

Share Prices-Exchange Rates Nexus: Evidence from Kenya

Abstract:

Kenya adopted a floating exchange rate regime in 1993. Since then the exchange rates have been determined by the market forces of demand and supply. Undoubtedly, the changes in exchange rates do have a diverse effect across the economic spectrum in any country. The sectoral and economy wide effects of exchange rates may ultimately be reflected in the share prices. The objective of this research was to examine how changes in exchange rates and stock prices are related to each other for Kenya over the period November 1993 -April 2011. The findings have implications for investors, investment managers, regulators, listed companies, financial institutions and other market players. The economic theory points to the relationship between stock price and exchange rates but does not properly define the direction of the relationship. The research used Toda and Yamamoto method to determine the relationship between stock prices and exchange rates. The results indicate that there is bi-directional causal relationship between exchange rate and share price. As regards the sign of causality, negative causality exists in both directions.