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Interest rate changes and common stock returns of financial institutions: evidence from the UK

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Abstract

The objective of this paper is to examine the impact of interest rate changes on the common stock returns of portfolios of financial institutions in the UK. The five groups of financial institutions examined are banks, insurance companies, investment trusts, property investment companies and finance firms. In addition, a wide sample of nonfinancial firms is considered for comparison purposes. A two-index model is employed to test the effect of both current and unanticipated interest rate changes. An element of volatility in market yields is also introduced in a three-index model to measure the effect of variability in interest rates on the returns of these financial intermediaries. Two main implications emerge from the present paper for both financial and nonfinancial firms. First, a significant negative relationship seems to exist between the common stock returns and the changes in interest rates. Second, common stock returns and variability of interest rates are related with a significant positive coefficient.

Keywords:

Financial Institutions Stock Returns Unexpected Interest Rate Changes Interest Rate Volatility

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