

# No correlation between real economic growth and stock market: report

The performance of the Sri Lankan equities market has little or no correlation with the real economic growth of the country, and stock investments are not a good hedge against inflation, the Colombo based private equity fund, Jupiter Capital, said in a recent

research report.

In reaching this conclusion, the report analysed the annual Gross Domestic Product (GDP) growth data and the CSE performance as measured by growth in All Share Price Index (ASPI) from 1991 to 2013.

According to the research,

the relationship between GDP and stock market performance is primarily driven by expectations effect and wealth effect.

Expectation effect refers to stock market trends driven by expected changes in the GDP. When the economy is expected to grow, company performance

is also expected to follow same trend which will be reflected in share prices. Increase in share prices will cause the overall market to move up.

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## No correlation...

The relationship espoused by wealth effect refers to growth in GDP caused by increase in stock market performance. Stock market gains increase wealth for investors or stock holders. This wealth creation results in increased expenditure – both consumption and capital expenditure which in turn stimulates the economy.

In Sri Lanka's case, the correlation coefficient of GDP growth and annual changes of ASPI

are near zero (and negative), indicating there is no relationship between the two variables, i.e. between performance of the equity market and real economy.

Meanwhile, one way to ascertain if equity market has provided an inflation hedge is to examine the correlation between the nominal growth in GDP and the stock market index. Ideally stock market index and nominal GDP growth should have some positive correlation.

However, the analysis by Jupiter Capital shows that the correlation between nominal GDP growth and ASPI index is a weak negative figure.

"This means that historical data do not show that investing in Sri Lankan stock market can protect investors from losing value of money due to inflation," the research report noted.