Effect of Exchange Rate Volatility on the Ghana Stock Exchange

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Abstract

The study looked at the relationship between Stock Markets and Foreign Exchange market, and determined whether movements in exchange rates have an effect on stock market in Ghana. The Exponential Generalised Autoregressive Conditional Heteroskedascity (EGARCH) model was used in establishing the relationship between exchange rate volatility and stock market volatility. It was found that there is negative relationship between exchange rate volatility and stock market returns - a depreciation in the local currency leads to an increase in stock market returns in the long run. Where as in the short run it reduces stock market returns. Additionally, there is volatility persistence in most of the macroeconomic variables; current period's rate has an effect on forecast variance of future rate. It was also revealed that an increase (decrease) in trade deficit and expectation in future rise in trade deficit will decrease (increase) stock market volatility. In addition, the consumer price index has a strong relationship with stock market volatility. This means that an increase in consumer price will lead to a rise in stock market volatility. Finally, there is the presence of leverage effect and volatility shocks in stock returns on the Ghana Stock Exchange.

Keywords: volatility, leverage, exchange rate, returns, Ghana Stock Exchange

JEL Classification: N2, N27

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