RELATION BETWEEN STOCK PRICE AND EXCHANGE RATE: RECENT EVIDENCE FROM INDIA

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ABSTRACT

The paper makes an attempt to explore the relationship between stock price and exchange rate in India, particularly focusing on the issue of causality and information spillover. The study differs from most of the previous literature by focusing on both first and second moment of the distribution and moreover it distinguishes between contemporaneous and dynamic spillover effect for more interesting insights. We consider the daily data on S&P CNX Nifty, Sensex and INR/$ exchange rate from Jan 2008 to Feb 2012, in order to analyze the situation after the outburst of global financial crisis. Using the Granger causality test and GARCH model the paper comes up with four major findings. First, there is a clear evidence of Portfolio approach. Second, mean spillover is bidirectional in contemporaneous sense. But it is unidirectional in dynamic sense, from stock price to exchange rate. Third, pure volatility spillover is unidirectional from stock price to exchange rate, for either type - within a day and across the days. Finally, surprise volatility spillover is unidirectional from stock price to exchange rate in dynamic sense. But it is bidirectional in contemporaneous sense.

KEYWORDS : Causality, Exchange Rate, Information Transmission, Stock Price.
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