

Stock Transactions and Financial Integration in Australia: The Missing Links

Rajarshi Mitra^{*}

Abstract

This paper builds on Phylaktis and Ravazzolo (2005) and examines the short-run and long-run sensitivity of the total value of stock transactions in Australia (as a percentage of GDP) to changes in the real effective exchange rate. The sample period is 1980-2016. The Johansen (1995) cointegration test indicates no long-run relation for the bivariate model. However, a significantly negative long-run relation is observed between the two variables when stock transactions in the United States (as a percentage of GDP) are included in the model. The adjustment coefficient in the error correction model is significantly negative, which ensures rapid adjustment toward long-run equilibrium. The Granger causality test for the trivariate model indicates bidirectional causality between the real effective exchange rate and the total value of stock transactions in Australia (as a percentage of GDP). We conclude that the U.S. stock market acts as a conduit for the link between the stock and the foreign exchange markets in Australia.

Keywords: Real Effective Exchange Rate, Stock Index, VECM.

JEL Classification: F31, F41, O56.

¹Associate Professor, Institute for International Strategy, Tokyo International University, 1-13-1 Matoba-kita, Kawagoe, Saitama 350-1197, Japan.
E-mail: rmitra010@hotmail.com.