6. Recommendations

The importance of industrial output as measured by Index of Industrial Production and Gross Domestic Product; Monetary policy and Inflation has been highlighted once again by this study, which indicates that in order to sustain the bull run in the Indian stock market, it is imperative that

1. Indian corporate sector keeps performing because increasing returns are the foundation for the permanence of the asset prices in the stock market. And this is highlighted by the increase in Index of industrial production and increased gross domestic product. It is in fact a widely acknowledged fact today, that a world-class infrastructure will be needed in India to provide the platform for faster, consistent growth and for India to become a major world economic power. As the regional markets evolve into a national market, obviously, there will be a greater pressure for systems such as a national gas grid, a national highways system, and an expanded aviation network. As these regional markets grow, so will the attractiveness of India as an investment destination.

2. There should be ample liquidity in the market, as any effort by the RBI to squeeze money supply has serious implications for the stock market, and any hike in interest rates not only effects the cost of capital for the companies but also makes debt a better investment option for the investors.

3. Inflation must be kept under control, and for combating inflation, hike in interest rates is not the apt solution. No doubt it can provide temporary relief (though some studies have doubt even on this) but
the permanent solution lies in increasing the supply, so that there is no dearth of the supply, and thus market forces of demand and supply, keeps prices under control.

4. Though oil prices and exchange rate has not played a very significant role in the chosen time period of the study, but we cannot ignore these variables. Any significant variations from the mean might lead to disastrous effect on the Indian stock market.

The realization of this fact is gradually seeping in the strategies of the government. Government is also emphasizing upon the importance of increasing the supply of goods. Micro-finance is getting a major push, so that at least there is no paucity of funds for farmers and small entrepreneurs, and they can go for harvesting/production in a big way. This will not only increase the supply of basic agricultural/consumable products for the consumers but will also reduce the cost of production for the companies which uses such products as their raw materials leading to growth in the stock market.

To the extent the capital inflows are exceptionally high, strategies to reduce the volatility in the stock market needs to be evolved. So proper regulation of the stock markets needs to be in place to ensure the safety and integrity of operations (Mayya 2006). So the best strategy would be to ‘stitch in time’.

1. One of the strategies can be adjusting the exposure margins as per the market trend or regulating the speculative open positions. i.e. Either, when ever the market is bearish, the exposure margins on the short side could be increased so that it acts as a deterrent against sales and lowered on the long side, while being adequate to cover the risk of a further fall in prices, so as to encourage
purchases and vice versa; or in a sharp bull run, speculative long open positions above a specified level can be reduced by a certain percentage points everyday. Similarly, speculative short positions can be reduced by a certain percentage, everyday, till the frantic condition in the market subsides.

2. In a situation, when the economy is inundated with excess liquidity arising out of FII inflows, the FEMA rules may be amended so as to make it mandatory for FIIs to retain a stipulated percentage of the inflows with the bank and the bank in turn would be required to transfer these balances to the RBI. The impounded balance would be released to FIIs after a stipulated period. However the measures of such a nature should be exceptional, to be used only in extreme situations wherein the liquidity arising out of extremely large and volatile FII inflows reaches unmanageable proportions. Furthermore, such a measure, to be effective, should be used as a temporary measure only for a few months.

3. Now that the Indian stock markets have come to be dictated by FIIs, the medium-to-long term solution is to increase the strength of retail individual investors (RIIs). Various means like raising the minimum limit of public offer for entitlement of listing can be raised from the present of 25%, there share could be rasied from a present of 35% etc.