

**Impact of Interest Rate Changes on Stock Prices
in the Karachi Stock Exchange**



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ABSTRACT

Stock markets play a vital role in the economic development of a country. They also serve as a medium where investors can invest and businesses can raise capital. For this reason, an understanding of the factors which impact stock market prices is important. Considerable work has been done on the impact of macro-economic factors on stock prices in developed countries, but the amount of literature available on developing economies, particularly Pakistan, is limited. This research studies the impact of one such variable, interest rates, on stock prices in Pakistan. Daily 6-month KIBOR rates and KSE-100 index data was collected for a nine year period, from September 2001 to June 2009. The data was analyzed using statistical tools like Augmented Dickey Fuller Test, Ordinary Least Squares regression, Generalized Autoregressive Conditional Heteroskedasticity model and Granger-Causality Test. The results proved that interest rate changes have a causal relationship with stock prices in Pakistan. Moreover, they have a negative relationship with stock prices. This implies that an increase in interest rates in Pakistan causes stock prices to decline and vice versa.

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LIST OF ACRONYMS

KSE	Karachi Stock Exchange
LSE	Lahore Stock Exchange
ISE	Islamabad Stock Exchange
KIBOR	Karachi Inter-Bank Borrowing Rate (Unless otherwise specified, refers to 6-month KIBOR)
FY	Fiscal Year
GDP	Gross Domestic Product
SBP	State Bank of Pakistan
ADF	Augmented Dickey Fuller Test
OLS	Ordinary Least Squares
GARCH	Generalized Autoregressive Conditional Heteroskedasticity
GARCH-M	Generalized Autoregressive Conditional Heteroskedasticity-In-Mean