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Analyzing the Relationship Between Change in Money Supply and Stock Market Prices

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ANALYZING THE RELATIONSHIP BETWEEN CHANGE IN MONEY SUPPLY AND STOCK MARKET PRICES

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This paper examines the relationship between change in the money supply and stock prices. This paper also dichotomizes change in the money supply into anticipated and unanticipated change and analyzes each of their relationships with stock market prices. Competing theories exist on how change in the money supply affects stock prices. The Keynesian economists argue that change in the money supply and stock prices are positively related, where as the real activity theorists argue otherwise. This study finds a positive relationship between change in the money supply and stock prices, agreeing with the Keynesian economists. Economists also debate on the relationship of anticipated and unanticipated change in money supply with the stock market prices. The proponents of Efficient Market hypothesis (EMH) argue that anticipated change in money supply would not have a significant impact on stock prices and only unanticipated change in the money supply would matter, whereas the opponents of EMH argue that anticipated change in money would matter too in determining the stock prices. This paper finds that anticipated change in money supply matter more than unanticipated change, concluding that EMH does not persist.