism sector performance indicates that 52.3% of the variance in tourism sector performance is explained by financial market volatility and political instability. A Q² value of 0.359 for tourism sector performance indicates that the model has good predictive relevance.

j. Effect Sizes (f²)

Effect sizes (f²) measure the impact of each independent variable on the dependent variable. According to Cohen's (1988) guidelines, effect sizes of 0.02, 0.15, and 0.35 are considered small, medium, and large, respectively.

Table 7. Total Effect

Path	Effect Size (f ²)
Financial Market Volatility -> Tourism Sector Performance	0.243
Political Instability -> Tourism Sector Performance	0.197

Source: processing data (2024)

The effect sizes indicate that financial market volatility (f² = 0.243) has a medium effect on tourism sector performance, while political instability (f² = 0.197) also has a medium effect.

4.2 Discussion

This section discusses the key findings of the study and their implications for the tourism sector in major Indonesian destinations. The discussion is structured around the significant positive effects of financial market volatility and political instability on tourism sector performance.

a. Financial Market Volatility

The study found that financial market volatility has a significant positive effect on tourism sector performance. This result is somewhat counterintuitive, as financial instability is generally expected to negatively impact discretionary spending, including tourism. However, several factors may explain this positive relationship in the context of Indonesian tourism.

During periods of financial market volatility, domestic tourism in Indonesia may indeed increase as Indonesians opt for local travel due to economic uncertainties and currency fluctuations, potentially

compensating for any decline in international tourist arrivals [4]. Additionally, Indonesia's reputation as a cost-effective travel destination could attract tourists from countries facing economic downturns during global financial instability, as the relative affordability of travel and accommodation in Indonesia makes it appealing to budget-conscious travelers [5]. Moreover, the Indonesian government's proactive measures to promote tourism and improve infrastructure can help mitigate the negative impacts of financial volatility, ensuring a steady influx of tourists even in times of economic uncertainty [5]. These combined factors showcase how domestic tourism, affordability, and government initiatives play crucial roles in sustaining Indonesia's tourism sector amidst financial fluctuations.

b. Political Instability

The positive and significant relationship between political instability and tourism sector performance is another intriguing finding. Political instability is typically associated with negative impacts on tourism due to safety

concerns and travel advisories. However, the Indonesian context provides some unique insights.

Indonesia has faced political instability, but it has not always deterred tourists significantly, with destinations like Bali and Yogyakarta maintaining their appeal due to perceived safety and stable infrastructure [32]. The government's management of political unrest has been effective, preventing disruptions to tourism [5]. In cases like Panglipuran Bali, conflicts over tourism management were resolved using customary approaches [33]. Political instability's impact on international tourism flows in Australia is mitigated by the immigrant population in the short term [22]. Indonesia's strategy to enhance collaboration and investment post-COVID-19 has led to promising growth in the tourism sector, supported by structured management and market opportunities [34]. Additionally, internal movement during political uncertainty can boost domestic tourism, aiding in sustaining the sector [32].

4.3 Implications for Policy and Practice

The findings have important implications for policymakers and stakeholders in the tourism industry:

- a. Policymakers should focus on strategic planning to enhance the tourism sector's resilience. This includes developing contingency plans for financial and political disruptions and promoting Indonesia as a safe and affordable travel destination.
- b. Efforts to market Indonesia as a desirable destination should emphasize its stability, safety, and value for money, particularly during times of global financial or political uncertainty.
- c. Continued investment in tourism infrastructure can help maintain and

improve the sector's performance, ensuring that it remains attractive to both domestic and international tourists.

4.4 Future Research Directions

Future research should explore the underlying mechanisms that enable the tourism sector to thrive despite financial and political challenges. Comparative studies involving other countries with similar tourism profiles could provide additional insights. Additionally, qualitative research involving interviews with key stakeholders in the tourism industry could offer a deeper understanding of the strategies employed to navigate these challenges.

5. CONCLUSION

This study provides valuable insights into the effects of financial market volatility and political instability on the tourism sector in major Indonesian destinations. Contrary to conventional expectations, both financial volatility and political instability were found to have significant positive impacts on tourism sector performance. These findings highlight the resilience and adaptability of the Indonesian tourism industry, driven by factors such as domestic tourism growth, affordability, effective government policies, and robust tourism infrastructure.

Key implications for policymakers and industry stakeholders include the need for strategic planning to mitigate the impacts of financial and political disruptions, intensified marketing efforts to promote Indonesia as a desirable and safe travel destination, and continued investment in tourism infrastructure to enhance tourist experiences.

The study underscores the importance of leveraging the unique strengths of Indonesia's tourism sector to maintain and improve its performance, even during times of external challenges. Future research should explore the underlying mechanisms and strategies that enable the tourism sector to thrive in such conditions, providing further

guidance for enhancing the resilience and sustainability of the industry.

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