ABSTRACT

This study examined the long and short-run relationships between stock prices and the selected macroeconomic variables (foreign exchange rates, GDP, Money supply (M3), world oil prices and tax burden) in Tanzania, based on a sample of quarterly data from November 2006 to March 2012.The study tests the time series properties of the series using the Augmented Dickey Fuller (ADF) and the Philips and Perron (PP) tests. In addition, the Johansen and Juselius cointegration tests, Vector Autoregressive (VAR) and Error correction Model (VECM) are also applied to check for short-term and long term relationship between the variables.

The empirical results show that all the series are integrated of order one (that is I(1)) and evidence of cointegration is established using the Johansen and Juselius methodology. Furthermore, causality tests reveal strong evidence of long-run bidirectional relationships between stock prices and foreign exchange rates, GDP, money supply and world oil prices in the models. Policy-wise, the findings imply that the policy makers such as monetary authorities in Tanzania are not constrained to take stock market developments into account in achieving their exchange rate, GDP, and balance of trade control policy objectives, as established in the study. This study therefore, recommends putting measures in place that would promote greater stability and efficiency of Tanzanian's foreign exchange market, money supply and GDP.

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