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AN ANALYSIS OF THE RELATIONSHIP BETWEEN THE SOVEREIGN CREDIT DEFAULT SWAPS AND THE STOCK MARKET OF PAKISTAN THROUGH HANDLING OUTLIERS

Abstract:

This study examines the relationship between the Sovereign Credit Default Swap (SCDS) market and Karachi Stock Exchange (KSE). Previous literature in this lieu rarely handles the effect of outliers' presence in data. This study applies Split Sample Skewness Based Boxplot (SSSBB) technique for outlier detection and proposes SSSBB-Winsorization for handling outliers. The results depict a significant role of outliers in the determination of the correlation and causal relationship between these markets. Findings suggest a negative and statistically significant correlation between SCDS and KSE, which is increasing gradually. Moreover, by using Granger causality test, this study finds bidirectional causality between both the markets, which implies informational efficiency of both markets in the prediction of each other.

Keywords:

Granger causality, KSE, Outliers, Sovereign CDS, Winsorization