The Impact of Monetary Policy on the Equity Market

Abstract

Prior studies examining the impact of monetary policy instruments on the equity market have produced mixed results. This problem is important to address because of the substantial impact of monetary policy on the economy and economic resource allocation via the equity market. The purpose of this study was to determine the impact of change in money supply (M2), change in Federal Funds Rate (FFR), and change in Federal Funds Futures (FFF) on the expected rate of returns of publicly traded companies while controlling for the rate of return of the whole equity market and size of the sampled companies. The capital asset pricing model formed the theoretical foundation. The research questions addressed the significance of the monetary policy instruments M2, FFR, and FFF on the expected rate of returns of publicly traded companies. The research design was ex post facto. To answer the research questions, annual data were collected for the period of January 2005 through January 2015 for the rate of return on the overall equity market, rate of return on stocks of 90 publicly traded companies, size of the sample companies, M2, FFR, and FFF. A multiple regression showed a positive effect of market rate of return and company size, a positive moderation effect of M2, and a negative moderation and mediation effect of FFR and FFF on the expected rate of returns of publicly traded companies ($p < .05$). These findings could have positive social change implications in that they may help individual and institutional investors in their investment decision making, leading to better allocation of economic resources. The findings may also assist monetary policy authorities in assessing the impact of monetary policy on the equity market and thus preempting stock market crashes.