ABSTRACT

The present trend of expansion and liberalisation of stock markets in the emerging economies and the regional financial turbulences of the past decade has made the stock market-real economy nexus a core issue of macro economic theory and policy. This study examines the link between stock market behaviour in India in the post-reform period and the macro economic condition of the country, particularly, economic growth. The study addresses four basic aspects- the link between stock market development and long term economic growth, the causal relationship between stock indices and major macro economic variables, the impact of stock market development on the capital structure of corporate firms, and the impact of stock market development on the saving and risk hedging patterns of retail investors.

The study uses stock market development indicators like market capitalisation ratio, turn over ratio value traded ratio, and two major stock indices of the country viz. the Sensex and the CNX Nifty for the period 1993-2005. The study uses econometric techniques such as OLS regression, unit root, cointegration, and Granger causality to examine long term relationships between stock market and economic variables, and a primary survey to examine the impact of stock market development on retail investors. The analysis provides support to the view that stock market development boosts economic growth, and influences capital structure decisions of firms. The Granger causality tests reveal that stock indices lead changes in money supply and interest rate, rather than being led by them and thus provide evidence for semi-strong form efficiency of Indian stock market. The survey based analysis shows that stock market development has not been instrumental enough to enhance mobilisation of household saving in the country.

Key Words: Financial system, Stock market, Economic growth, Stock prices, Macro economic variables, Capital structure, Cointegration, Causality, Retail investors.