

Foreign Exchange Volatilities and Stock Prices: Evidence from London Stock Exchange

Authors : Mahdi Karazmodeh, Pooyan Jafari

Abstract : One of the most interesting topics in finance is the relation between stock prices and exchange rates. During the past decades different stock markets in different countries have been the subject of study for researches. The volatilities of exchange rates and its effect on stock prices during the past 10 years have continued to be an attractive research topic. The subject of this study is one of the most important indices, FTSE 100. 20 firms with the highest market capitalization in 5 different industries are chosen. Firms are included in oil and gas, mining, pharmaceuticals, banking and food related industries. 5 different criteria have been introduced to evaluate the relationship between stock markets and exchange rates. Return of market portfolio, returns on broad index of Sterling are also introduced. The results state that not all firms are sensitive to changes in exchange rates. Furthermore, a Granger Causality test has been run to observe the route of changes between stock prices and foreign exchange rates. The results are consistent, to some level, with the previous studies. However, since the number of firms is not large, it is suggested that a larger number of firms being used to achieve the best results. However results showed that not all firms are affected by foreign exchange rates changes. After testing Granger Causality, this study found out that in some industries (oil and gas, pharmaceuticals), changes in foreign exchange rate will not cause any changes in stock prices (or vice versa), however, in banking sector the situation was different. This industry showed more reaction to these changes. The results are similar to the ones with Richards and Noel, where a variety of firms in different industries were evaluated.

Keywords : stock prices, foreign exchange rate, exchange rate exposure, Granger Causality

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