National GDP Growth and Changes of Stock Market Indices

Evidence from France, Germany, Great Britain and Japan

Daniel Limberg
Lukas Mueller

13 Mai 2016

Abstract

Using data from France, Germany, Great Britain and Japan we provide an analysis of the effect of the GDP growth rate compared to previous quarters on changes of national stock market indices. Findings indicate that the role of banks as intermediaries on the market can potentially explain whether there is a relationship between GDP growth and growth of a national stock index. Controling for various, lagged covariates in a comprehensive OLS model, we find that for France GDP growth has statistically significant effects on the CAC40. For Germany and Japan the effects are less statistically significant and for Great Britain, with a capital based financial market, we do not observe a statsistically significant effect at all. First, this indicates that different financial market strucutres play a crucial role for investment behavior. Second, these findings support the notion that the financial markets are disconnected from the real economy and to a certain degree do no longer reflect economic growth.

Contents

1 Introduction

Nowadays, equity prices have become the nexus between capitalism and our daily life on the globe. Especially the financial crisis and the following European sovereign debt crisis darken the beauty of this nexus, that was once proclaimed to be a good - if not the best - example of a functioning market mechanism. In this paper, we investigate an odd relation that is a part of the nexus: The relationship between GDP growth and a subset of national equity prices; that is national stock indices. The intuitive assumption that one automatically has is fairly straight forward: The better an economy performs, the higher expectations of market participants, investments and trust in the future. In turn, we should - naturally - obtain an increase in the *level* of a national stock market index given good economic performance within a country. In other words it is reasonable to argue, that the growth of national stock indices is caused by a healthy real economy. However, the more interesting question is beyond this intuitive assumption: Focusing on four OECD countries (France, Germany, Great Britain and Japan) we investigate whether the quarterly GDP growth rate (in%) has an effect of the *changes* of the indices (in %). If so, are there different levels of statistical significance for the effect of GDP growth across the different countries? That is, we do not compare the size of the effects (i.e. coefficients) across countries since we investigate on different dependent variables. We take the four major national stock market indices of the countries as our dependent variables: The CAC40 (France), DAX (Germany), FTSE100 (Great Britain) and the NIKKEI (Japan). We control for a row of other, lagged explanatory determinants - not only from within the national economy (e.g. inflation rate) but also external, more global factors (e.g. oil price). We elaborate on the specific covariates below. For our analysis we focus on the time period between the beginning of 1999 (where ECB interest rates became relevant) and the end of 2015.

The rest of this paper is structured as follows. In the next section 2 we provide a brief Literature Review and introduce basic findings of the field for our topic. Section 3 provides of Research Question and Hypothesis. We then introduce our Data and Variables of Interest in section 4. We continue with some basic Descriptive Statistics (section 5) before we provide our Analysis and Discussion in section 6. We end with Limitations and opportunities for Future Research (section 7) and a Conclusion (section 8). Note that we provide diagnostics and a variation of our final model in the Appendix.

2 Literature Review

We would like to provide a two-step review of existing literature. In the first part we summarize general findings of the field regarding national indices: What are determinants that ought to be influential on the level of national indices? In the second, more narrow step, we focus on the relationsship between GDP growth and national indices: Did previous studies find a relationship after all? Were causal assumptions confirmed?

2.1 National Indices

Dimson et al. provide a solid and helpful introduction to the subject[1] with a focus on world's stock markets and the question of returns (Dimson, Marsh, and Staunton 2009). The field provides a tremendous amount of research on the question of what influences stock markets in general and national indices in specific. Work includes research on herding effects in advanced (Chiang and Zheng 2010), Chinese (Tan et al. 2008) or Japanese stock markets (Chang and Dong 2006).
Other scholars aim to predict the direction of indices via neural networks - as an attempt to go beyond traditional (non-)linear models. Examples of this stream of research include the work of Guresen et al. (Guresen, Kayakutlu, and Daim 2011) or a study of the Istanbul stock exchange index (Kara, Boyacioglu, and Baykan 2011). Other authors investigate the effect of the media (Tetlock 2007) or even the weather on stock markets (Symeonidis, Daskalakis, and Markellos 2010, Kang et al. (2010), Yoon and Kang (2009), Goetzmann and Zhu (2005), Cao and Wei (2005)).

[1]The work of Dimson et al. was regularly updated. The 2009 edition is the most recent version available.

Contagion and spill-over effects are also of interest for the field. Boyer et al. provide empirical evidence that stock market crises are spread globally through asset holdings of international investors. The more open (i.e. accessible) the stock markets, the higher the co-movements, they find (Boyer, Kumagai, and Yuan 2006). Kenourgios et al. conclude very similar (Kenourgios, Samitas, and Paltalidis 2011). Furthermore, the field moved on to insights from behavioral economics. Bollen et al. provide an interesting piece of work and find correlations between what they call the *twitter mood* and the Dow Jones Industrial Average over time (Bollen, Mao, and Zeng 2011). The work of Zhang et al. (Zhang, Fuehres, and Gloor 2011) and Si et al. (Si et al. 2013) follow a similar approach and find almost identical results.

2.2 GDP Growth and National Indices

The field provides various studies which focus on the relationship between GDP growth (or macroeconomic determinants of GDP growth) and stock markets in general. For example, Claessens et al. "study how local stock market development and internationalization listing, trading, and capital raising in international exchanges are related to economic fundamentals" (Claessens, Klingebiel, and Schmukler 2006). Duca states that there is a clear co-movement between stock market prices and GDP in developed economies. Assuming causal effects he finds that "the level of economic activity in a country can potentially depend on the stock market amongst other variables" (Duca 2007). On the other hand, Ritter finds that cross-country correlation of real stock returns and per capita GDP growth over 1900-2002 is negative. This is mainly traced back to the fact that increases in capital and labor inputs (i.e. two main determinants of GDP growth) in new corporations (i.e. representing innovation) do not necessarily imply higher dividends (Ritter 2005).

For 42 emerging markets Yartey examines the effect of institutional and macroeconomic determinants on stock market developments (Yartey 2008). Similar studies focus on these determinants for a wide range of countries. These include OECD countries like Belgium (Van Nieuwerburgh, Buelens, and Cuyvers 2006), France (Sraer and Thesmar 2007), Germany (Antonios 2010) or New Zealand from 1990 to 2003 (Diebold and Yilmaz 2008). And developing markets such as Malaysia (Rahman, Sidek, and Tafri 2009) or BRICS-countries like India (Singh 2010, Agrawalla and Tuteja (2007)) and South Africa (Hsing 2011) in general.

3 Research Question and Hypothesis

Do changes in GDP growth lead to changes in the country's national stock market index?

- H_0: There are statistically significant effects of GDP growth on the growth rates of a country's stock market index.
- H_1: There are no statistically significant effects of GDP growth on the growth rates of a country's stock market index.

4 Data and Variables of Interest

In the following we introduce our variables of interest and briefly summarize how they fit our purpose. All variables were collected on (or aggregated to) a quarterly format.

Variables	Number	Origin of Data	Time Range
Dependent Variables	4	Yahoo Finance	Quarter 1 1999 - Q4 2015
Covariates	6	ECB, OECD	Quarter 1 1999 - Q4 2015

4.1 Dependent Variables

We use data from Yahoo Finance to derive four dependent variables. We are interested in equity prices in the form of national stock market indices from four OECD countries: France, Germany, Great Britain and Japan. The indices measure the combined stock values of companies and/or equities in a country which are top performing according to given benchmarks. We measure the dependent variables as the % change of the average closing value, compared to the previous quarter. In other words, we are not interested in the *levels* but rather in the *changes* of the indices over time.

Dependent Variables	Official Title	Scope
CAC40 (France)	Cotation Assisté en Continu 40	40 highest Market Caps
DAX (Germany)	Deutscher Aktienindex	30 major Companies
FTSE100 (Great Britain)	Fin. Times Stock Exchange 100 Index	100 Companies
NIKKEI (Japan)	NIKKEI 225	225 Equities

4.2 Covariates

In the following we control for various covariates. We use a lag of one quarter and another lag of two quarters for all covariates. If not indicated differently, the default for the covariates is a lag of one quarter. For the control variables we differentiate between country-specific and general covariates that apply to all countries. Starting with country-specific covariates (i.e. variables that are unique to France, Germany, Great Britain and Japan), we use OECD data to derive the three following covariates. Among them is our key independent variable: GDP growth. We also use private consumption and the inflation rate (measured through the CPI) within the countries as additional control variables.

Country-specific Covariates	Measured
GDP growth	% change to previous quarter
Consumer price index (CPI)	% change to previous quarter
Private consumption	% change of share of GDP to prev. quarter

From the ECB database we use the deposit facility (i.e. interest rate for banks[2] making overnight deposits with the Eurosystem). Quite noticeable is the fact that since June 2014 the rate is negative. That is, quite counter-intuitive, banks are penalized when making deposits. Again using OECD data, we also take the quarterly GDP growth rate of the USA as a proxy for the general development of the world economy since the economy of the USA has a profound impact on other national business cycles. And national recessions in the US may have severe repercussions across the globe which was demonstrated again after 2007 when the US subprime mortgage crisis turned into a global recession. Moreover, the West Texas Intermediate (WTI) price changes are taken as an indicator of global economic health and a crucial determinant of economic growth.

Covariates	Measured
ECB deposit facility	% change to previous quarter
GDP growth USA	% change to previous quarter
WTI	% change to previous quarter

[2]We rakishly use the term "banks" for this paper. While "Financial Institutions" would be more appropriate to apply, we dare to continue with "banks" for reasons of simplicity.

At the early stage of research for this paper other covariates were taken into account: the ECB's interest rate on the main refinancing operations (MRO), the unemployment rate for the four countries of interest and the brent crude oil price. However, a first variance inflation factor (vif) test after prelimenary regressions suggested to ignore the mentioned variables.

5 Descriptive Statistics

Before going into our analysis, we now turn to a brief description of our variables of interest.

5.1 Overview Dependent Variables

Starting with the dependent variables, Figure 1 below presents a first overview: The % change of the average closing value of the indices to the previous quarter. The graphs range from the first quarter in 1999 to the last quarter in 2015. Given the financial crisis, the CAC40, DAX, FTSE100, and NIKKEI share a remarkable but unsurprising downturn in the end of 2008 and in early 2009.

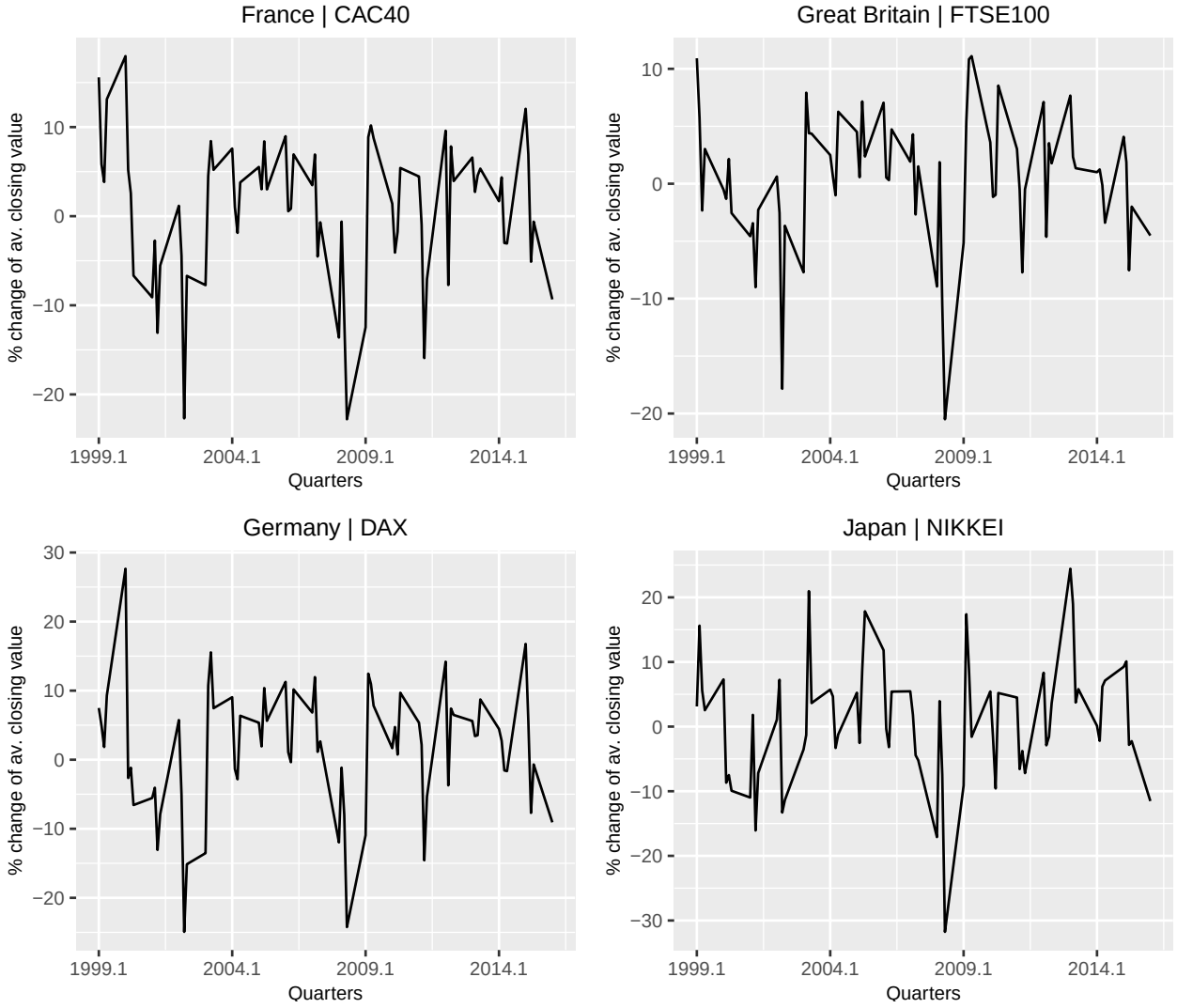


Figure 1: Dependent variables: % change of average closing values of national stock indices over time

5.2 Frequency Distribution of Dependent Variables

In the next step, the histograms below summarize the frequency distributions of the dependent variables. Please note the different scales of the axes. It becomes visible that all four national indices with their % change of the average closing value cluster around 0, although the CAC40 and the DAX are slightly scewed to the right. For now, we assume the variables to be normally distributed. In following research to this assignment we should, however, consider log-transformation especially in the case of Japan.

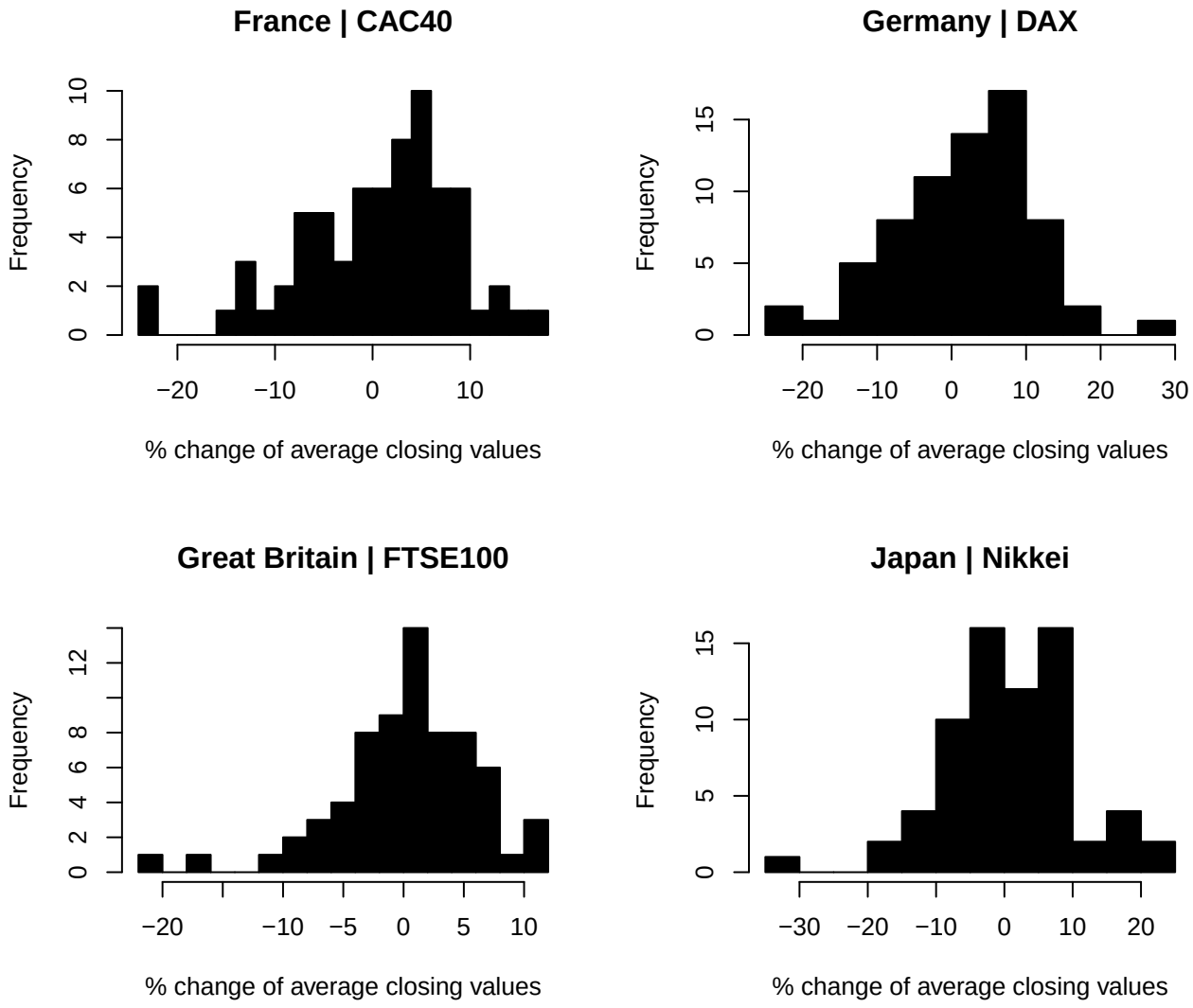


Figure 2: Dependent variables: Frequency distributions

5.3 Overview Independent Variables

Another interesting overview is given with Figure 2 which summarizes the developments of our key independent variables over the same time (i.e. Q1 1999 until Q4 2015). Our country-specific, key independent variables measure GDP growth (in % change to previous quarter) for the country in question. Remarkable again is the major, well visible downturn during and in the aftermath of financial crisis in all four graphs.

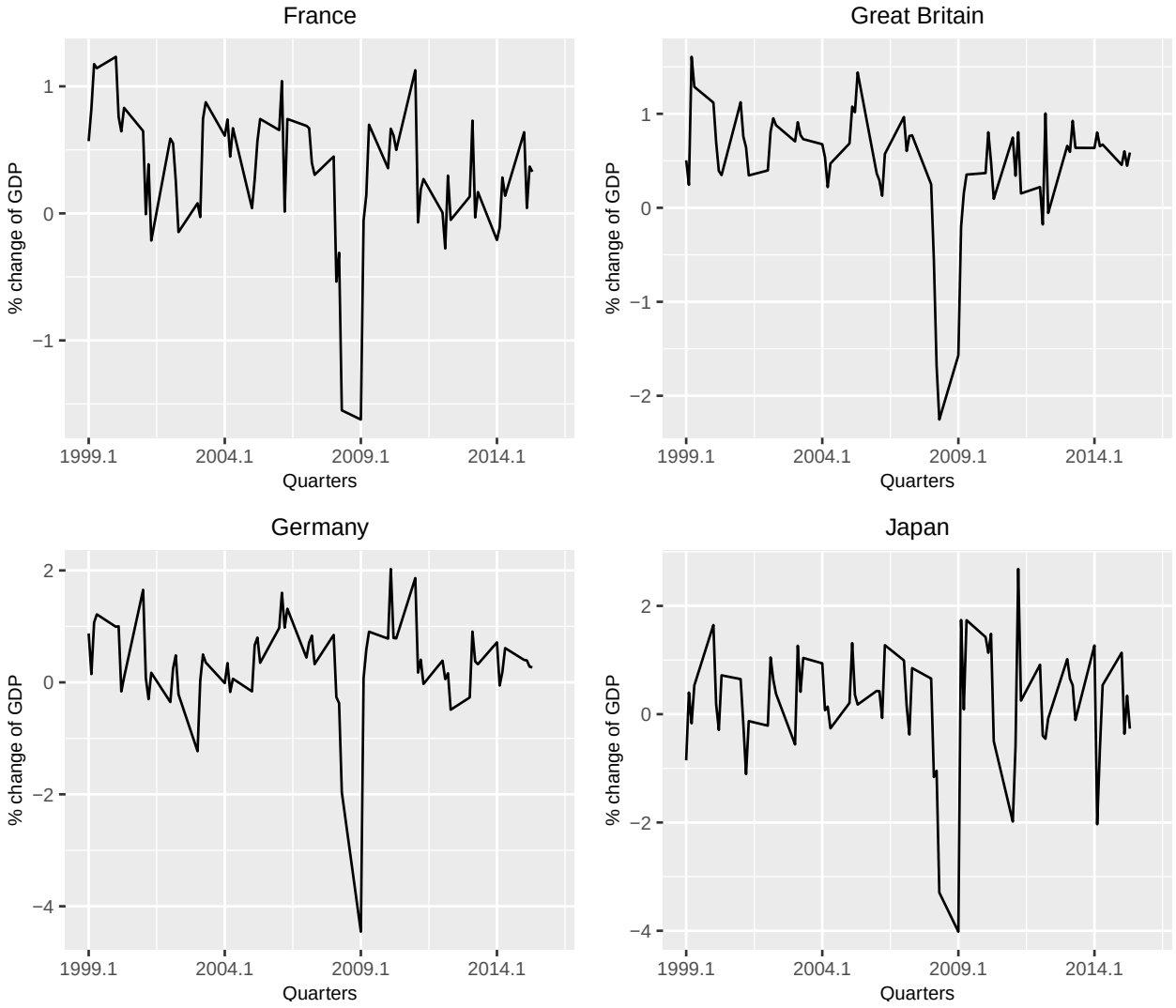


Figure 3: Key independent variables: GDP growth over time

5.4 Key Characteristics of Variables of Interest

The table below summarizes the main characteristics for the depent (National stock market indices) and key indepent (GDP growth) variables for our analyzed time period of Q1 1999 to Q4 2015. At first glance, our N=69 in all cases seems fairly small. However, note that we aggregated our original, raw data into a quarterly format. In the original dataset we obtained around 4400 observations for each dependent variable. In terms of the changes of the national indices, the DAX reached the highest (+27.6%) and the NIKKEI the lowest (-31.8%) values. Japan experienced the highest (2.7%) and Germany the lowest (-4.5%) values for quarterly GDP growth in the time period.

Table 5: Descriptive statistics

Statistic	N	Mean	St. Dev.	Min	Max
CAC40	69	0.6	8.2	−22.8	18.0
DAX	69	1.5	9.3	−24.9	27.6
FTSE100	69	0.3	5.9	−20.5	11.1
NIKKEI	69	0.7	9.5	−31.8	24.4
France GDP growth	69	0.3	0.5	−1.6	1.2
Germany GDP growth	69	0.3	0.9	−4.5	2.0
Great Britain GDP growth	69	0.5	0.6	−2.3	1.6
Japan GDP growth	69	0.2	1.1	−4.0	2.7

5.5 Joint Distributions

Below, we obtain the joint distributions between our dependent and key independent variables for the four countries. Here, we use GDP growth lagged by one quarter, which we also use in the following analysis section. The key dependent variables on the y-axes are in % changes of average closing values for the given indices.

Remarkable are the few outliers in negative GDP growth for Germany, France, and Japan, which suggest a downward trend. However, the confindence intervals already indicate that one needs to be careful with drawing conclusions from this section of the graphics. More interesting is the general upward trend for Germany, Japan, and Great Britain that starts around and above a GDP growth of 0%. This supports the original idea we described earlier on: A well performing national economy should, in theory, lead to a rise in the national stock market index. Quite to the contrary, we see rather a stagnation instead of a rise around and above a GDP growth of 0% for Japan. While we need regression modeling to draw true conclusions from this correlation, it should also be mentioned again that the NIKKEI combines the highest number of equities of all dependent variables. It is probably fair to assume that the high number of equities balances the relationship.

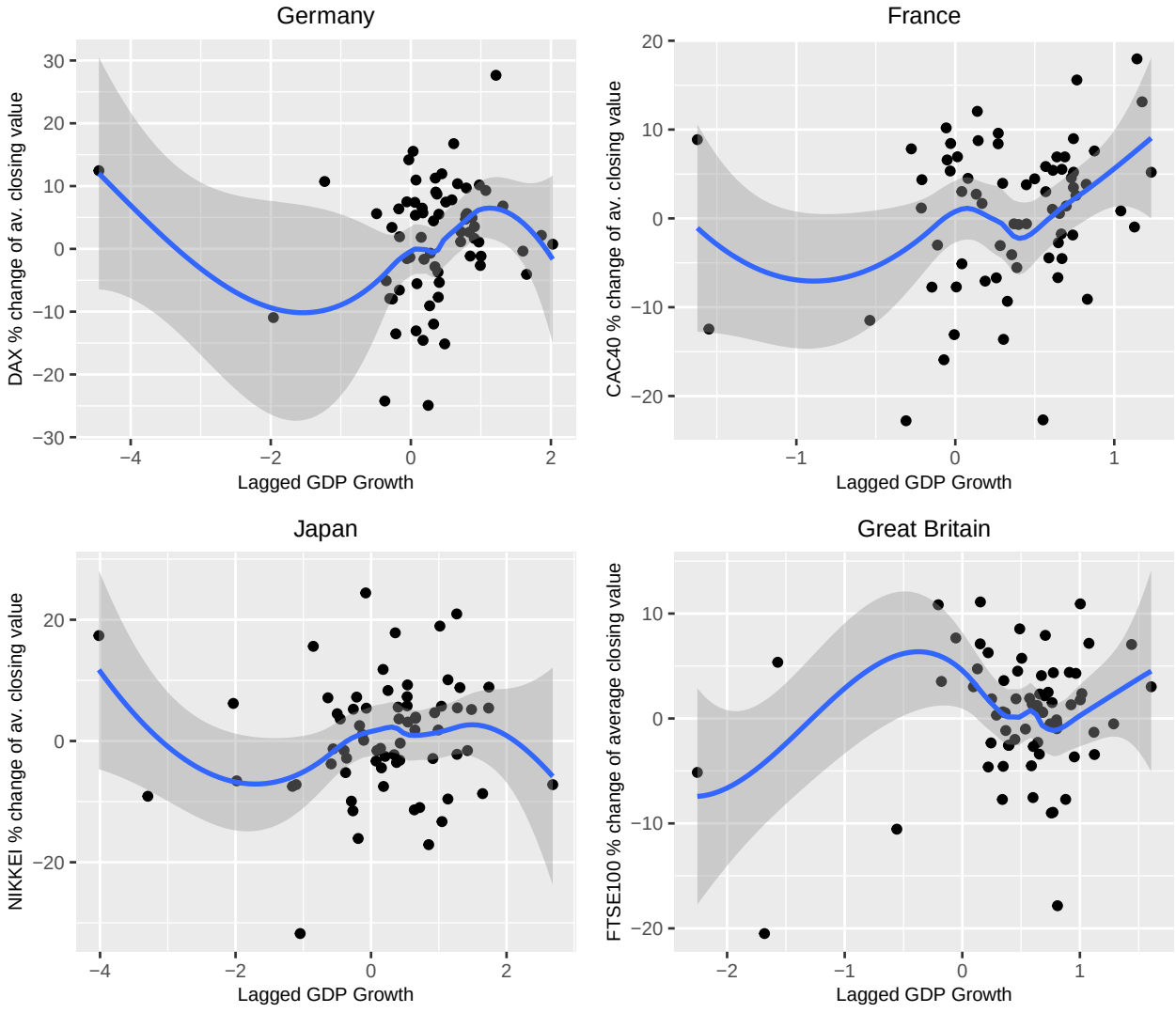


Figure 4: Joint distributions of dependent and key independent variables

6 Analysis and Discussion of Results

For the analysis section we draw our main conclusions from the comprehensive resgression table below. However, before going into the most promising model that we found during our research, we would like to offer a very basic model as a starting point of the analysis. We only regress the change of the four national stock indices on the lagged quaterly GDP growth of the respective country.

Table 6: Basic Model

	Dependent variable:			
	CAC40	DAX	FTSE100	NIKKEI
	(1)	(2)	(3)	(4)
France GDP growth	3.921**			
	(1.886)			
Germany GDP growth		0.810		
		(1.312)		
Great Britain GDP growth			1.800	
			(1.128)	
Japan GDP growth				0.516
				(1.075)
Constant	−0.721	1.251	−0.569	0.621
	(1.162)	(1.204)	(0.893)	(1.174)
Observations	69	69	69	69
R^2	0.061	0.006	0.037	0.003
Adjusted R^2	0.047	−0.009	0.022	−0.011
Residual Std. Error (df = 67)	8.029	9.376	5.824	9.601
F Statistic (df = 1; 67)	4.322**	0.381	2.545	0.230
Note:				*p<0.1; **p<0.05; ***p<0.01

Only for France the basic model shows a statistically significant relationship between the quarterly GDP growth rate and percentage changes in the respective stock market index. All other coefficients are statisitcally insignificant but show the same positive trend. This result forshadows the significance of the coefficients for lagged quaterly GDP growth in the extended model. The coefficient for France will not change its level of significance when controlling for inflation, private consumption, the Europen Central Bank's deposit facility rate, the change in World Texas Intermediate prices, quarterly US GDP growth, and year factors. The coefficients for Germany, Great Britain, and Japan, however, become weakly statistically significant (at the 10 percent level). This might suggest a certain degree of robustness. However, it should be kept in mind that the stock indices measure the stock performances of either a few selected companies and/or equities. Thus, the four coefficients should be compared with caution. Looking at a variation of the final model[3] we see the statistical significance of the coefficients for lagged quaterly GDP growth unchanged. Only the coefficient for France increases its statistial significance to the 1 percent level.

Looking at Table 7[4] we see that the effect of lagged, quarterly GDP growth on national stock indices growth of the current quarter is only statistically significant in the case of France. It is weakly significant (at the 10 percent level) for Germany and Japan. Significance levels for Great Britain do not allow to tell whether the effect is different from zero. The effect of GDP growth becomes insignificant for all countries when lagged by two time periods (i.e. quarters). The effect is always positive which suggests that a healthy growing economy correlates with a growing stock market. That the effect of GDP growth becomes insignificant (standard errors increase relative to the coefficient) when lagged by two periods suggests that the channel of

[3] Appenidx: Table 9.

[4] The VIF test sugests an acceptable degree of collinearity between the variables for this model. See Appendix.

Table 7: Final model

	Dependent variable:			
	CAC40	DAX	FTSE100	NIKKEI
	(1)	(2)	(3)	(4)
France GDP growth	8.020**			
	(3.169)			
France GDP growth (two q. lag)	2.417			
	(3.468)			
France inflation	−9.222***			
	(2.823)			
France inflation (two q. lag)	−5.454*			
	(2.945)			
France pr. consumption	−3.528			
	(2.856)			
France pr. consumption (two q. lag)	1.320			
	(2.972)			
Germany GDP growth		3.717*		
		(2.011)		
Germany GDP growth (two q. lag)		0.447		
		(1.815)		
Germany inflation		−9.295*		
		(4.771)		
Germany inflation (two q. lag)		−1.893		
		(4.869)		
Germany pr. consumption		−2.408		
		(2.412)		
Germany pr. consumption (two q. lag)		−0.632		
		(2.441)		
Great Britain GDP growth			1.823	
			(1.754)	
Great Britain GDP growth (two quarter lag)			2.609	
			(2.013)	
Great Britain inflation			−3.054	
			(2.029)	
Great Britain inflation (two q. lag)			−0.892	
			(1.901)	
Great Britain pr. consumption			0.115	
			(1.389)	
Great Britain pr. consumption (two q. lag)			1.245	
			(1.397)	
Japan GDP growth				3.731*
				(2.073)
Japan GDP growth (two q. lag)				1.722
				(2.004)
Japan inflation				−7.805**
				(3.765)
Japan inflation (two q. lag)				−5.631
				(3.487)
Japan pr. consumption				−3.576
				(2.220)
Japan pr. consumption (two q. lag)				−2.336
				(2.212)
ECB deposit facility	−9.098	−8.455	−1.803	−12.814
	(6.730)	(9.966)	(5.240)	(8.457)
ECB deposit facility (two q. lag)	−14.694**	−24.691***	−10.549**	−13.956*
	(6.058)	(7.188)	(4.146)	(7.981)
WTI	−0.022	−0.150	−0.044	−0.219
	(0.115)	(0.159)	(0.080)	(0.131)
WTI (two q. lag)	−0.014	−0.266	0.019	−0.096
	(0.115)	(0.174)	(0.094)	(0.147)
USA GDP growth	0.599	1.909	−0.839	2.837
	(2.167)	(2.972)	(1.890)	(3.035)
USA GDP growth (two q. lag)	−2.490	0.047	−1.898	−1.714
	(2.410)	(2.796)	(1.758)	(3.005)
1999	−9.307	−14.344	−9.009	−13.689
	(6.948)	(8.983)	(5.399)	(8.413)
2000	0.382	2.095	−5.125	−11.873*
	(4.418)	(6.190)	(3.710)	(6.412)
2001	−15.214***	−15.825**	−12.402***	−19.575***
	(4.588)	(6.197)	(3.725)	(6.176)
2002	−19.321***	−29.100***	−16.179***	−21.937***
	(5.115)	(7.668)	(4.101)	(6.815)
2003	−9.268	−16.551*	−9.567**	−18.036**
	(6.208)	(8.730)	(4.720)	(8.487)
2004	−4.949	−6.920	−3.572	−10.338
	(5.057)	(6.652)	(3.773)	(6.148)
2005	−0.604	−4.214	−1.539	−3.261
	(4.574)	(6.412)	(3.681)	(5.925)
2007	−4.311	1.516	−1.874	−7.470
	(4.067)	(5.667)	(3.343)	(5.412)
2008	−10.908**	−11.066	−10.915**	−13.184*
	(5.290)	(6.896)	(4.306)	(7.007)
2009	−11.522	−19.095*	1.274	−18.577*
	(7.340)	(10.171)	(6.520)	(9.547)
2010	−8.717*	−10.626	−0.665	−16.717**
	(4.576)	(6.631)	(3.923)	(6.632)
2011	−10.678**	−9.067	−2.689	−8.912
	(4.704)	(5.685)	(3.892)	(5.498)
2012	−1.848	−4.789	−1.809	−10.146
	(5.482)	(6.570)	(3.997)	(6.585)
2013	−6.149	−5.463	−2.734	3.357
	(5.095)	(6.073)	(3.595)	(6.484)
2014	−9.055	−13.345*	−7.509*	−0.542
	(5.538)	(6.709)	(3.751)	(7.731)
2015	−9.579*	−16.603**	−9.127**	−12.054*
	(5.121)	(6.636)	(4.030)	(7.113)
Constant	11.669**	13.821**	5.860	10.567*
	(4.994)	(6.226)	(4.033)	(5.249)
Observations	66	66	66	66
R^2	0.730	0.637	0.653	0.656
Adjusted R^2	0.526	0.363	0.391	0.395
Residual Std. Error (df = 37)	5.566	7.516	4.531	7.359
F Statistic (df = 28; 37)	3.572***	2.322***	2.491***	2.516***
Note:				*p<0.1; **p<0.05; ***p<0.01

influence between the real and the financial economy is rather immediate.

The effect of inflation measured as the change of the consumer price index lagged by one period is negative and statistical significant for France and Japan. Results suggests that increasing inflation decreases performances of the respective stock market indices in these countries. This negative effect is weakly significant for Germany. Significant levels decrease for all countries when looking at the effect lagged by two periods. The effect, however, stays weakly significant for France which also showed the highest significance for the effect lagged by one quarter. These results suggest that the inflation does have a negative effect on stock market indices. It is not clear how the channel of influence works since intuition would suggest that at a higher inflation rate consumers rather invest than safe.

Coefficients for both variables and both lags of quarterly GDP growth and inflation rate (i.e. consumer price index) for Great Britain are statistically insignificant. First, this result can be interpreted as the real sector not being a significant determinant of the financial performance of the stock of the companies included in the FTSE100. One explanation would be that in the Anglo-Saxon world, the financial system is a capital market based system as opposed to a system which relies more on financial intermediaries. Thus, it is much more flexible and volatile independently of the real sector. Second, the statistically insignificant, negative coefficient of changes in consumer prices does indicate that people do not decrease savings and increase investments. This can be explained by the different set up of the financial sector in Great Britain as compared to the other countries. Such a financial sector might follow different underlying dynamics. Since these financial markets rely far less on banks people have a different propensity to save. Put differently, investments into stocks take place anyway regardless of the inflation rate. It should be noted, however, that in Germany and Japan this effect is only significant at the 10 percent level and thus, general conclusions are difficult to draw from these results.

Looking at the quarterly change of the European Central Bank's deposit facility the variable yields negative, statistically significant results for France, Germany, and Great Britain when lagged by two periods. For Japan the coefficient is only statistically significant at the 10 percent level. In simple terms, the negative effect suggests that when the deposit facility interest increases, banks' revenues increase when storing their money overnight at the ECB. This implies that a high interest rate incentives the banks to keep liquidity off markets. The negative effect suggests that increasing volumes of liquidity held at banks does hurt the stock market: Less liquidity dampens investments. It seems straightforward that this effect is only weakly significant for Japan since Japanese banks are not directly affected by changes of the deposit facility. Moreover, the statistical insignificance of the effect, when lagged by one period, can be explained by the outside lag of the political decision making process. Such decisions need time to have an actual effect on the economy. The effects of a change in the central bank's monetary policy on an individual may not become visible before a certain time has passed.

All other coefficients for all other variables are not statistically significantly different from zero. The effect for changes in private consumption is negative for France Germany and Japan. For France, however, the effect becomes positive when lagged by two periods. The effect is positive for Great Britain. This could suggests again a difference in the propensity to safe and consume respectively. The variables to measure the world economy as quarterly US GDP growth and the change in WTI oil prices also have no statistically significant effect which is surprising since the US economy is traditionally viewed as a strong factor determining global economic health. Compared to the baseline year of 2006, generally all year factors display a negative sign and are predominantly statistically insignificant. 2006 was the peak performing year financially and economically. One year later, in 2007, the financial crisis started in the USA with the breakdown of Lehman Brothers in September and continued to spill over to Europe in 2008/2009 culminating in the European sovereign debt crisis. Thus, comparing the other years with 2006, all years would perform worse and thus, have a negative impact on the stock indices performances relative to 2006. Except for the years 2001, 2002, and 2008 factors are generally not statistically significant.

The final model does explain a relatively large portion of the variance in the dependent variables. When

looking at the $Adjusted - R^2$ which is lowest for Germany with $Adj. - R^2 = .36$ and highest for France with $Adj. - R^2 = .53$ it should be noted, however, that a direct comparison is difficult to make. The four dependent variables are all differently composed, and thus, variables measuring the same concept may have a different effect across the four regression models.

Finally, the results suggest to not reject the H_0 that there are statistically significant effects of GDP growth on the growth rates of a country's stock index for France. We confirm the H_1 for all other national stock indices: There are no statistically significant effects of the quarterly GDP growth rate on the growth rates of a country's stock market index in the cases of Germany, Great Britain and Japan. Thus, the findings of this paper suggests that in France developments in the real economy forecast stock market developments. However, in Germany, Great Britain and Japan the developmemnts in the stock market are detached from developments in the country's real economy.

7 Limitations and Future Research

The analysis is subject to certain limitations.[5] First, it should be noted that one has to take results with caution: if the GDP growth of an economy and stock market performance of its best firms and equities are intertwined (i.e. both variables causes each other) then the regression model's estimates suffer from reverse causality. The analysis tries to mitigate this endogeneity problem by introducing two lags for GDP growth and each other variable. However, if the reverse causality is too strong and both variables would effectively measure the same concept, then the lag is the only variance in the regression. Second, a Breusch-Pagan test suggests that the analysis suffers from heteroskedasticity. We cannot accept the null and thus, have to assume that the variance of the residuals is dependent on the values of the changes in stock indices which renders coefficients inconsistent. Third, the analysis employs a Breusch-Godfrey test to look for serial autocorrelation. The test does indicate that we can accept the null and thus, can assume no serial autocorrelation is present in the data. Consequently, we assume that the standard errors are not underestimated. Since we deal with a time series we conclude that there is an acceptable degree of heteroskedasticity. The result of the Breusch-Pagan test might not be as reliable in the presence of lagged dependent variables. Fourth, the external validity of the results must be seen with utmost caution. We have only looked at four national stock indices which are all composed differently and measure stock performances in industrial nations of the OECD. In summary, we can conclude that the coefficients statistical significance is reliable to a certain degree since standard errors are assumed to be efficient. However, internal validity is harmed by the small sample size. Concerning external validity, results should only be taken as indicative and not as final conclusive evidence since they rely on four OECD countries only.

Future Research could further invest into interactions: Is the true effect of GDP growth on changes of national stock market indices dependent on a second covariate? Also interesting should be approaches that aim for a higher external validity than we did: Studies could include national indices of other OECD countries or re-focus solely on BRICS or developing countries. Another pathway for future research could be to stay closer to the format of the original raw data: While we collapsed and aggregated data to quarterly format, analysis with monthly, weekly or even daily data should yield some interesting results. Especially, since we found that the effects of changes in GDP growth on the changes of national stock market indices are of rather immediate than long-term nature. Applying log transformation of the dependent variables is another possible option that may alter results.

[5] Diagnostics results can be found in the Appendix. All tests are done for each regression separately.

8 Conclusion

This paper used economic data from France, Germany, Great Britain and Japan to provide an analysis of the effect of national GDP growth on changes of national stock market indices. Key findings indicated that the role of banks as intermediaries on the market can potentially explain whether there is a relationship between GDP growth and stock index growth. Controling for various covariates the paper found that for France GDP growth had statistically significant effects on the CAC40. Germany and Japan did so to a lesser extent, and Great Britain with a capital based financial market did not observe a statsistically significant effect. Moreover, the negative coefficient for the change in the deposit facility of the ECB suggested a statistical significant relationship for all countries except Japan. This was in line with the original intuition. It could have been expected that the coefficient is not significant for Japan, since it is much more tied up with the Asian economy. All other coeffcients are not statistical significant. First, this indicates that different financial market strucutres play a role in how people invest their money. Whereas in Great Britain banks do not play such a huge role as intermediaries on the market, they do so in France, Germany, and Japan. The paper argues that people on theses different markets have a different propensity to safe. Put differently, in Great Britain people are much more likely to invest. Second, these findings support the notion that the financial markets are disconnected from the producing sector to a certain degree and do no longer reflect real economic growth.

Overall, the results suggested to not reject the H_0 that there are statistically significant effects of GDP growth on the growth rates of a country's stock index for France. We confirmed the H_1 for all other national stock indices: There are no statistically significant effects of the quarterly GDP growth rate on the growth rates of a country's stock market index in the cases of Germany, Great Britain and Japan. Thus, the findings of this paper suggested that in France developments in the real economy forecast stock market developments. However, in Germany, Great Britain and Japan the developmemnts in the stock market are detached from developments in the country's real economy.

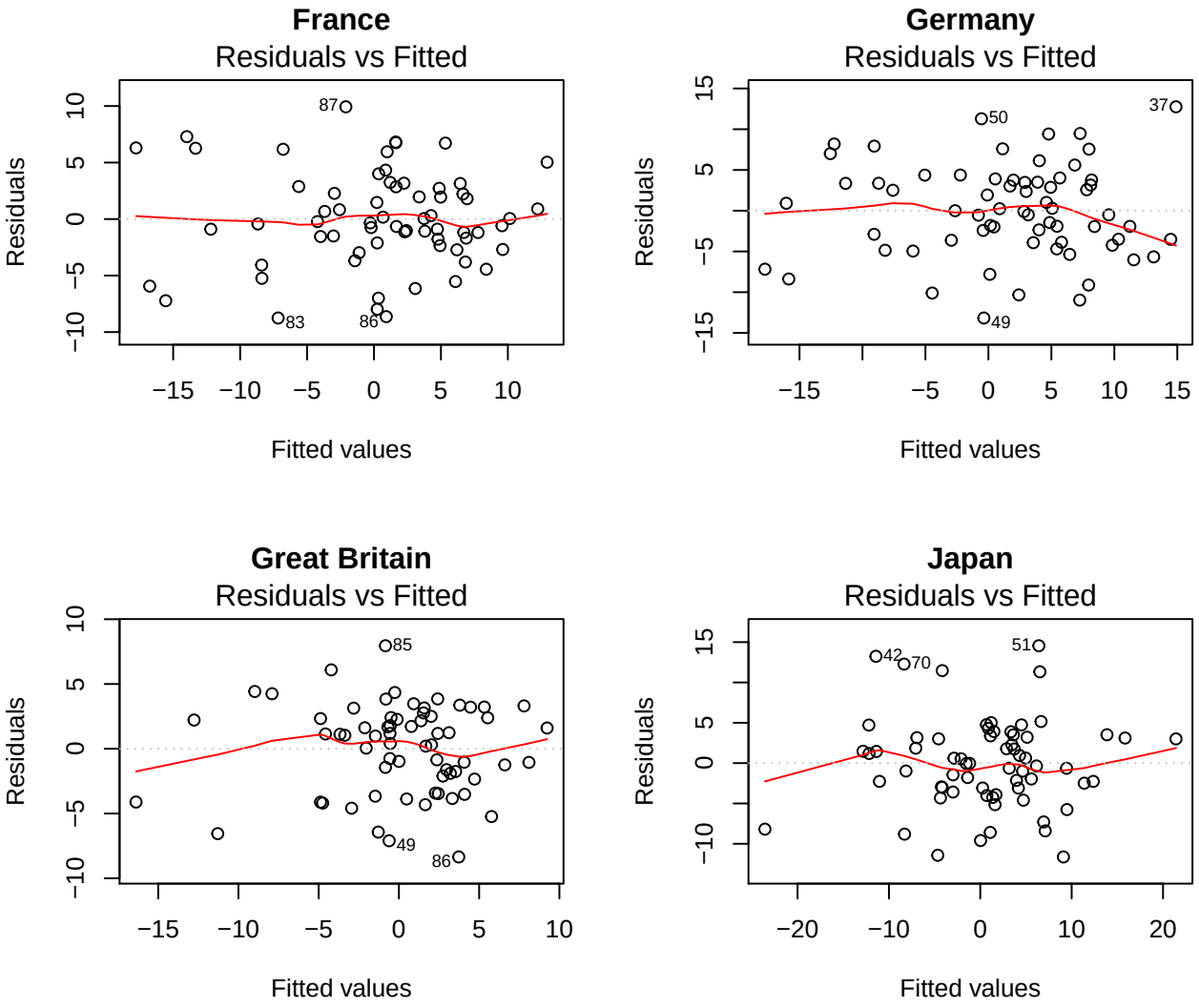
9 Acknowledgments

We would like to take the opportunity to acknowledge not only the inventors of R (R Core Team 2014) but also the surrounding community that supplies fantastic add-on packages. Without their appreciated work, this paper could not have been written (Bache and Wickham 2014, Hlavac (2015), Wickham (2009), Maindonald and Braun (2014), Wickham (2011), Wickham (2014), Zeileis and Grothendieck (2005), Hope (2013), Gandrud (2016b), Gandrud (2016a), Arel-Bundock (2014), Arel-Bundock (2013)). Finally, we also would like to acknowledge the providers of our raw-data: Yahoo Finance, the OECD database and the ECB website.

10 Appendix

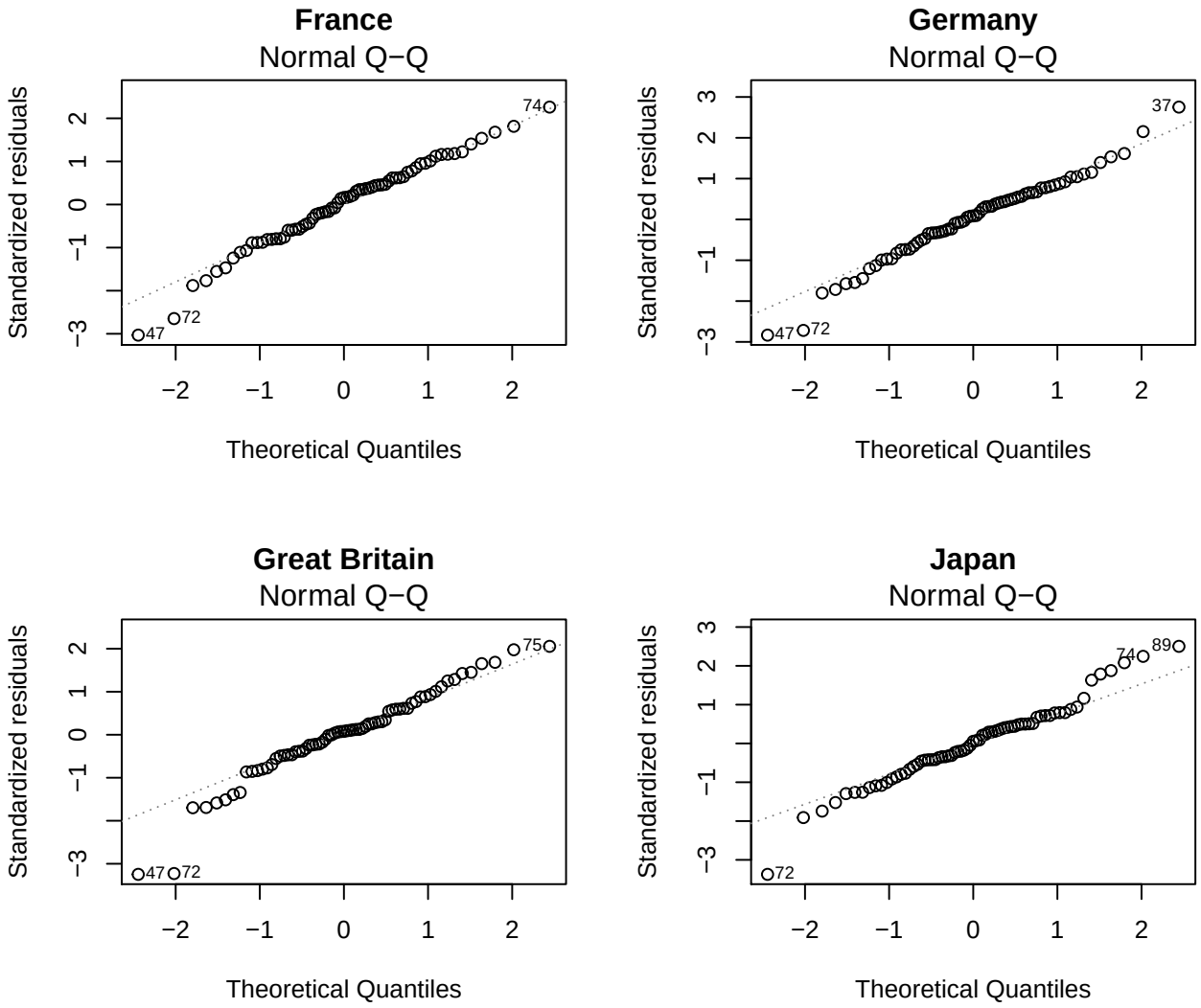
All following diagnostics refer back to our comprehensive, final model.

10.1 Heteroscedasticity



Looking at the four graphs we see that the basic models suffer to a certain degree from heteroskedasticity. This stems from outliers which bias the results in the graphs. We conclude that the overall degree of hetereoskedasticity is acceptable since the general relationship seems to be random.

10.2 Diagnose of non-normality of Errors



The graphs give and idea of the distribution of the error term in the regression. Ideally, the error terms should be normally distributed, and not show a right or left skew. In these graphs, however, we show a cummulative distribution function. That means that we want small residuals in the lower quantiles of the distriution and large residuals in the upper quantiles of the distribution of the error term. Put differently, we would expect a crosswise line from the lower left bottom to the upper right corner. All four lines suggest such a crosswise pattern indicating the degree of normality of error terms.

10.3 Variance Inflation Factor Test

Table 8: Variance Inflation Factor

	France	Germany	Britain	Japan
GDP growth	5.80	3.62	3.95	6.22
GDP growth (two q. lag)	6.96	2.97	5.20	5.89
inflation	2.96	2.79	3.84	4.43
inflation (two q. lag)	3.11	2.92	3.40	4.03
pr. consumption	3.50	2.29	3.22	5.59

	France	Germany	Britain	Japan
pr. consumption (two q. lag)	3.79	2.39	3.43	5.55
ECB deposit facility	5.13	6.17	4.69	4.63
ECB deposit facility (two q. lag)	4.16	3.21	2.94	4.13
WTI	3.56	3.71	2.58	2.64
WTI (two q. lag)	3.49	4.35	3.53	3.24
USA GDP growth	4.12	4.25	4.73	4.62
USA GDP growth (two q. lag)	5.11	3.77	4.11	4.55
1999	3.02	2.77	2.75	2.53
2000	2.37	2.55	2.52	2.85
2001	2.55	2.55	2.54	2.65
2002	3.17	3.91	3.08	3.22
2003	4.67	5.07	4.08	5.00
2004	3.10	2.94	2.61	2.62
2005	2.54	2.73	2.48	2.44
2007	2.01	2.14	2.05	2.03
2008	3.39	3.16	3.39	3.41
2009	6.53	6.88	7.78	6.32
2010	2.54	2.92	2.82	3.05
2011	2.68	2.15	2.77	2.10
2012	3.64	2.87	2.92	3.01
2013	3.15	2.45	2.37	2.92
2014	3.72	2.99	2.57	4.15
2015	3.18	2.93	2.97	3.51

10.4 Breusch-Pagan Test

```
Breusch-Pagan test
```

data: M13 BP = 36.354, df = 28, p-value = 0.1338

```
Breusch-Pagan test
```

data: M14 BP = 27.92, df = 28, p-value = 0.4687

```
Breusch-Pagan test
```

data: M15 BP = 23.901, df = 28, p-value = 0.6868

```
Breusch-Pagan test
```

data: M16 BP = 37.341, df = 28, p-value = 0.1115

10.5 Breusch-Godfrey Test

```
Breusch-Godfrey test for serial correlation of order up to 2
```

data: M13 LM test = 22.741, df = 2, p-value = 1.153e-05

```
Breusch-Godfrey test for serial correlation of order up to 2
```

data: M14 LM test = 24.185, df = 2, p-value = 5.602e-06

```
Breusch-Godfrey test for serial correlation of order up to 2
```

data: M15 LM test = 15.528, df = 2, p-value = 0.0004247

```
Breusch-Godfrey test for serial correlation of order up to 2
```

data: M16 LM test = 17.964, df = 2, p-value = 0.0001257

10.6 Model Variation

Table 9: Variation of Final Model

	Dependent variable:			
	CAC	DAX	FTSE	Nikkei
	(1)	(2)	(3)	(4)
France GDP growth	9.544***			
	(3.396)			
France GDP growth (two q. lag)	0.636			
	(2.830)			
France inflation	−7.124**			
	(2.716)			
France pr. consumption	−3.266			
	(2.944)			
Germany GDP growth		2.013		
		(1.988)		
Germany GDP growth (two q. lag)		−1.750		
		(1.881)		
Germany inflation		−6.130		
		(5.049)		
Germany pr. consumption		−2.344		
		(2.184)		
Great Britain GDP growth			2.169	
			(1.719)	
GDP Great Britain GDP growth (two q. lag)			3.164	
			(1.986)	
Great Britain inflation			−3.347**	
			(1.494)	
Great Britain pr. consumption			−0.085	
			(1.345)	
Japan GDP growth				3.118*
				(1.830)
Japan GDP growth (two q. lag)				−0.443
				(1.220)
Japan inflation				−9.521***
				(3.068)
Japan pr. consumption				−3.169
				(2.086)
ECB deposit facility	−11.930*	−10.899	−2.441	−12.868
	(6.937)	(9.323)	(4.989)	(8.471)
WTI	0.013	−0.039	0.005	−0.037
	(0.113)	(0.169)	(0.080)	(0.123)
USA GDP growth	2.186	3.764	0.638	4.169
	(2.319)	(3.126)	(1.825)	(2.817)
USA GDP growth (two q. lag)	−3.064	−1.116	−1.742	−3.563
	(2.391)	(2.995)	(1.675)	(2.716)
1999	−4.044	−6.401	−2.723	−3.842
	(6.064)	(8.254)	(4.732)	(7.638)
2000	0.043	0.196	−6.059	−10.695*
	(4.756)	(6.636)	(3.631)	(6.007)
2001	−14.363***	−14.736**	−9.989**	−17.334***
	(4.912)	(6.706)	(3.754)	(6.242)
2002	−14.758***	−21.727***	−11.162***	−16.065**
	(5.061)	(7.233)	(3.864)	(6.347)
2003	−5.080	−8.825	−4.533	−10.172
	(6.173)	(8.393)	(4.475)	(7.491)
2004	−4.452	−5.684	−1.918	−6.562
	(5.163)	(7.201)	(3.883)	(6.317)
2005	0.604	−3.378	−0.165	−1.192
	(5.096)	(6.894)	(3.759)	(6.152)
2007	−4.966	0.027	−2.799	−7.362
	(4.532)	(6.173)	(3.460)	(5.658)
2008	−11.674**	−14.177**	−8.514**	−13.756**
	(5.379)	(6.738)	(4.055)	(6.243)
2009	−1.398	−8.082	8.131	−11.841
	(7.327)	(10.223)	(5.591)	(8.174)
2010	−7.448	−5.683	0.272	−12.317*
	(4.866)	(6.586)	(3.786)	(6.489)
2011	−10.250**	−7.703	−2.234	−8.329
	(4.729)	(6.183)	(3.617)	(5.660)
2012	−1.602	−2.922	−0.165	−7.602
	(5.743)	(7.189)	(3.998)	(6.585)
2013	−2.163	−2.426	−0.353	6.893
	(4.977)	(6.508)	(3.534)	(6.005)
2014	−5.723	−9.770	−5.440	0.515
	(5.688)	(6.902)	(3.792)	(6.431)
2015	−4.069	−6.750	−6.045	−5.081
	(5.187)	(6.879)	(3.909)	(6.307)
Constant	6.749	9.734*	3.076	7.856*
	(4.364)	(5.639)	(3.073)	(4.638)
Observations	67	67	67	67
R^2	0.611	0.475	0.576	0.578
Adjusted R^2	0.389	0.175	0.334	0.336
Residual Std. Error (df = 42)	6.292	8.496	4.737	7.793
F Statistic (df = 24; 42)	2.749***	1.583*	2.377***	2.394***
Note:				*p<0.1; **p<0.05; ***p<0.01

Bibliography

Agrawalla, Raman K, and SK Tuteja. 2007. "Causality Between Stock Market Development and Economic Growth: A Case Study of India." *Journal of Management Research* 7 (3). South Asia Publications: 158.

Antonios, Adamopoulos. 2010. "Stock Market and Economic Growth: An Empirical Analysis for Germany." *Business and Economics Journal* 2010. HATASO Enterprises, LLC: 1–12.

Arel-Bundock, Vincent. 2013. *WDI: World Development Indicators (World Bank)*. https://cran.r-project.org/web/packages/WDI/index.html.

———. 2014. *Countrycode: Convert Country Names and Country Codes*. https://cran.r-project.org/web/packages/countrycode/index.html.

Bache, Stefan Milton, and Hadley Wickham. 2014. *Magrittr: A Forward-Pipe Operator for R*. https://CRAN.R-project.org/package=magrittr.

Bollen, Johan, Huina Mao, and Xiaojun Zeng. 2011. "Twitter Mood Predicts the Stock Market." *Journal of Computational Science* 2 (1). Elsevier: 1–8.

Boyer, Brian H, Tomomi Kumagai, and Kathy Yuan. 2006. "How Do Crises Spread? Evidence from Accessible and Inaccessible Stock Indices." *The Journal of Finance* 61 (2). Wiley Online Library: 957–1003.

Cao, Melanie, and Jason Wei. 2005. "Stock Market Returns: A Note on Temperature Anomaly." *Journal of Banking & Finance* 29 (6). Elsevier: 1559–73.

Chang, Eric C, and Sen Dong. 2006. "Idiosyncratic Volatility, Fundamentals, and Institutional Herding: Evidence from the Japanese Stock Market." *Pacific-Basin Finance Journal* 14 (2). Elsevier: 135–54.

Chiang, Thomas C, and Dazhi Zheng. 2010. "An Empirical Analysis of Herd Behavior in Global Stock Markets." *Journal of Banking & Finance* 34 (8). Elsevier: 1911–21.

Claessens, Stijn, Daniela Klingebiel, and Sergio L Schmukler. 2006. "Stock Market Development and Internationalization: Do Economic Fundamentals Spur Both Similarly?" *Journal of Empirical Finance* 13 (3). Elsevier: 316–50.

Diebold, Francis X, and Kamil Yilmaz. 2008. "Macroeconomic Volatility and Stock Market Volatility, Worldwide." National Bureau of Economic Research.

Dimson, Elroy, Paul Marsh, and Mike Staunton. 2009. *Triumph of the Optimists: 101 Years of Global Investment Returns*. Princeton University Press.

Duca, Gevit. 2007. "The Relationship Between the Stock Market and the Economy: Experience from International Financial Markets." *Bank of Valletta Review* 36 (3): 1–12.

Gandrud, Christopher. 2016a. *DataCombine: Tools for Easily Combining and Cleaning Data Sets*. Berlin, Germany: Hertie School of Governance. https://cran.r-project.org/web/packages/DataCombine/index.html.

———. 2016b. *Repmis: Miscellaneous Tools for Reproducible Research*. https://CRAN.R-project.org/package=repmis.

Goetzmann, William N, and Ning Zhu. 2005. "Rain or Shine: Where Is the Weather Effect?" *European Financial Management* 11 (5). Wiley Online Library: 559–78.

Guresen, Erkam, Gulgun Kayakutlu, and Tugrul U Daim. 2011. "Using Artificial Neural Network Models in Stock Market Index Prediction." *Expert Systems with Applications* 38 (8). Elsevier: 10389–97.

Hlavac, Marek. 2015. *Stargazer: Well-Formatted Regression and Summary Statistics Tables*. Cambridge, USA: Harvard University. http://CRAN.R-project.org/package=stargazer.

Hope, Ryan M. 2013. *Rmisc: Rmisc: Ryan Miscellaneous*. http://CRAN.R-project.org/package=Rmisc.

Hsing, Yu. 2011. "The Stock Market and Macroeconomic Variables in a BRICS Country and Policy Implications." *International Journal of Economics and Financial Issues* 1 (1). Econjournals: 12.

Kang, Sang Hoon, Zhuhua Jiang, Yeonjeong Lee, and Seong-Min Yoon. 2010. "Weather Effects on the

Returns and Volatility of the Shanghai Stock Market." *Physica A: Statistical Mechanics and Its Applications* 389 (1). Elsevier: 91–99.

Kara, Yakup, Melek Acar Boyacioglu, and Ömer Kaan Baykan. 2011. "Predicting Direction of Stock Price Index Movement Using Artificial Neural Networks and Support Vector Machines: The Sample of the Istanbul Stock Exchange." *Expert Systems with Applications* 38 (5). Elsevier: 5311–9.

Kenourgios, Dimitris, Aristeidis Samitas, and Nikos Paltalidis. 2011. "Financial Crises and Stock Market Contagion in a Multivariate Time-Varying Asymmetric Framework." *Journal of International Financial Markets, Institutions and Money* 21 (1). Elsevier: 92–106.

Maindonald, John H., and W. John Braun. 2014. *DAAG: Data Analysis And Graphics Data and Functions*. http://CRAN.R-project.org/package=DAAG.

R Core Team. 2014. *R: A Language and Environment for Statistical Computing*. Vienna, Austria: R Foundation for Statistical Computing. http://www.R-project.org/.

Rahman, Aisyah Abdul, Noor Zahirah Mohd Sidek, and Fauziah Hanim Tafri. 2009. "Macroeconomic Determinants of Malaysian Stock Market." *African Journal of Business Management* 3 (3). Academic Journals: 95.

Ritter, Jay R. 2005. "Economic Growth and Equity Returns." 5. *Pacific-Basin Finance Journal*. Vol. 13. Elsevier.

Si, Jianfeng, Arjun Mukherjee, Bing Liu, Qing Li, Huayi Li, and Xiaotie Deng. 2013. "Exploiting Topic Based Twitter Sentiment for Stock Prediction." *ACL (2)* 2013: 24–29.

Singh, Dharmendra. 2010. "Causal Relationship Between Macro-Economic Variables and Stock Market: A Case Study for India." *Pakistan Journal of Social Sciences* 30 (2): 263–74.

Sraer, David, and David Thesmar. 2007. "Performance and Behavior of Family Firms: Evidence from the French Stock Market." *Journal of the European Economic Association* 5 (4). Wiley Online Library: 709–51.

Symeonidis, Lazaros, George Daskalakis, and Raphael N Markellos. 2010. "Does the Weather Affect Stock Market Volatility?" *Finance Research Letters* 7 (4). Elsevier: 214–23.

Tan, Lin, Thomas C Chiang, Joseph R Mason, and Edward Nelling. 2008. "Herding Behavior in Chinese Stock Markets: An Examination of A and B Shares." *Pacific-Basin Finance Journal* 16 (1). Elsevier: 61–77.

Tetlock, Paul C. 2007. "Giving Content to Investor Sentiment: The Role of Media in the Stock Market." *The Journal of Finance* 62 (3). Wiley Online Library: 1139–68.

Van Nieuwerburgh, Stijn, Frans Buelens, and Ludo Cuyvers. 2006. "Stock Market Development and Economic Growth in Belgium." *Explorations in Economic History* 43 (1). Elsevier: 13–38.

Wickham, Hadley. 2009. *Ggplot2: Elegant Graphics for Data Analysis*. Springer-Verlag New York. http://ggplot2.org.

———. 2011. "The Split-Apply-Combine Strategy for Data Analysis." *Journal of Statistical Software* 40 (1): 1–29. http://www.jstatsoft.org/v40/i01/.

———. 2014. *Reshape: Flexibly Reshape Data.* https://CRAN.R-project.org/package=reshape.

Yartey, Charles Amo. 2008. "The Determinants of Stock Market Development in Emerging Economies: Is South Africa Different?" *IMF Working Papers*, 1–31.

Yoon, Seong-Min, and Sang Hoon Kang. 2009. "Weather Effects on Returns: Evidence from the Korean Stock Market." *Physica A: Statistical Mechanics and Its Applications* 388 (5). Elsevier: 682–90.

Zeileis, Achim, and Gabor Grothendieck. 2005. "Zoo: S3 Infrastructure for Regular and Irregular Time Series." *Journal of Statistical Software* 14 (6): 1–27. doi:10.18637/jss.v014.i06.

Zhang, Xue, Hauke Fuehres, and Peter A Gloor. 2011. "Predicting Stock Market Indicators Through Twitter 'I Hope It Is Not as Bad as I Fear'." *Procedia-Social and Behavioral Sciences* 26. Elsevier: 55–62.