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Review Paper

Stock markets and economic growth of India - a study on impact of market capitalization on GDP

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Abstract

The two fold policies of Indian economic system i.e. fiscal and monetary policy has been resulted into the efficient survival of economy of India after the inheritance of almost collapsed economy from the British Regime which was assisted by the NEP (liberalization, privatization and globalization) later on. Stock market is the most promising sector for raising the financial system of the Indian economy. After the phase of liberalization stock market has proven as an effective tool for competing with the economies of foreign countries. After the commencement of the stock market in the year 1875, it has contributed significantly towards strengthening of the economy by proving as an emerging platform for savers and investors. Various indices of the stock market has presented as an effective tool for the purpose of measuring developments of the economic performance. Frequency of financial crisis over India has affected adversely on the financial industry resulting into risks and uncertainties of the stock market. But CAPM, APT, Portfolio diversification acted as effective risk management tools of stock market which has driven NIFTY, SENSEX towards the growth and its rapid and unpredictable changes had astonished the expansion of the Indian economy with the aspects like real estates, equities, bonds and debentures. Gross Domestic Product is an important indicator of growth of an economy which has observed that the recently developing economies (BRIC) countries are getting more powerful than the countries which have a strong economic power traditionally such as economies of US and Germany. It has been predicted that the position of Indian economy will be at the third largest level among the globe after 2035. Stock market with its recent developments is an appreciable aspect of the financial system which is a highly contributing factor for the economic growth. It has become a magnificent job for new researchers to focus towards stock market aspects for the research works. A series of ascertainable studies already exists in this particular field. This research paper is an effort to determine the contribution of stock market developments in the growth of Indian economy. The secondary data sources such as bulletin reports of NSE, BSE, old as well as recent researches studies has been adopted for this paper in order to explore some new horizons of this aspect of the economy.

Keywords: Stock market, stock market developments, market capitalization, Indian economy, economic growth, NSE, BSE.

Introduction

The financial sector of India has experienced a convincing anatomical changeover from the beginning of Indian economic reforms since 1990s which improvised the economical and financial balances that enabled India transition from inward looking and protectionist one to fully integrated in the world trading system.

The capital market of India has been asssigned quite governing state after the LPG policy and stock market lead a significant role in financing corporate industries, encouragement erpreneurship, mobilization and allocation of resources in order to promote growth of economy. The Bombay Stock exchange has established in the year 1875 with the specific objective of taking financial industry of India to new heights and its enlargement at the same time Indian economy was facing the competition of financial standards of the international market. With innovative strategies and policies of BSE, the development phase started. At present there are 23 stock exchanges are running over India with appreciable infrastructure and great functioning among which the leading exchanges are NSE and BSE. Initiatives were taken and policies were formed during 80s ensuring the financial stability, abstaining excessive fluctuations and volatality in intrest rates without chocking availability of credit to various sectors.

This moderated the threats resulting from deregulation and globalisation of Indian market of finance which tends to assist the sectors of the economy by allocating the scarce resources in an effective way[1].

Thereafter SEBI came into existence as the top regulating authority tending to ensure disclosure and transparancy. As per recent trends the expansion and diversification of the stock market activities with the modernised technical advancements is highly appreciable with the usage of electronic medium of transactions and trading in recent years and thus after coping with the adversities of the factors like demonetisations and GST, the stock market is positively influencing the good resource allocation, increase over national income as well as providing financial assistance to the corporate sectors through funds and incentives and therefore paving a way to the rebuilding growth of economy in the form of growth of GDP rates which are estimated to be more high in upcoming quarters of the financial year.

Review of literature: It is a widely debated topic in the researching field that the growth of an economy is driven by its financial market or not which has promoted excellent factual studies.

Pardy in his generative work Institutional Reform in Emerging Securities Markets propounded that the capital markets are tremendous factors of channelizing savings of domestic sectors into the funds allocation to the deficit business units in countries which are less developed[2].

Equity markets and growth: Cross country evidence on timing and outcomes measured the developments of the stock markets on the basis of various parameters and argued the significant relation between economic growth and developments of stock markets with respect to emerging economies of 47 countries[3].

Stock market development and economic growth: The case of selected African countries have found a positive and significant influence of the stock markets on the growing factors of economies of the countries which comes under the category of economy with upper middle income[4].

Correlation and causality between Stock Market and Macro Economic Variables in India: An Empirical Study revealed that stock market can affect positively to economy but do not affect much strongly to the real growth of GDP as there are only 2% of the Indian population exists who are the investors of the stock market[5].

Anju Bala in her research paper "Indian Stock Market – Review of Literature" has examined that the liquidity of stock market has widely affected by the corporate listings on the stock exchanges.

Elimination of risk element is not possible with the functioning of the financial markets as fiscal deficit is prevalent but it can compete over with opportunities by finding out the volatilities and variations in the trends[6].

Naik and Padhi had observed the positive contribution of the Indian financial sector towards the relative growth of market trends and the economy[7].

Effect of stock market development on economic growth of major South Asian and East Asian economies: A comparative analysis revealed in the South Asian region economies the stock market is affecting the economic growth more significantly[8].

Objectives of the study: The primary objective of this research paper is to determine the impact ofIndian stock market developments inthe economic growth of the country. Under this study the critical appraisal of economic growth in relation with developments of the stock market andits resulting phenomenon on the economic growth for upcoming years estimations have been focused on and studied: i. To know the mentdevelop trends of stock market of India. ii. To knowthe economic growth of the country is driven by the developments of the stock market or not.

Methodology

Secondary sources of data such as reports and bulletins of RBI, various stock exchanges Journals, websites of financial express and economic times and various news stand has been used. Reference contains links and websites for all the sources which are used in the research. Market capitalization (MC), Total value traded ratio (TVT) are used as independent variables for reflecting developments of the stock market and Real Gross Domestic Product ratio is used as variable of economic growth of the country.

This study used data from the year 2000 to 2017 third quarters to find out the impact of developments of stock market on the economic growth of India taking the Indian market capitalization to GDP (%).

The Indian economy was introduced with a number of financial reforms in the period of 1980s with Globalization for the purpose of attracting equity investment from the foreign countries. For the implementation of new economic policy in the developing countries it is quite essential to channelize the funds from surplus units to the deficit units which can be done through the stock market. In the Indian context the stock market has played a vital role in the growth of economy to an extent.

Results and discussion

Stock market is a market that provides a framework for the public companies to get their shares listed for the purpose of trading. Stock market is subdivided into the primary market and the secondary market.

Primary market facilitates the companies to raise funds from the general public through initial public offering[9]. In stock exchange stocks and other securities can also be traded through stock brokers.

It is essential for stock to get listed on an exchange in order to be bought and sold. Therefore it can be said a meeting place for all buyers and sellers. Bombay Stock Exchange and the National Stock Exchange are the main stock exchanges of India.

Table-1: Main Stock Exchanges in India.

National stock exchange
Bombay Stock exchange
Calcutta stock exchange
Cochin stock exchange
Multi commodity stock exchange
Derivatives exchange
OTC exchange
Pune stock exchange
Interconnects exchange

Main indices of tracking stock markets: i. Benchmark Index- shows overall performance of a stock market, ii. Sectoral Index- shows performance of a certain sector in economy like technical, construction, finance, consumer products etc.

Back in the 1990's, every city had an Stock Exchange (Calcutta Stock Exchange, Bombay Stock Exchange, Bangalore Stock Exchange) etc. NSE broke the barrier of trading region-wise by allowing traders to trade across regions which served as a big boon to the trading community who instead of restricted to the same region spread over widely, thereby giving them a bigger exposure[10].

SENSEX and NIFTY: There are some of the bases such as capitalization of market, type of industry a company belongs to and size and number of the companies upon which the companies are classified to form an Index. Index are the groups formed by some of the common traits of companies among all the listed companies of the stock exchanges. BSE SENSEX (a group of 30 stocks) and BSE 500 (a group of 500 stocks) are fine examples of such Indexes. There are many such indices and are not limited to only SENSEX and the NIFTY. Nifty Bank is a major index and similar is the BSE Small cap and BSE Midcap. Index values are calculated by using the value the grouped values of the stocks. Change in the price of the stocks thus affects the index values also[11]. Therefore an index is taken as the indicator of market changes.

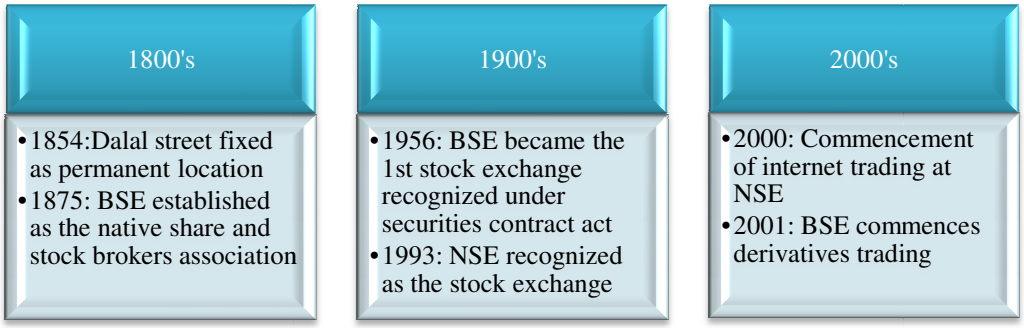

Figure-1: s'1800Periodical Developments in Indian stock markets since .

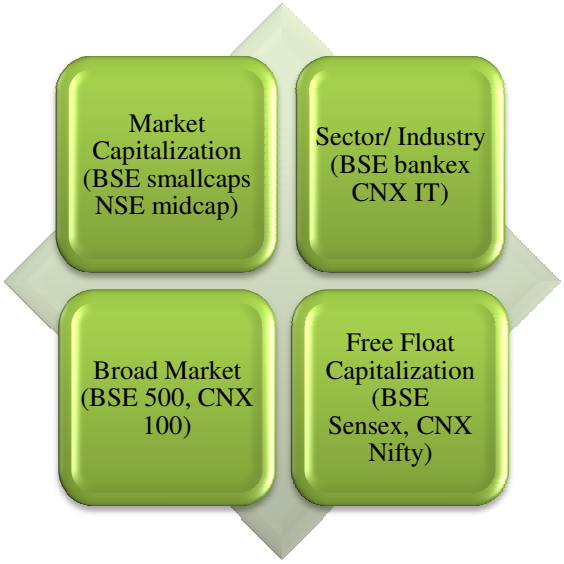

Figure-2: Stock market growth indices.

Some of the important Indian indices are: i. Benchmark indices - BSE SENSEX and NSE Nifty, ii. Sectoral indices - BSE BANKEX and CNX IT, iii. Market capitalization based indices - BSE Smallcap and BSE Midcap, iv. Broad-market indices - BSE 100 and BSE 500.

changes to Recent develpoments and newly introduced S tockMarket: i. Stock market recent developments are related with some of the IT developments easing the stock markets are: subscriptions such as cellular mobiles, telephones, broad bands, wired and individual internet usage etc. ii. Stock market integral developments are**:** Equity market turnover, stock market value traded to GDP market capitalization to GDP, accessing with ease to local equity market.

Developmental trends of Indian Securities market: Corporate securities market, SEBI act 1992, Screen based trading, Reduction of trading cycle, Equity derivatives, Risk management, Short selling, Cross margining, Research in securities market, Testing and certifications, Demutualization, Dematerialization, Clearing corporation, Investors protection, Globalization, Launch of VIX 2, Direct market access, Launch of (lending and borrowing schemes, currency futures, intrest rate futures), ASBA and ICDR regulations 2009.

Economic Growth: Economic growth refers to the incremental inflation adapted goods and services values prevalent in the market over a time period in the economy. Usually it is measured in the terms of increasing (%) rate in real GDP, as GDP is important indicator of strength of a country and a key indicator of the economic growth.

India GDP Annual Growth Rate: Through the view of occupational structure, about 60% of the total GDP contribution has been observed from the most fast growing territory sector of the economy which provides social as well as business assisting services (financing, insurance, banking, real estate, trade, hotels, transport, telecom, communication etc.). The primary sector consisting of genetic and extracting industries like forestry, agriculture, mining, fishing contributes 12% in the GDP and employees around 60% of the labor force. Manufacturing and construction accounts for 15% in total GDP and other 5% is contributed through water and gas supplies[12].

In the recent context of year 2017 the state of expansion of the Indian economy was 6.3 percent in the second last quarter of 2017 and a very low as 5.7 percent in the previous quarter noticed as the lowest percent in last three years while the estimated market expectations was 6.4 percent. Both the sectors of economy i.e. public and private sector showed a slowdown in the growth of inventories and investments. The averaged GDP is determined 6.12% in the period of year 1951 to 2017 in which the highest GDP as 11.40% has been recorded in the 2010 first quarter and as low as -5.20% in the fourth quarter of the year 1979.

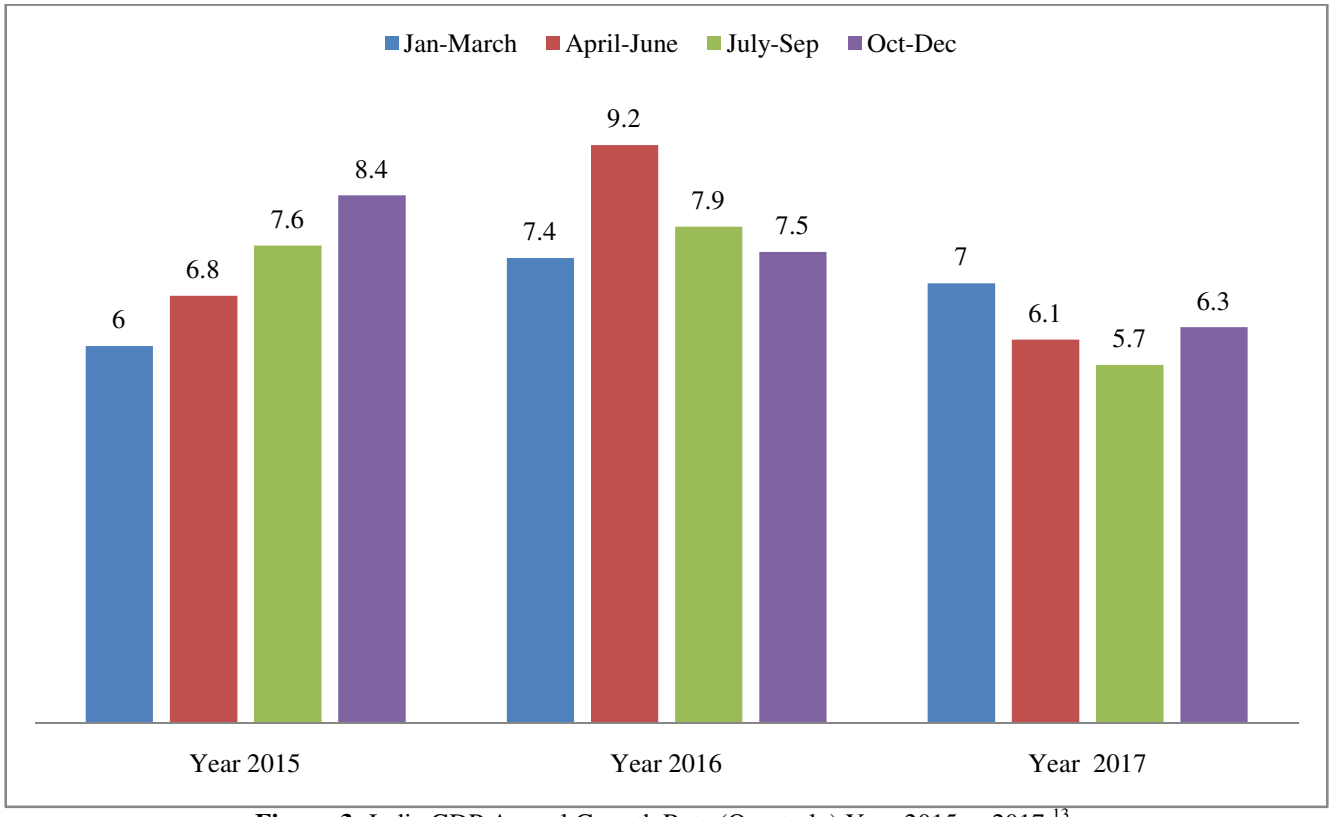

Figure-3: India GDP Annual Growth Rate (Quarterly) Year 2015 to 2017 [13].

Interpretation: The above graph shows India's annual GDP growth rate from the financial year 2015 to financial year 2017 on the quarterly basis predicting as the 6.3% GDP growth rate in the last quarter of financial year 2017.

Table-2: Chart showing 10 years periodical GDP growth rates with estimates till financial year 2021[14].

Years	GDP Growth rates (%)
2012	5.46
2013	6.39
2014	7.51
2015	8.01
2016	7.11
2017	6.72
2018*	7.37
2019*	7.8
2020*	7.93
2021*	8.1

Interpretation: The above table shows the raised growth in GDP rates from the year 2012 to 2016 but a slight downfall in 2017 as well as estimate to rise up from the year 2018 and at the peack of this decade in 2021 (*refers to estimates).

Stock Market and Economy: There exists a two way relationship of stock market and economy.

Way how the developments of the stock market affects economy of India: i. Consumer: "wealth effect" applies here as increase in the price of stocks also increase the consumers wealth resulting into the higher spending level. ii. Business: "tobin q effect" applies here as the corporate sector also raise an increased level of funds per share to finance the investment projects if the stock market touches a higher price extent[15].

Beside several other factors, Stock markets are the significant factors that tends to promote the economic growth of the country. Rate of interest also affects the economy because borrowing costs will increase with the higher rate of interest. Falls in the interest rates can stimulates the growth of economy as slowing down of the business investments and consumers spending reduces economic growth.

Role of Stock Markets in the Economic Growth of India are as follows: The role of stock market in the process of economic growth is quite significant as the stock market is the creator of liquidity in the economic flows. Liquidity of the financial market instruments was an enhancing aspect of innovative field during the earlier face of Industrial Revolution in the India.

Interpretation: The Table-3 shows the changes and percentage changes in the SENSEX values over the last decade with relation to its impact on GDP as market capitalization GDP ratio.

Table-3: The (%) years with 10changes in stockmarket performance on the basis of sensex values of period of changes and market capitaisation GDP ratio[16].

Financial Year	Change in SENSEX Value	% Change	Midcap/GDP Ratio	Below/Above average
FY07	1792.14	15.89	83	Above
FY08	2572.34	19.68	103	Above
FY09	-5918.12	-37.87	55	Below
FY10	7625.78	77.01	95	Above
FY11	1752.6	9.91	88	Above
FY12	-2016.19	-10.38	71	Below
FY13	1431.57	8.23	64	Above
FY14	3521.52	18.67	66	Above
FY15	5511.05	24.55	81	Above
FY16	-2918.28	-10.33	69	Below
FY17	4350.86	17.22	80	Above

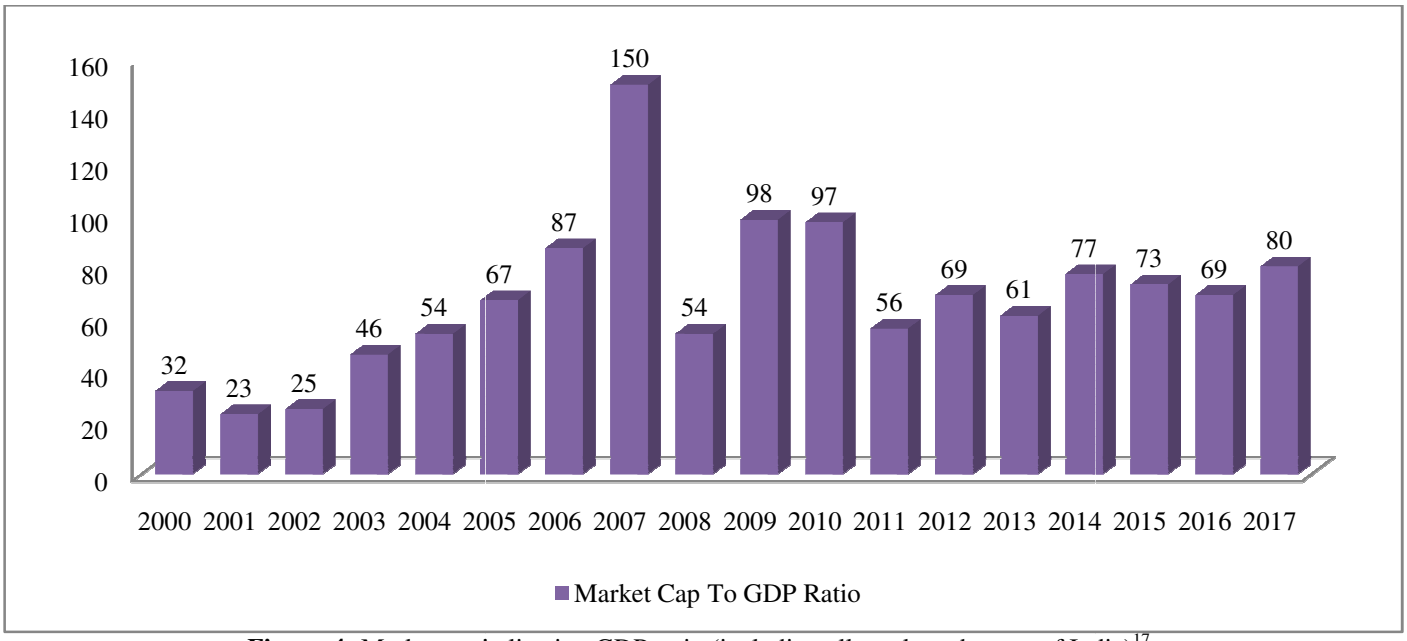

Figure-4: Market capitalization GDP ratio (including all stock exchanges of India)[17].

Interpretation: The above figure represents the percentage of market capitalization to the GDP ratio of a period of seventeen years from the year 2000 to year 2017.

Conclusion

The schedule of financial reforms of capital market reform was an integral part of Indian economy since the formation of planning commission taken place. It is generally accepted that the advancement of the stock market is recognized vital to national financial extension as it: i. Provides an additional channel for mobilizing and encouraging private economical savings. ii. Arrange productivity of the investments through allocation of fundamental capital. iii. Access managerial control through the market for commercial discipline. Indian stock markets have grown widely in terms of market turnover ratio andcapitalization[18].

The financial and money market of India has strengthen over a years. The numbers of stock exchanges rise out of 8 in 1971 to 9 in 1980 to 21 in 1993 and further to 23 as on year 2000. The number of listed companies also increased over the identical time 1,599 to 9,871 in the year 2000. BSE market capitalization GDP ratio at current market figure also developed in large from around 28 percent in thenew1990s to 45 percent at the end of the nintees after marking a fall in certain interceding generation.

In the terms of market capitalization India ranked twenty-first over the globe. 19th in the change of total value traded and second in the terms of listed domestic companies. Though the financial and money market of India established more than a century ago, it continued to be quite passive from the post-independence periods of early nintees with only 4 percent capitalization ratio (market capitalization to GDP)[19].

However during last two decades the activities of the stock market have undergone wide changes with the increased demand of the capital which has been resulted into the improvement and developments in the stock markets. It can be recognized that till the nintees institutional term lending acted as the primary source of Industrial finance in India. The financial institutional's system of raising money through government guaranteed bonds provided as a cushion to the corporates to absorb relatively high risks of implementing new projects. It is overwhelmingly concluded that that the Indian stock market with its continuing developments is acting as an engine for the economic growth of the country and the market regulators and economic policymakers should focus their attention towards establishing and sustaining a dynamic capital market in order to foster a sound and continued economic growth.

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