Abstract

This paper explores the causal links between nine fundamental variables and stock prices in Pakistan’s Karachi Stock Exchange index – KSE 100. It contributes significantly to the study of the stock exchange performance in Pakistan since the findings of prior studies were mostly divergent. Monthly data from January 2000 to April 2014 are used to analyze the impacts of the Industrial Production Index, the money supply, the Pak-US interest rate differential, the real effective exchange rate, the balance of trade, the expected inflation, the government debt to GDP, the inflow of portfolio investment, and the earning yield on the KSE 100 Index. Multiple regression analysis and Granger Causality tests under VAR are employed for this purpose. The findings of this study have identified the Pakistan-US interest rate differential, the real effective exchange rate, the balance of trade, the expected inflation, the government debt to GDP, and the earning yield as significant predictors of the stock index. The KSE 100 Index is found to be a leading indicator for the M2 money supply growth in Pakistan. The results of this study imply that policy makers play a crucial role in Pakistan’s stock market through the manipulation of fundamental variables.

Keywords: KSE 100 Index; Fundamental Analysis; Stock Market; Industrial Production; Money Supply; Interest Rate Differential; REER; Balance of Trade; Expected Inflation; Government Debt to GDP; Portfolio Investment; Earning Yield.

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