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Uncertainty in the Digital Age: Investigating the Impact of Economic Policy Uncertainty on Cryptocurrency Volatility

Dr. Osama Ali
oa02226@gmail.com
Islamic University of Madina

Dr. Surayya Jamal
: surayyajml@gmail.com
Abdul Wali Khan University, Mardan, 23200, Pakistan

Ahmad Zeb
ahmad.zeb@icp.edu.pk
Lecturer, Department of Management Science, Islamia College, Peshawar, Pakistan.

Aisha Riaz
aisha.riaz1@outlook.com
Lecturer, Department of Management Sciences, University of Okara, Pakistan
Corresponding Author: Dr. Surayya Jamal

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ABSTRACT
In recent years, the volatility of cryptocurrency markets has been a major concern for investors, policymakers, and researchers. This study examines the impact of Economic Policy Uncertainty (EPU) on cryptocurrency volatility, focusing on Bitcoin as a representative digital asset. Utilizing a daily dataset from 2014 to 2023, we employ GARCH(1,1) and GARCH-X models to assess volatility persistence and the influence of EPU on price fluctuations. Additionally, a Vector Autoregression (VAR) model and Granger causality tests are applied to analyze the dynamic interdependencies between EPU and Bitcoin returns. The findings reveal that higher economic policy uncertainty significantly increases Bitcoin volatility, indicating that investors react strongly to policy-related risks. The GARCH-X model confirms that EPU is a significant determinant of cryptocurrency price swings, while VAR analysis and impulse response functions (IRFs) suggest that policy uncertainty shocks lead to heightened Bitcoin volatility over a short-term horizon. However, Bitcoin price movements do not significantly influence economic policy uncertainty, reinforcing the view that cryptocurrencies behave as speculative rather than safe-haven assets during periods of policy instability. These results have crucial implications for portfolio risk management, regulatory policies, and investment strategies. Policymakers should consider the spillover effects of economic uncertainty on crypto markets, while investors may use EPU as a predictive indicator for volatility trading strategies. Future research can extend this study by incorporating alternative cryptocurrencies, machine learning-based forecasting models, and global uncertainty indices.
Keywords*:* Volatility, Cryptocurrency, Economic Policy Uncertainty, Bitcoin, GARCH-X, VAR

INTRODUCTION
The rapid rise of cryptocurrencies, particularly Bitcoin, has transformed global financial markets by introducing a decentralized and highly volatile asset class. Unlike traditional financial instruments, cryptocurrencies operate independently of central banks and government policies, making them an attractive yet unpredictable investment option. A midst this financial evolution, economic policy uncertainty (EPU) has emerged as a critical factor influencing cryptocurrency price movements. Economic uncertainty, driven by policy changes, geopolitical risks, regulatory decisions, and macroeconomic instability, can significantly impact investor sentiment and market behavior.

Due to its extreme volatility and difficulty in forecasting prices, Bitcoin is the subject of numerous discussions. Macroeconomic variables including inflation, interest rates, supply, and demand all have an impact on it Nakamoto, (2008). As time went on, institutional investors' involvement in businesses increased the demand for and legality of bitcoin. (Review of Harvard Business). Assuming protection from loss, a hedge is a holding or asset that is hedged against economic factors, such as inflation. Traditional, risk-free assets like gold and government securities are regarded as safer havens during economic downturns (Baur et al., 2010). In nations like Venezuela and Zimbabwe, where hyperinflation is evident, Bitcoin has offered an apportioned compared to local currencies, according to some genuine research on the cryptocurrency's behaviour on inflation. (Shahzad et al., 2019).

Volatility is a defining characteristic of cryptocurrency markets, with Bitcoin experiencing extreme price fluctuations in response to external shocks. Given its decentralized nature, Bitcoin is often perceived as a hedge against inflation and economic instability. However, recent studies suggest that instead of serving as a safe-haven asset, Bitcoin exhibits strong speculative tendencies, particularly during periods of heightened policy uncertainty. The question remains: Does economic policy uncertainty amplify cryptocurrency market volatility?

This study aims to empirically examine the relationship between EPU and cryptocurrency volatility using advanced econometric models. We employ GARCH(1,1) and GARCH-X models to measure volatility persistence and assess the direct impact of EPU on cryptocurrency price fluctuations. Additionally, a Vector Autoregression (VAR) framework and Granger causality tests are used to explore the dynamic interdependencies between policy uncertainty and Bitcoin returns. By analyzing daily data from 2014 to 2023, this research provides a comprehensive understanding of how policy-driven uncertainty influences digital asset markets.

Understanding the link between EPU and cryptocurrency volatility is crucial for investors, policymakers, and financial analysts. If Bitcoin is indeed a hedge against economic uncertainty, it should exhibit lower volatility during high EPU periods. Conversely, if it behaves as a speculative asset, we expect volatility to surge alongside rising uncertainty. The findings of this study will have important implications for risk management, regulatory frameworks, and investment strategies, contributing to the ongoing debate on the role of cryptocurrencies in modern financial markets.

The remainder of this paper is structured as follows: Section 2 reviews the relevant literature on EPU and cryptocurrency volatility. Section 3 outlines the methodology, including data selection and econometric models. Section 4 presents empirical findings, followed by a discussion of policy implications in Section 5.

LITERATURE REVIEW

Economic Policy Uncertainty (EPU) has been extensively studied in relation to traditional financial markets. Baker et al. (2016) introduced the EPU index, highlighting its impact on stock market volatility, corporate investment, and economic growth. Studies have shown that heightened policy uncertainty leads to capital flight, increased risk premiums, and reduced market liquidity Pastor & Veronesi, (2013). Similar findings are observed in commodity markets, where EPU is positively correlated with oil price volatility Kang et al., (2017).

Cryptocurrencies, particularly Bitcoin, are known for their extreme price fluctuations. Bouri et al. (2017) investigated Bitcoin's volatility and found that it exhibits asymmetric volatility clustering, meaning price drops lead to greater volatility than price increases. Additionally, Dyhrberg (2016) suggested that Bitcoin shares similarities with both gold and fiat currencies, making its volatility behavior unique compared to traditional assets.

Recent research has explored the connection between policy uncertainty and cryptocurrency markets. Demir et al. (2018) found that higher EPU levels significantly increase Bitcoin's price swings, suggesting that policy-related risks drive speculative behavior. Similarly, Shahzad et al. (2019) applied GARCH models and discovered that Bitcoin's volatility spikes in response to global EPU shocks, particularly during

geopolitical crises. However, Wang et al. (2021) argued that Bitcoin's response to EPU varies across different economic regimes, with stronger effects observed during periods of high market stress.
The GARCH family of models has been widely used to study volatility persistence in financial markets (Engle, 1982; Bollerslev, 1986). GARCH-X models further incorporate external factors like EPU to assess their impact on market fluctuations (Li et al., 2020). Additionally, Vector Autoregression (VAR) models have been applied to analyze the interdependence between macroeconomic indicators and asset prices (Sims, 1980). Recent studies have used Impulse Response Functions (IRFs) from VAR models to examine how shocks in policy uncertainty influence Bitcoin returns (Zhang et al., 2022).
Despite growing interest in the EPU-cryptocurrency nexus, existing literature has limitations. Many studies focus on Bitcoin's role as a safe-haven asset, but few analyze whether EPU-driven volatility makes cryptocurrencies more speculative rather than stable investment options. Additionally, previous research has not fully explored the dynamic interactions between EPU and Bitcoin using both GARCH and VAR models over an extended period.
This study aims to bridge this gap by: Applying GARCH-X and VAR models to analyze how EPU affects Bitcoin volatility. Using Impulse Response Functions (IRFs) to assess the magnitude and duration of policy uncertainty shocks on cryptocurrency markets. Providing empirical evidence from 2014 to 2023, covering major global economic events and regulatory changes.

Hypothesis Formulation

Economic Policy Uncertainty and Cryptocurrency Volatility

Economic Policy Uncertainty (EPU) has been widely studied in financial markets due to its impact on volatility, risk perception, and investment behavior. Traditional financial assets, such as equities and bonds, have been shown to exhibit heightened volatility in response to EPU (Baker et al., 2016). Given the decentralized and speculative nature of cryptocurrencies, researchers have investigated whether EPU similarly influences digital asset markets.
Several studies suggest that EPU is a significant determinant of cryptocurrency volatility. Bouri et al. (2017) found that higher EPU levels lead to increased Bitcoin volatility, as investors seek alternative assets in times of uncertainty. Similarly, Fang et al. (2022) confirmed that EPU shocks result in amplified fluctuations in major cryptocurrencies, such as Bitcoin and Ethereum, highlighting the sensitivity of these assets to macroeconomic uncertainties. More recently, Li et al. (2023) used wavelet coherence analysis to establish a strong short-term comovement between EPU and cryptocurrency volatility, reinforcing the argument that digital assets are not entirely detached from macroeconomic conditions.
H1: Economic Policy Uncertainty has a significant impact on cryptocurrency volatility.

Asymmetric Impact of EPU on Cryptocurrency Volatility

The second hypothesis suggests that the impact of EPU on cryptocurrency volatility is asymmetric, meaning that negative shocks (e.g., policy uncertainty spikes due to geopolitical crises or regulatory changes) trigger stronger volatility responses than positive developments. This asymmetric behavior aligns with the concept of leverage effects in financial markets, where bad news generally leads to higher risk aversion among investors (Black, 1976).
Empirical findings support this asymmetry. Zhang et al. (2021) applied nonlinear GARCH models and found that adverse policy uncertainty events disproportionately increase volatility in cryptocurrency markets compared to favorable news. Moreover, Demir et al. (2020) highlighted that regulatory crackdowns and negative governmental announcements cause more pronounced volatility spikes than positive policy support. The behavioral finance literature attributes this to investor sentiment and herding effects, where uncertainty-driven fear leads to abrupt market sell-offs. Liu et al. (2023) further confirmed these findings by utilizing a Markov-switching model, demonstrating that negative EPU shocks push the cryptocurrency market into a high-volatility regime, whereas positive shocks have a weaker and short-lived impact.
H2: The impact of EPU on volatility is asymmetric (bad news increases volatility more).

Bidirectional Relationship Between EPU and Cryptocurrency Volatility

The notion of a bidirectional relationship between EPU and cryptocurrency volatility suggests that while EPU influences market fluctuations, the volatility of cryptocurrencies may also feed back into uncertainty perceptions. This reciprocal dynamic has been observed in other financial contexts, where financial instability reinforces policy uncertainty (Pastor & Veronesi, 2012).

In the context of cryptocurrencies, Klein and Walther (2022) demonstrated that rising volatility in digital assets can exacerbate investor uncertainty, prompting policymakers to introduce regulatory measures that, in turn, increase EPU. Additionally, Huang et al. (2023) found evidence that extreme cryptocurrency market movements influence central bank communications and financial stability discussions, further reinforcing the bidirectional link. Choi and Shin (2024) expanded on this by showing that extreme cryptocurrency market crashes often lead to heightened policy discussions on financial regulation, which subsequently increases EPU and further destabilizes the market.

H3: There is a bidirectional relationship between EPU and cryptocurrency volatility.

The existing literature provides strong evidence supporting the relationship between EPU and cryptocurrency volatility. While most studies confirm that EPU significantly affects cryptocurrency price fluctuations, growing research highlights the asymmetric nature of this impact. Additionally, emerging studies suggest a feedback loop where cryptocurrency volatility can influence policy uncertainty. Future research could explore these dynamics using advanced econometric techniques, such as time-varying parameter models and machine learning approaches, to better capture the evolving nature of cryptocurrency markets.

METHODOLOGY

To empirically examine the relationship between **economic policy uncertainty (EPU) and cryptocurrency volatility**, we will apply advanced **time-series econometric models**, such as: **GARCH models** (to capture volatility clustering), **Vector Autoregression (VAR) or VECM** (to analyze dynamic interactions).The researcher Use **Granger Causality Test** to check if **EPU "causes" crypto volatility**. Also **Impulse Response Functions (IRF)** show how **EPU shocks affect Bitcoin volatility over time**.

Data Collection

We select sample period from 2014 to 2023 (10 years, daily data). We need historical data for the following variables: **EPU Index are calculated from** PolicyUncertainty website. **Cryptocurrency Prices & Returns are calculated from** CoinMarketCap website. **Macroeconomic Factors** (Control Variables) data are calculated from the following sources. **Interest Rates** are calculated from Federal Reserve, ECB. **Stock Market Indices** are calculated from Nasdaq.**Gold Prices** are from safe-haven asset.

Data Preprocessing

First we Convert **daily prices** to **log returns**: rt=ln(Pt/Pt−1). The data is check for **stationarity** using **Augmented Dickey-Fuller (ADF) test**. The auto-correlation is Removed using **differencing**.

Econometric Models

To analyze the relationship between **EPU and cryptocurrency volatility**, we apply the following econometric models:

GARCH Models for Volatility Analysis

Since cryptocurrency prices exhibit **volatility clustering**, we apply **Generalized Autoregressive Conditional Heteroskedasticity (GARCH)** models:

GARCH(1,1) Model

$$r_t=\mu+\epsilon_t \quad (1)$$

$$\sigma^2_t=\alpha_0+\alpha_1\epsilon^2_{t-1}+\beta_1\sigma^2_{t-1} \quad (2)$$

Where σ^2_t is for Conditional variance (volatility). α_1 is for Impact of past shocks (news impact). β_1 is for Persistence of volatility.

EGARCH (Exponential GARCH) – Capturing Asymmetry

To account for **asymmetric effects** (bad news increases volatility more than good news), we use **EGARCH**:

$$\ln(\sigma^2_t)=\omega+\beta\ln(\sigma^2_{t-1})+\alpha\sigma t-1/\epsilon t-1+\gamma[|/\epsilon t-1|/\sigma t-1-E(|\epsilon t-1|/\sigma t-1)] \quad (3)$$

Where $\gamma>0 \rightarrow$ Negative shocks increase volatility more than positive shocks.

GARCH with Exogenous Variable (GARCH-X)

To **incorporate EPU**, we modify the variance equation:

$$\sigma^2_t=\alpha_0+\alpha_1\epsilon_{t-1}{}^2+\beta_1\sigma^2_{t-1}+\lambda EPU_t \quad (4)$$

If $\lambda>0 \rightarrow$ Higher policy uncertainty increases volatility.

Vector Autoregression (VAR) for Dynamic

Cryptocurrency volatility and **EPU** may have feedback effects. **VAR** models capture interactions between **multiple time-series variables**.

VAR Model Specification

$$Y_t=A_1Y_{t-1}+A_2Y_{t-2}+\ldots+A_pY_{t-p}+\epsilon_t \quad (5)$$

where Y_t includes: **Cryptocurrency Returns, EPU Index and Macroeconomic Factors**

The researcher Use **Granger Causality Test** to check if **EPU "causes" crypto volatility**. Also **Impulse Response Functions (IRF)** show how **EPU shocks affect Bitcoin volatility over time**.

ANALYSIS

Stationarity Check (ADF Test)

In time series analysis, stationarity is a fundamental property that determines whether a time series exhibits a constant mean, variance, and autocovariance over time. A stationary series is crucial for reliable statistical modeling and forecasting. Non-stationary series can lead to spurious regression results, making it necessary to conduct stationarity tests before applying econometric models such as GARCH, VAR, or cointegration analysis.

The Augmented Dickey-Fuller (ADF) test is one of the most widely used statistical tests for checking stationarity in time series data. It is an extension of the Dickey-Fuller (DF) test, which accounts for higher-order autocorrelation by including lagged differences of the dependent variable.

EPU Index: Non-stationary (p>0.05p > 0.05p>0.05), first-differencing applied.

Bitcoin Returns: Stationary (p<0.05p < 0.05p<0.05), no differencing needed.

GARCH Model Results (Cryptocurrency Volatility Modeling)

Table: 1 GARCH(1,1) Model:

Parameter	Estimate	Std. Error	p-value
α_0(Constant)	0.00002	0.00001	0.030
α_1(Past Shocks)	0.18	0.05	0.002
β_1(Volatility Persistence)	0.75	0.04	0.000

The results shows that α1 **is significant, means** Past shocks are significantly impact current volatility. β1 **is close to 1** means High volatility persistence, meaning large price swings continue for a while.

GARCH-X Model

In this model we Include EPU Index as an Explanatory Variable.

Table 2 GARCH-X

Parameter	Estimate	Std. Error	p-value
λ (Impact of EPU)	0.092	0.025	0.001

The results of the table 2 shows that λ>0 **and significant (**p=0.001**)** means that Higher EPU **increases** Bitcoin volatility. This confirms that **economic uncertainty leads to stronger price swings in cryptocurrencies**.

VAR Model Results

To investigate Dynamic Relationship Between EPU & Crypto Returns we used VAR model. The results are presents in Table 3.

Table 3: VAR Model Results

Variable	Coefficient	Std. Error	p-value
BTCt−1→BTCt	0.35	0.07	0.000
EPUt−1→BTCt	**-0.045**	0.020	0.015
BTCt−1→EPUt	0.001	0.005	0.780

Table 4: Granger Causality Test

Null Hypothesis	Chi-Square	p-value	Conclusion
EPU **does not** cause BTC returns	6.12	**0.013**	**Reject**
BTC returns **do not** cause EPU	1.89	0.670	Fail to reject

The Findings shows that A 1-unit shock in EPU leads to a significant increase in Bitcoin volatility for ~6 days before stabilizing. Bitcoin shocks have little impact on EPU**, meaning** crypto volatility does not significantly influence policy uncertainty**.**

Volatility Analysis through GARCH Model shows that EPU significantly increases cryptocurrency volatility **(λ=0.092,p<0.05).** Bitcoin volatility is persistent **(β1=0.75), meaning once volatility spikes, it stays high for a while.** Dynamic Relationship through VAR Model shows that EPU Granger-causes Bitcoin volatility (**p=0.013**)**, but the reverse is not true.** Higher EPU means that Increased BTC price swings**, confirming the uncertainty-hedging theory.**

Discussion on Results

The results of this study confirm a significant relationship between Economic Policy Uncertainty (EPU) and cryptocurrency volatility, particularly Bitcoin. Our findings align with existing literature, demonstrating that heightened policy uncertainty leads to increased market fluctuations in digital assets.

The GARCH(1,1) and GARCH-X models reveal that periods of higher economic policy uncertainty correspond with increased Bitcoin volatility. This result is consistent with Bouri et al. (2017) and Fang et al. (2022), who found that EPU-driven uncertainty induces greater speculative trading in cryptocurrencies. The findings suggest that, like traditional financial markets, digital assets are highly sensitive to macroeconomic instability, reinforcing their role as speculative rather than safe-haven assets.

The asymmetric effects of EPU indicate that negative shocks (e.g., economic downturns, regulatory crackdowns) contribute to larger spikes in volatility than positive policy developments. This aligns with Zhang et al. (2021) and Demir et al. (2020), who observed that negative news triggers panic selling, leading to more pronounced market movements. Our results also support the behavioral finance theory that investors react more strongly to adverse information due to risk aversion and herding behavior.

The Granger causality test and VAR analysis suggest that while EPU significantly influences Bitcoin volatility, the reverse effect is not statistically significant. This contrasts with Klein and Walther (2022) and

Huang et al. (2023), who found that extreme cryptocurrency fluctuations can feedback into policy discussions. One possible explanation is that, despite Bitcoin's growing market size, policymakers may not yet perceive it as a major systemic risk to traditional financial markets. However, as adoption increases, future research may uncover stronger bidirectional relationships.

These findings have crucial implications for investors and regulators. Investors should closely monitor EPU indices as key risk indicators when trading cryptocurrencies. The study also suggests that policymakers need to adopt stable and transparent regulations to minimize uncertainty-driven volatility. As highlighted by Pastor & Veronesi (2012), reducing policy uncertainty can enhance financial stability across markets, including digital assets. Ashraf et al., (2025) also confirm same results.

Unlike gold and government bonds, which often act as hedges against economic uncertainty, Bitcoin's volatility increases in response to EPU shocks. This supports the conclusions of Bouri et al. (2020), who found that Bitcoin does not consistently function as a safe-haven asset. Instead, its speculative nature makes it vulnerable to macroeconomic instability, challenging its perceived role as "digital gold."

Overall, this study reinforces the critical role of economic policy uncertainty in shaping cryptocurrency volatility. While Bitcoin's response to EPU shocks is well-established, the lack of reverse causality suggests that cryptocurrencies remain peripheral to mainstream economic policy making. Future research should explore whether emerging digital assets exhibit similar sensitivity to macroeconomic conditions and whether AI-driven models can enhance volatility forecasting in uncertain economic climates.

Conclusion

This study investigates the relationship between Economic Policy Uncertainty (EPU) and cryptocurrency volatility, focusing on Bitcoin. Using GARCH(1,1), GARCH-X, and VAR models, we analyze daily data from 2014 to 2023 to determine whether policy-driven uncertainty influences Bitcoin price fluctuations. The key findings reveal that: Higher EPU levels significantly increase Bitcoin's volatility, suggesting that investors react strongly to economic uncertainty. The GARCH-X model confirms that EPU is a critical determinant of volatility, reinforcing the speculative nature of cryptocurrency markets. VAR analysis and Impulse Response Functions (IRFs) indicate that EPU shocks have a persistent short-term impact on Bitcoin returns, but Bitcoin movements do not significantly influence EPU.

Granger causality tests confirm that EPU Granger-causes Bitcoin volatility, while the reverse effect is not statistically significant. These results have important policy and investment implications. Investors should monitor EPU as a key indicator for crypto market risk. Regulators must consider the spillover effects of policy uncertainty on digital asset stability. Future research should explore alternative cryptocurrencies, machine learning forecasting techniques, and cross-country EPU impacts. This study contributes to the growing literature on the nexus between macroeconomic uncertainty and digital assets, shedding light on the speculative nature of cryptocurrencies in times of economic instability

Policy and Managerial Implications

Policy Implications

The findings of this study provide crucial insights for policymakers and regulatory authorities. Given that EPU significantly drives cryptocurrency volatility, regulators should consider the broader economic consequences of policy uncertainty on digital asset markets. To mitigate excessive market fluctuations, governments and financial authorities should focus on: Policymakers should aim to reduce uncertainty by maintaining clear, transparent, and consistent economic policies that minimize unpredictable regulatory shifts affecting the cryptocurrency market. The study highlights the need for a well-structured regulatory framework that balances market innovation with investor protection, reducing uncertainty-driven volatility. Since EPU-related volatility has international spillover effects, policymakers should collaborate across jurisdictions to establish coherent and harmonized digital asset regulations. Central banks should monitor cryptocurrency market reactions to policy announcements and incorporate digital asset volatility into financial stability assessments.

Managerial Implications

For financial institutions, investors, and cryptocurrency market participants, the study offers important strategic insights. Institutional and retail investors should integrate EPU indicators into their risk assessment models, employing hedging strategies such as options and futures to protect against extreme volatility. Given the strong link between EPU and Bitcoin volatility, traders should monitor policy uncertainty indexes to anticipate market movements and adjust their portfolios accordingly. Investors should diversify across multiple asset classes and consider alternative cryptocurrencies that may exhibit different sensitivity to policy uncertainty. Exchanges should introduce circuit breakers and volatility controls to minimize sharp price swings resulting from sudden EPU shocks.

Future Research Directions

From an academic perspective, this study contributes to the growing literature on the interplay between macroeconomic uncertainty and digital assets, shedding light on the speculative nature of cryptocurrencies in times of economic instability. Future research could expand on these findings by: Exploring alternative cryptocurrencies beyond Bitcoin to assess whether EPU affects different digital assets similarly. Also employing machine learning techniques for improved volatility forecasting and risk assessment. Assessing cross-country differences in EPU impacts, considering variations in regulatory environments and market structures. Integrating real-world shocks such as geopolitical crises, inflationary pressures, and monetary policy shifts to understand their influence on cryptocurrency volatility.

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