

Macroeconomic determinants of stock market return with special reference to the Colombo Stock Exchange (CSE)

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ABSTRACT

The linkage between macroeconomic variables and the movement of stock prices for developing countries have been widely discussing topic in research arena. CSE is one of the top performing markets in Asia with an average annual index growth rate of 27% and currently it shows the continuous upward trend. There for this study explores the association between selected macroeconomic variables and sectorial indexes. Since it would be almost impossible to incorporate every potential aspect to explain the stock market behavior we limit our study to the selected monthly macro economic variables such as inflation rate (IR), three months treasury bill rate (TBR) and exchange rate US\$ =LKR (ER) for the period of 5 years from 2005 to 200and we select five sectors in CSE as proxy for represent all twenty sectors. Those are Banks Finance and Insurance (BFI), Diversified Holdings (DH), Hotels and Travels (H&T), Telecommunications (Telecom), and Trading. Collected data were analyzed using the SPSS software and Stepwise regression analysis was applied to test for the linkage. Upon testing stepwise regression analysis we show that changes in CSE sectorial indexes do perform a significant relationship with, IR, TBR, and ER. Coefficient of determination (R²) for BFI, DH, H&T, Telecom, and Trading are 60%, 50%, 60%, 68%, and 42% respectively. All the three variables are significant at 1 % level for all the sectors except DH and Trading. Another important finding was ER doesn't make significant influence on the sectorial indexes in DH and Trading. An overall finding concludes that Colombo Stock Exchange is sensitive to changes in the macroeconomic variables. It is hoped that the finding of this study would provide some meaningful insights to the body of knowledge, policy makers as well as the practitioners.

Key words - Macroeconomic variables. Colombo Stock Exchange (CSE)