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MACRO-ECONOMIC FACTORS EFFECTING INDIAN STOCK MARKET INTEGRATION: A REVIEW OF LITERATURE

Paridhi Saini* and ShivaliDhameja**

*Assistant Professor, Shri Ram College of Commerce, DU
** Assistant Professor, Shri Ram College of commerce, DU
Research Scholar, Department of Commerce, DSE

Abstract:-Exploring the dynamics of macro-economic factors and their impact on Indian stock market this paper study some of the major macroeconomic factors like foreign exchange regime, foreign investments, real estate decompositions, inequality in resource allocation etc. which create volatility in the stock market return or describe the inefficiency of market caused by unrelated world market extrapolations. These factors can be acknowledged as the major building blocks in the study of stock market integration.

Keywords: Macro-Economic , Market Integration , Review Of Literature , global markets.

INTRODUCTION

This study examines the current state of Indian stock market and the major factors which effects it's interlink age with the global markets. Before moving forward firstly we explain what does it mean by primary and secondary market?

PRIMARY MARKET

The primary market is an important part of capital market, which deals with issuance of new securities. It enables corporates, public sector institutions as well as the government to raise resources (through issuance of debt or equity based securities), to meet their capital requirements. In addition, the primary market also provides an exit opportunity to private equity and venture capitalists by allowing them to off-load their stake to the public. Initial Public Offer (IPO) is the most common way for firms to raise capital in the primary market. In an IPO, a company or a group floats new securities for subscription by the public. In return, the issuing conglomerate receives cash proceeds from the sale, which are then used to fund operations or expand the business. It is only after an IPO that a security becomes available for trading in the secondary market of the stock exchange platform. The price at which the securities are issued is decided through the book building mechanism; in the case of oversubscription, the shares are allotted on a pro-rata basis. When securities are offered exclusively to the existing shareholders of a company, as opposed to the general public, it is known as the Rights Issue. Another mechanism whereby a listed company can issue equity shares (as well as fully and partially convertible debentures, which can later be converted into equity shares), to a Qualified Institutional Buyer (QIB) is termed as Qualified Institutional Placement. In addition to domestic market, companies can also raise capital in the international market through the issuance of American Depository Receipts (ADRs), Global Depository Receipts (GDRs) and also by way of External Commercial Borrowings (ECBs). Capital Market

The secondary market is where securities are traded after being initially offered to the public in the primary market and/or being listed on the stock exchange. The stock exchanges along with a host of other intermediaries provide the necessary platform for trading in the secondary market, and also for clearing and settlement. The securities are traded, cleared, and settled within the regulatory framework prescribed by the exchanges and the SEBI. The NSE has laid down rules and guidelines for various intermediaries with regard to the admission and the fee structure for trading members, listing criteria, and the listing fees for companies. With the increased application of information technology, the trading platforms of the stock exchanges are accessible from anywhere in the country through their trading terminals. The trading platforms are also accessible through the

Internet. In a geographically widespread country like India, this has significantly expanded the reach of the exchanges. The secondary market is composed of equity markets and the debt markets.

STOCK MARKET INTEGRATION

The interlink ages of the Indian stock market in recent years, with the major stockmarkets in Asia and also the linkages of the Asian stock markets with the stock markets of the US, known tobe the lodestar of global equity markets. The study of the existence of interlink-ages among internationalcapital markets has serious implications for portfolio diversification as well as has important implicationsfor macroeconomic policies that influence trade and fiscal balances of countries and the financial policies ofdifferent agents within the capital importing economy.As gains from diversification were found to be significant, Asiancapital markets have attracted a substantial proportion of the international capital flows to emerging markets.

In a country like India where the stock market isundergoing significant transformation with the liberalization measures, there are also concerns regarding it exposure to risk in case of a global/regional crisis, i.e. a need to know how far contagion can affect the India stock market in a more and more globally integrated environment.

One outcome of the efforts of the Indian government at liberalizing the country' s capital market, has been theincreased integration of the Indian stock market with international financial markets, through variouschannels like foreign portfolio investments (FII investments) and the ADR/GDR route, whereby Indianshares are listed and traded on the US and other international stock exchanges.

REVIEW OF LITERATURE

Earlyworks in this field can help us to understand the state of integration of stock markets at global level, it came up with strong evidence of interlink-age between the stock marketsaround the globe, a result of global economic integration. Agmon (1972), Hilliard (1979) showedthe presence of interdependency between markets in the developed countries during the 60s.Ripley (1973) argued that this interdependency vanishes for countries with isolated markets.The interest in the interdependency between the global stock markets heightened after the globalmarket crash of October 1987. Koch and Koch (1991) used dynamic simultaneous equations to obtain the result that the marketsare getting increasingly interdependent. They also concluded that there exists some localized contagion effect. Masih and Masih (1997c, 1997d, 2001) performed the co-integration test toprove the interdependency among the Asian market and also the dominant influence of the USand the UK.Arshanapalli and Doukas (1993) confirmed the dominant role ofUS in the global financial scenario. Lee and Kim (1994) cited evidence for a significant increase in the co-movementof the stock price indices after the crash.Koutmos (1996) used multivariate VAR-EGARCH model to conclude that there is interdependency among the European markets. Rijckeghem and Weder (1999) have argued thatfinancial market interlinkage results in a shock spillover. Baig and Goldfajn (1998) showed thepresence of contagion in Asian financial markets.

Glezakos, Merika and Kaligosfiris (2007) examined the short and long-run interlinkages betweenmajor world financial markets with particular attention to the Greek stock exchange. They havefound strong influence of the US financial market, DAX and FTSE on the other markets of thesample.Although most of the authors have cited a clear interlink-age between national stock markets,Koop (1994) used Bayesian methods to deny any such trend. Also, Corhay, et al (1995) studiedthe stock markets of Australia, Japan, Hong Kong, New Zealand and Singapore to conclude thatthere does not exist any single stochastic trend for these countries.Ryan Suleimann (2002, 2003) has shown that the NASDAQ-100 is a major origin for the shocksin the IT.CAC and the NEMAX by constructing VAR model with GARCH errors. He has alsoinvestigated the co-movement of the volatility between these two indices.

A recent study investigates the integration of 11 African markets relative to the world and emerging markets over the period, March 1997 to January, 2013. The investigation is conducted using a multifactor asset pricing model. The findings of the study support partially integrated African market as both world and emerging market factors are pertinent on the African markets also the evidence is generally sensitive to the period of investigation suggesting changing integration through time.

However, studies in the context of India are limited in this respect. Sarkar et al (2001, 2003 and2007), in their detailed time-series and cross-section studies on Indian Stock markets in the 90sand early years of the new century, examined volatility, investigated the possible presence ofasset bubbles and financial fragility, but the question of transmission mechanism, if any, was notadequately addressed. Sharma and Kennedy (1977) find strong link between Indian, US and UKmarkets. Rao and Naik (1990) conducts a Cross-Spectral analysis and finds a weak relationshipof Indian market with international markets which they attribute to the controlled IndianEconomy regime throughout the 70s with liberalization measures initiated only in the late 80s.Wong, Agarwal and Du (2005); also tries to identify the volatility transmissionchannels for Indian stock market in recent years.

Srinivasan Palamalai, Kalaivani M., and Christopher Devakumar examines the stock market integration among major stock markets of emerging Asia-Pacific economies, viz. India,Malaysia, Hong Kong, Singapore, South Korea, Taiwan, Japan, China, and Indonesia. The Johansen and Juselius multivariatecointegration test, Granger causality/Block exogeneity Wald test based on the vector error correction model (VECM)approach, and variance decomposition analysis were used to investigate the dynamic linkages between marketsthe studyresults suggest that although long-term diversification benefits from exposure to these markets might be limited, short-runbenefits might exist due to substantial transitory fluctuations.

Some of the major macroeconomic factors which create volatility in the stock market return or describe the inefficiency of market caused by unrelated world market structure can be identified as foreign exchange regime, foreign investments, real estate decompositions, inequality in resource allocation etc. these factors can be counted as the major building blocks in the study of stock market integration. Out of these two major factors influence stock market integration are as follows:

EFFECT OF FOREIGN EXCHANGE REGIME

INR/USD exchange rates and foreign exchange reserves, representing currencies/exchange rates play a major role in SENSEX returns due to the integration of global stock markets.1(988810)INR/USD exchange rates were strongly negatively correlated with SENSEX returns it is also supported by the Dash and Rao (2011) study .Recent empirical study done by Sudharshan Reddy Paramati and Rakesh Gupta in this area of research suggest that there is substantial lead-lagrelationship from call money rates to exchange rates and stock returns. Similar relationshipalso found from exchange rates to call money rates and stock returns. However, there is noevidence of lead-lag causation from stock returns to call money and exchange rates.It is also identified that call money rates and exchangerates Granger cause stock returnsand did not find reverse causality from stock returns tocall money and exchange rates. So the historical information of call money rates and exchangerates can be utilized for predicting the movements of stock returns.

Effect of Foreign Institutional Investment (FII)

Some of the noticeable results found in various studies on effect of FII on Indian equity market are

FII flows to and from the Indian market end to be caused by return in the domestic equity market and not the other way round;
Returns in the Indian equity market is indeed an important (and perhaps the single most important) factor that influences FII flows into the country;
While FII sale and FII net inflow are significantly affected by the performance of the Indian equity market, FII purchase is not responsive to this market performance;
FII investors do not seem to use Indian equity market for the purpose of diversification of their investment;
Return from exchange rate variation and fundamentals of the Indian economy may have influence on FII decisions, but such influence does not seem to be strong, and;
Daily FII flows are highly auto-correlated,
FII's are effective monitors in reducing the agency costs of publicly traded companies.

Even a recent empirical study byHarendra Kumar Behera in 'An Assessment of FII Investment in Indian Capital Market' also finds the significant impact of foreign investment on Indian stock market liquidity and volatility

CONCLUSION

This paperreveals the various studies through in the area of stock market integration at world level as well as in Indian context. Initial research work were based on the co-integration testing and co-movement of stock prices among different countries stock exchanges however later on a new vision have been identified into this field which evaluate the specific factors like foreign investments and foreign exchange mechanism which intrinsically influence the process of integration of stock markets. This paper also identifies the impact of foreign exchange regime on stock market efficiency and prediction of stock returns and also enlists the effect of Foreign Institutional Investments (FII)on stock market liquidity and volatility.

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Paridhi Saini
Assistant Professor, Shri Ram College of Commerce, DU

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