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LIQUIDITY SHOCKS AND STOCK MARKET EFFICIENCY IN SOUTH AFRICA

Abstract:

The literature highlights the dynamic nature of financial markets. Researching financial market dynamics is important for monetary policy authorities. Two important variables when researching the dynamics of stock markets specifically are liquidity shocks and the efficiency of stock markets. The research aims to determine the link between liquidity shocks and stock market efficiency in South Africa. one goal monetary authorities target is to have efficient capital markets mainly because they encourage efficient capital allocation, enhancing economic growth. Using the JSE all-share index, the research uses ARDL and VAR models to understand the link. Impulse response and variance decomposition analysis are employed to visualise and interpret the reaction of capital market efficiency to liquidity shocks and the duration of the shocks. The theoretical underpinnings of the study are based on existing theories such as the Efficient Market Hypothesis, and the Behavioural Finance theory, Adaptive Market Hypothesis. The research uses two liquidity measures, the stock market turnover and the Amihud illiquidity measure. The results show that in the short run, liquidity shocks worsen efficiency in the All-share index, while illiquidity shocks have no real effects on the All-Share index.

Keywords:

Liquidity shocks, Amihud illiquidity measure, Stock market efficiency, ARDL, VAR, JSE South Africa

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