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Relationship between stock returns and inflation

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Abstract

The question of whether common stocks can act as a hedge against inflation has received tremendous attention in the economics and finance literature, but with little or no evidence for African countries. This letter examines the Fisher hypothesis for 6 African countries. Using OLS estimates we find positive relationship between inflation and stock returns in Kenya and Nigeria. However, instrumental variable estimates provide consistent results and confirms the validity of a generalised Fisher hypothesis in 3 markets: Kenya and Nigeria at the 12 month horizon, and Tunisia at 60 month horizon. This suggests that investors should expect stocks to be a good hedge against inflation over long horizons.

Notes

[1] The studies such as Anari and Kolari (2001) use cointegration while studies like Spyrou (2001) concentrate on both short- and long-run methods.