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Can macroeconomic variables explain long-term stock market movements? A comparison of the US and Japan

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Abstract

Within the framework of a cointegration model, we investigate whether a number of macroeconomic variables can explain long-term stock market movements in the US and Japan. A comparison of the US and Japanese stock markets shows a significant relationship between the two markets. The results suggest that the long-term interest rate and the US stock market are cointegrated, while the Japanese stock market and the US stock market are not. The long-term interest rate and the US stock market are positively related, while the Japanese stock market and the US stock market are negatively related. The results suggest that the long-term interest rate and the US stock market are cointegrated, while the Japanese stock market and the US stock market are not. The long-term interest rate and the US stock market are positively related, while the Japanese stock market and the US stock market are negatively related. These contrasting results may be

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due to the slump in the Japanese economy during the 1990s and consequent liquidity trap.

Notes

¹ Chen et al. ([1986](#)) use a PVM framework to investigate the impact of systematic risk factors upon stock returns, through factor influences on future cash flows or the discount rate of those cash flows. They found that the yield spread between long- and short-term government bonds, expected inflation, unexpected inflation, industrial production growth and the yield spread between corporate high- and low-grade bonds significantly explain stock market returns.

² In Japan, the Nikkei fell almost 75% over the 13 years from 1990.

³ The derivation of the PVM could easily be extended to allow a time-varying expected discount rate.

⁴ See inter alia Fama ([1981](#)), Chen et al. ([1986](#)), Schwert ([1990](#)), Mukherjee and Naka ([1995](#)), Cheung and Ng ([1998](#)) and Binswanger ([2004](#)).

⁵ For example, see Chen et al. ([1986](#)) and Mukherjee and Naka ([1995](#)).

⁶ Full unit-root test results are available on request. Note we use the Schwarz

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⁷ These α values are not statistically significant at conventional levels. The α values are not binding using a likelihood ratio test. The α values are not binding at the 5% level, $\alpha = 0.079$, which is

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