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Relationship between Exchange Rate and Stock Market Volatility in India : An Empirical Analysis

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Abstract

The relationship between a country's forex market and its stock market has been a subject of research for many decades. Abundant trading opportunities can be tapped by understanding the relationship between the currency market and stock market volatility. This study is taken with an objective of understanding how the volatility in foreign exchange market is influencing the volatility in Indian Stock Market. For this purpose the trend of foreign currencies and Nifty index has been considered for a period of 7 years (January 2010 to December 2017). The autoregressive conditional heteroskedasticity (ARCH) model is used to understand the impact of volatility of foreign exchange rates on the Indian stock market. It is found that the volatility in the stock market is due to the nations internal causes and not due to the forex volatility.

JEL Code : E15 ; C32
Keywords : Foreign Exchange, Stock Market, Volatility, Currency Fluctuation, Return, Nifty, Granger Causality Test, ARCH-M.

I. Introduction

GROWTH AND STABILITY in stock market and stability in exchange rate are considered as important economic objectives of any country. Stability in exchange rate can be used as barometer of financial strength of any country whether it is a developed or a developing country. A strong and stable exchange rate shows the strength of the economy. On the other hand a very weak and unstable currency is a reflection of a weak and vulnerable economy.

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