The causality effect between global variables, foreign exchange rate and stock prices: A firm level analysis in consumer durables & apparel and energy sectors in the Colombo Stock Exchange

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Abstract

The emerging trend of investing in stock markets has increased the attention of investors on economic factors. This study aims to examine the causality effects between global variables, foreign exchange rate, and stock prices of consumer durables & apparel and energy entities listed in the Colombo Stock Exchange (CSE) of Sri Lanka, while using monthly statistical data for the period of 10 years starting from July 2009 to June 2019. Two companies from each sector of consumer durables & apparel and energy sectors in the CSE were considered for the firm level analysis. Lack of studies on the causality effects between global variables, foreign exchange rates and stock prices of companies listed in the CSE, made a kind of intensive destination to conduct a research study in Sri Lanka. The study used the Augmented Dickey-Fuller test to detect the stationary level of the time series data and found that all series are integrated at the first difference. The Johansen Cointegration test was employed to find the equilibrium relationship and found that non-existence of Cointegration among the variables. Further, the study used the Granger Causality test to detect the causality effect between variables. The Granger Causality test found a unidirectional causality effect from exchange rate to stock prices of two companies in the consumer durables & apparel and one company in the energy sector at different lag levels. The results also show a unidirectional causality running from gold prices to exchange rate and crude oil prices to stock prices for only one company in the energy sector. The findings also indicated that there is no causality effect between crude oil prices and foreign exchange rate in Sri Lanka. These findings hold practical implications for policymakers, stock market regulators, investors and analysts to make an accurate decision concerning the consumer durables, apparel and energy companies listed in CSE in Sri Lanka.

Keywords: *Colombo Stock Exchange, crude oil price, foreign exchange rate, granger causality, gold price,. stock prices*