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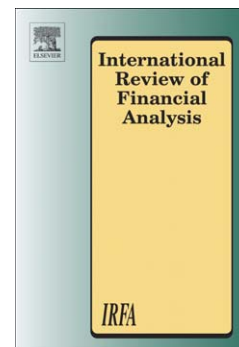
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On the linkages between stock prices and exchange rates: Evidence from the banking crisis of 2007–2010☆

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Abstract

This study examines the nature of the linkages between stock market prices and exchange rates in six advanced economies, namely the US, the UK, Canada, Japan, the euro area, and Switzerland, using data on the banking crisis between 2007 and 2010. Bivariate UEDCC-GARCH models are estimated producing evidence of unidirectional Granger causality from stock returns to exchange rate changes in the US and the UK, in the opposite direction in Canada, and bidirectional causality in the euro area and Switzerland. Furthermore, causality-in-variance from stock returns to exchange rate changes is found in the US and in the opposite direction in the euro area and Japan, whilst there is evidence of bidirectional feedback in Switzerland and Canada. The results of the time-varying correlations also show that the dependence between the two variables has increased during the recent financial crisis. These findings imply limited opportunities for investors to diversify their assets during this period.

Keywords: Causality-in-variance; Cointegration; Exchange rates; Stock prices

JEL Classification: C32; F31; G15

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