
Trend of Stock Market and Its Impact on Indian Economy

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Abstract:

The Indian markets have been plunging since the start of 2016; the S&P BSE Sensex has shed 10% since the New Year. The primary reasons for the current fall are not fundamentals of India but the global turmoil, which are not in hands of Indian Government.

Indian economy is the third largest economy in the world in terms of purchasing power. It is going to touch new heights in coming years. As predicted by Goldman Sachs, the Global Investment Bank, by 2035 India would be the third largest economy of the world just after US and China. It will grow to 60% of size of the US economy. This booming economy of today has to pass through many phases before it can achieve the current milestone of 9% GDP.

The Indian market is badly beaten by FII's outflows. The global investors are concerned about the faster than expected slowdown in Chinese economy, the Fed rate hike and the multi-year low commodity prices. The investors fear that the current geopolitical situation will drag the global economy into another recession.

Key-Words:

Introduction:

After India got independence from this colonial rule in 1947, the process of rebuilding the economy started. For this various policies and schemes were formulated. First five year plan for the development of the economy came into implementation in 1952. These Five Year Plans, started by Indian government, focused on the needs of the economy. Trade liberalization, financial liberalization, tax reforms and opening up to foreign investments were some of the important steps which also include **share market**, which helped the economy to gain momentum. The Economic Liberalization introduced by Man Mohan Singh in 1991, then Finance Minister in the government of P V Narsimha Rao, proved to be the stepping-stone for Indian economic reform movements.

To maintain its current status and to achieve the target GDP of 10% for financial year 2006-07, the economy of India has to overcome many challenges.

Challenges before Indian economy:

- **Population explosion:** This monster is eating up into the success of India. According to 2001 census of India, population of India in 2001 was

1,028,610,328, growing at a rate of 2.11% approx. Such a vast population puts lots of stress on economic infrastructure of the nation. Thus India has to control its burgeoning population.

- **Poverty:** As per records of National Planning Commission, 36% of the Indian population was living Below Poverty Line in 1993-94. Though this figure has decreased in recent times but some major steps are needed to be taken to eliminate poverty from India.
- **Unemployment:** The increasing population is pressing hard on economic resources as well as job opportunities. Indian government has started various schemes such as Jawahar Rozgar Yojna, and Self Employment Scheme for Educated Unemployed Youth (SEEUY). But these are proving to be a drop in an ocean.
- **Rural urban divide:** It is said that India lies in villages, even today when there is lots of talk going about migration to cities, 70% of the Indian population still lives in villages. There is a very stark difference in pace of rural and urban growth. Unless there isn't a balanced development the economy cannot grow.

These challenges can be overcome by the sustained and planned economic reforms.

These include:

- Maintaining fiscal discipline
- Orientation of public expenditure towards sectors in which India is faring badly such as health and education.

- Introduction of reforms in labour laws to generate more employment opportunities for the growing population of India.
- Reorganization of agricultural sector, introduction of new technology, reducing agriculture's dependence on monsoon by developing means of irrigation.
- Introduction of financial reforms including privatization of some public sector banks.

This booming **Indian economy** of today has to pass through many phases before it can achieve the current milestone. It is very important to overcome and to face the challenges in front of the economy of India in a more efficient and effective way to achieve productive, fruitful and desired results on a continuous basis. Do look at the **sensex** to get some idea about the stock market scenario.

Economic effects of the stock market

1. Wealth effect

The first impact is that people with shares will see a fall in their wealth. If the fall is significant it will affect their financial outlook. If they are losing money on shares they will be more hesitant to spend money; this can contribute to a fall in consumer spending. However, the effect should not be given too much importance. Often people who buy shares are prepared to lose money; their spending patterns are usually independent of share prices, especially for short term losses. The wealth effect is more prominent in the housing market. In Dec 2014, the value of the UK stock market was US \$6.06 trillion so it has a big impact on wealth.

2. Effect on pensions

Anybody with a private pension or investment trust will be affected by the stock market, at least indirectly. Pension funds invest a significant part of their funds on the stock market. Therefore, if there is a serious fall in share prices, it reduces the value of pension funds. This means that future pension payouts will be lower. If share prices fall too much, pension funds can struggle to meet their promises. The important thing is the long term movements in the share prices. If share prices fall for a long time then it will definitely affect pension funds and future payouts.

3. Confidence

Often share price movements are reflections of what is happening in the economy. E.g. a fear of a recession and global slowdown could cause share prices to fall. The stock market itself can affect consumer confidence. Bad headlines of falling share prices are another factor which discourage people from spending. On its own it may not have much effect, but combined with falling house prices, share prices can be a discouraging factor. However, there are times when the stock market can appear out of step with the rest of the economy. In the depth of a recession, share prices may rise as investors look forward to a recovery two years in the future.

4. Investment

Falling share prices can hamper firms ability to raise finance on the stock market. Firms who are expanding and wish to borrow often do so by issuing more shares – it provides a low cost way of borrowing more money. However, with falling share prices it becomes much more difficult.

5. Bond market

A fall in the stock market makes other investments more attractive. People may move out of shares and into government bonds or gold. These investments offer a better return in times of uncertainty. Though sometimes the stock market could be falling over concerns in government bond markets.

How does the stock market affect ordinary people?

Most people, who do not own shares, will be largely unaffected by short term movements in the stock market. However, ordinary workers are not completely unaffected by the stock market.

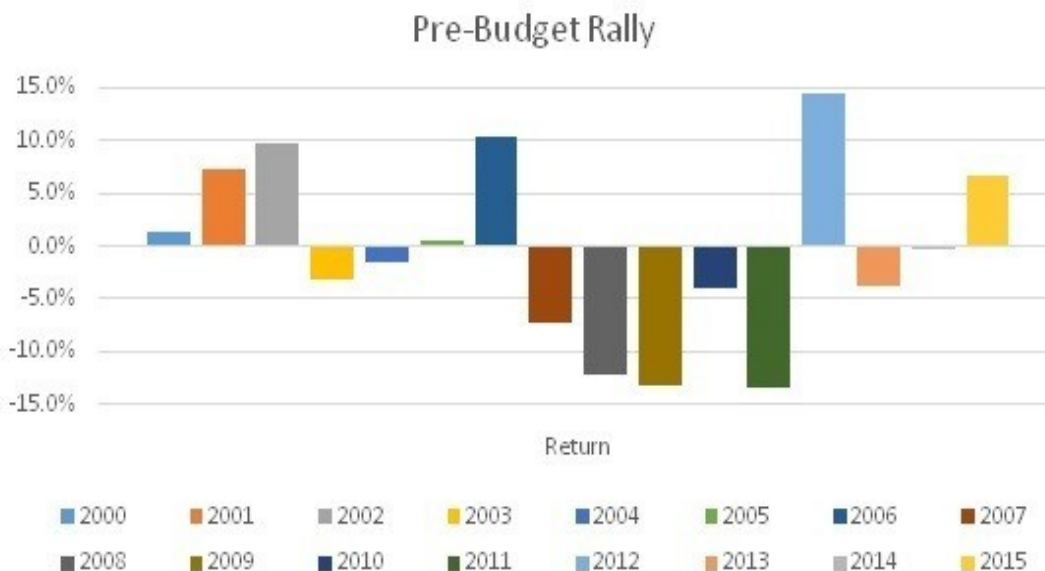
1. Pension funds. Many private pension funds will invest in the stock market. A substantial and prolonged fall in the stock market could lead to a fall in the value of their pension fund, and it could lead to lower pension payouts when they retire. Similarly, if the stock market does well, the value of pension funds could increase. Even if people don't own shares, it is quite likely people with a private pension will have some connection to the stock market.

2. Business investment. The stock market could be a source of business investment, e.g. firms offering new shares to finance investment. This could lead to more jobs and growth. The stock market can be a source of private finance when bank finance is limited. However, the stock market is not usually the first source of finance. Most investment is usually financed through bank loans rather than share options. The stock market only plays a limited role in determining investment and jobs.

3. Short-termism. It could be argued workers and consumers can be adversely affected by the short-termism that the stock market encourages. Shareholders usually want bigger dividends. Therefore, firms listed on the stock market can feel under pressure to increase short-term profits. This can lead to cost cutting which affects workers (e.g. zero contract hours) or the firm may be more tempted to engage in collusive practises which push up prices for consumers. It has been argued that UK firms are more prone to short-termism because the stock market plays a bigger role in financing firms. In Germany, firms are more likely to be financed by long-term loans from banks.

Typically, banks are more interested in the long-term success of firms and are willing to encourage more investment, rather than short-term profit maximisation.

In Last 16 years, BSE Sensex declined more than 5% in 4 occasions while it surged more than 5% in 5 occasions and rest of the time it was more or less flat. Therefore, empirically there is no set pattern for a pre-budget rally. The returns shown in the below graph are computed from the beginning of the January to the end of the February every year. So it is premature to say there will be a budget rally.



Three critical economic factors that influence the Indian stock market:

There are some factors which have their long-term impact and shape the growth path of stock market. Post 2008 the stock market in India has not seen the best of the times and these factors are responsible to a great extent for shaky performance of the stock market. There are three critical macro-

economic factors which have impacted stock markets in India since 2008 crisis. Let us look at how these factors have impacted stock markets in India.

Monetary policy and repo rate hike:

Changes in the repo rate have haunted banks for quite some time. Thirteen consecutive hikes in the repo rate have impacted the market badly. Every time when the Reserve Bank of India (RBI) hiked the repo rate, market reacted negatively and went down. Only after the pace of increase of repo rate slowed down market, breathed a sigh of

relief. In fact, such has been the impact of the series of monetary policy measures that the stock market in India pays more attention to the moves of RBI than its own regulator SEBI. The table below shows the relationship between stock market performance and repo rate hike.

Date	New Repo Rate	Change in Sensex
16-Sep-10	6%	-85
2-Nov-10	6.25%	-10
25-Jan-11	6.50%	-180
17-Mar-11	6.75%	-200
3-May-11	7.25%	-460
16-Jun-11	7.50%	-150
26-Jul-11	8%	-363
16-Sep-11	8.25%	57
24-Oct-11	8.50%	144
16-Apr-11	8%	56

Source: www.bseindia.com (All changes in Sensex rounded off)

As an investor, one needs to take note of this important factor which makes an impact on stock market movement. It is, in fact, not just the repo rate hike but the entire monetary policy of the central bank which has a bearing on the performance of stock market.

International crude oil price and inflation:

Crude oil prices are tracked in the Indian economy with lots of curiosity. Since India imports around 80% of crude oil from the international market, any significant change in price of petroleum makes an impact on inflation numbers which in turn impacts the stock market. Inflation numbers send the market up and down whenever they are announced. Post 2008, there has been a consistent inflationary pressure on the Indian economy which has created trouble for the stock market in India.

RBI data shows that the period 1995 to 2008 was the best for the Indian economy when inflation overall was just 5%. Between March 2008 and January 2012, it went up

and overall inflation number touched 7.6% while primary group had the highest inflation of 13%.

Period	Average inflation			
	Overall	Primary Group	Fuel Group	Manufactured Group
April 1983 - July 1987	6.0	6.6	6.5	5.7
August 1987 – October 1990	8.1	6.8	5.0	9.4
November 1990 - November 1995	11.1	12.3	12.5	10.4
December 1995 – February 2008	5.0	5.3	9.6	3.8
March 2008 - January 2012	7.6	13.0	8.8	5.4
April 1983 - January 2012	6.9	7.9	9.0	6.1

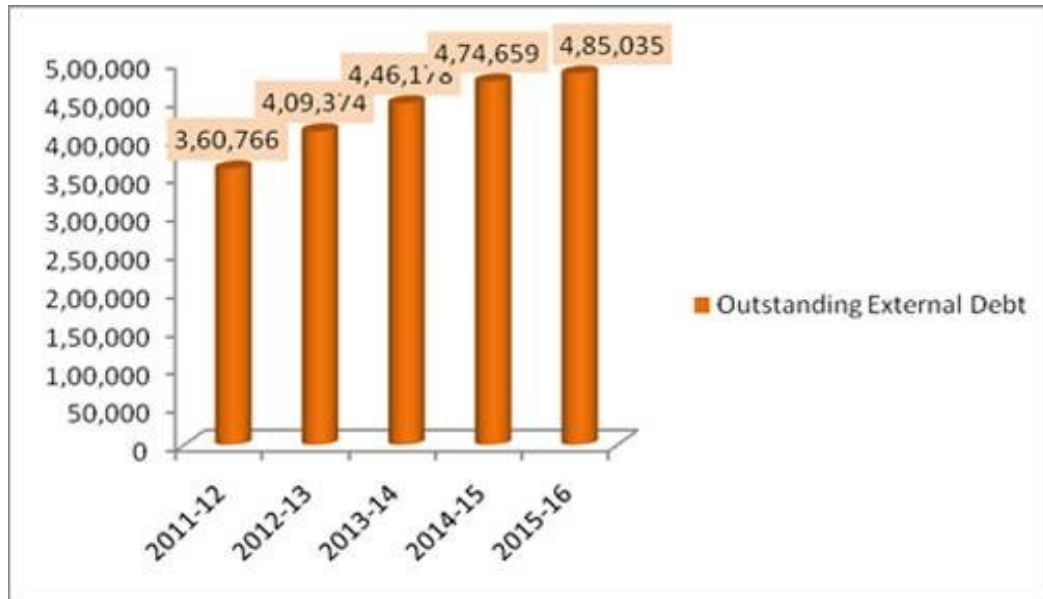
Source: RBI

Policy announcements of the government

The market, which was disappointed with the policy paralysis of the UPA-2, got a sudden boost with hike in diesel price and FDI in aviation and retail. The government became the darling of the market suddenly and it went up by close to 1,000 points within a few days. Whether it is GAAR or power sector reforms, the market monitors every move of the government. While the government provides strength to the market

through regulations, it provides growth impetus with policy announcements.

There is no denying the fact that almost every factor having economic characteristics makes an impact on the market but there is no denying the fact these three factors have been a companion of the stock market for the last five years. The performance of the stock market is positively related to these factors. As these factors become better, market will continue to perform better.



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