

IMF WORKING PAPER

© 1991 International Monetary Fund

This is a working paper and the author would welcome any comments on the present text. Citations should refer to an unpublished manuscript, mentioning the author and the date of issuance by the International Monetary Fund. The views expressed are those of the author and do not necessarily represent those of the Fund.

March 28, 1991

WP/91/27

Subject: Monetary Policy and the Price Behavior in Emerging Stock Markets

CORRIGENDUM

The attached cover page of WP/91/27 (March 1991) is reissued to correct the title of the paper.

Att: (1)

IMF WORKING PAPER

© 1991 International Monetary Fund

This is a working paper and the author would welcome any comments on the present text. Citations should refer to an unpublished manuscript, mentioning the author and the date of issuance by the International Monetary Fund. The views expressed are those of the author and do not necessarily represent those of the Fund.

WP/91/27

Corrected: 3/28/91

INTERNATIONAL MONETARY FUND

Exchange and Trade Relations Department

Monetary Policy and the Price Behavior in Emerging Stock Markets

Prepared by Peter K. Cornelius 1/

Authorized for Distribution by Chanpen Puckahtikom

March 1991

Abstract

This paper examines whether the six largest and most active emerging stock markets are informationally efficient with respect to changes in the money supply. To investigate if stock prices fully reflect the information contained in money supply changes, two different econometric techniques are employed. First, direct Granger-causality tests are used, which focus on the short-run relationship between stock prices and money. Second, the long-run behavior of the two variables is studied by means of co-integration tests. The results suggest that at least for two markets profitable trading rules can be developed to earn consistently higher-than-normal rates of return.

JEL Classification Numbers:

121, 313

1/ The views expressed are strictly those of the author and do not necessarily represent those of the International Monetary Fund. Geographical names in this paper are used solely for the convenience of the reader and do not imply the expression of any opinion whatsoever on the part of the International Monetary Fund, concerning the legal status of any country, territory, city, area, or of its authorities, or concerning the delimitation of its boundaries or national affiliation. The author is most grateful to the Capital Markets Department of the International Finance Corporation for the provision of numerous time series of stock price indexes, market capitalizations and values traded in the emerging stock markets. Helpful comments by Richard K. Abrams, Jagdeep Bhandari, Günther Engel, and Harry Trines are gratefully acknowledged.

Contents

	<u>Page</u>
Summary	iii
I. Introduction	1
II. The Direct Granger-Causality Test	3
1. Methodology	3
2. Data	5
3. Empirical Results	6
III. Test for Co-integration	8
1. Methodology	8
2. Empirical Results	11
IV. Conclusion	11
Tables	
1. Emerging Stock Markets: Granger-Causality Test of Stock Market Efficiency with M1 and M2	7
2. Unit Root Tests of Monthly Log Stock Price Indexes and Money Supply Aggregates	12
3. Co-Integrating Regressions and Tests for Co-integration	13
Charts	
1. Emerging Stock Markets	2a
a. Market Capitalization	
b. Value traded	
2. Stock Prices and Money	5a
a. India	6a
b. Korea	6a
c. Malaysia	6b
d. Mexico	6b
e. Taiwan (China)	6c
f. Thailand	6c
References	15