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Abstract

The literature on the relation between stock prices and exchange rates is very poor and includes few studies that have argued that exchange rate changes do effect stock prices.By relying on the portfolio approach to exchange rate determination, it is argued that a change in stock prices could also have an impact on exchange rates, i.e. there could be a two-way relationship between exchange rates and stock prices. Granger concept of causality as well as cointegration technique are employed to support this conjecture. The empirical results show that there is bidirectional causality between stock prices measured by S&P 500 index and the effective exchange rate of the dollar, at least in the short-run. The cointegration analysis reveals that there is no long-run relationship between two variables.

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