

The Effect of Interest Rate Volatility on BIST Financial Index Returns

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Abstract

The purpose of the paper is to determine whether differentiations in interest rates are considered by investors. Interest rate volatility can be crucial risk factor that affects market value for financial sector firms. Increasing interest rate volatility can induce higher required rate of returns that have negative impact on prices. However, there is a possibility of higher future cash flows depending on interest rates. BIST financial Index is chosen for the potential interest rate

exploitation abilities of including companies. BIST Financial Index comprises banks, investment trusts and other financial companies. In the study, BIST Financial Index returns are modeled with market index and interest rate volatility. Market index is represented by excess returns of BIST 100 index. Applying the GARCH(1,1) model, interest rate volatility is structured. The results shows that interest rate volatility have positive and significant effect on financial sector returns. The findings makes us to think that the banks and other financial institutions in Turkey are considered good at hedging interest rate risk and taking profits of different interest rates.

Keywords: Volatility, GARCH, Financial Index, Interest Rates, Returns