EQUITIES

Stock Returns, Inflation and the Volatility of Growth in the Money Supply

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A large body of work documents a negative relation between expected nominal stock returns and expected inflation in the U.S. and other developed countries. This paper argues that the volatility of expected growth in the money supply is an important determinant of this relation.

Previous studies focus on markets that reside in countries with relatively stable monetary policies. Therefore, the effects of the volatility of expected growth in the money supply are not apparent. We take this investigation to a set of emerging stock markets. Many of these markets reside in economies that have experienced substantial volatility in expected money supply growth.

We provide support for the proposition that as the volatility of expected growth in the money supply increases, the relation between movements in expected nominal returns and expected inflation should approach one-for-one.

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