Impact of Indian Economy on the Indian Stock Market

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Abstract— It is well debatable that stock market affects the working of an economy. But it is a sure act that the stock market is an indicator of the potential of the economy. Does really the economy affect's the stock market? And if than how and to what extent. The potential of the economy and the results in the new policies of the government and the economic changes affecting the trend of the stock market. The Indian stock market is the 5th largest in the world in terms of market capitalization and the Indian economy the 6th largest in the world. The Indian stock market which has doubled its investors by the sudden surge of the retail investors since the spread of covid-19. These investors are holding the market into a stable situation throughout the tough times like the rise in inflation, Russia-Ukraine war, China-US trade war, change in repo rates, currency fluctuation, rise in unemployment rates, the rising covid-19 cases in China and rise in the crude oil prices. And the different Indian economic factors affect the trend Indian stock market. Mainly the markets are affected by the inception of a government body in the India. Investors in India believes that a strong government body can bring potential progress, growth and international relations which are keys factors for a healthy growth of an economy and the stock market of that nation.

Keywords: India, Economy, Stock Market, Interest Rates, Government Body

I. Introduction

"The stock market is almost magical because it always leads the economy. It goes down long before the economy drops and then heads higher long before the economy rebounds. It always has" – Kenneth L Fisher.

Stock market is the network of aggregate buyers or sellers who are constantly involved in a loose network of economic transaction of buying and selling shares or stocks of publicly listed company. Different companies through their IPO's (Initial Public Offering) raises capital to expand their businesses. A stock buyer buys the stock of a company in the stock market with the help of a registered intermediary called stock broker. The stock market can be either bullish (indicated upward price momentum) or bearish (downward price momentum) or can be sideways (indicated the demand and supply are nearly equal). The economy of a nation can equally be affected by the performance of the stock market. Many economists believe stock market may not be the real economy but it is one of the indicators of the growth and functioning of the economy. In many cases for example the Great Crash of 1929 can be such an example that the world witnessed the stress the negative movement of the stock market can do on the economy. In a bullish market the stock market can affect the Gross Domestic Product of a country (GDP). As the stock prices rises the consumers and the firms has higher confidence and wealth which leads to a higher spending, resulting in the rise of the Gross Domestic Product and vice versa. The stock market can affect the components of the Gross Domestic product: consumption by households, investment by businesses, government spending on goods and services, and net exports. For an example during the days of negative returns of the stock market, a households investment portfolio would show negative returns which will affect the consumption behaviour of that household as they would be selecting and sending less, which will impact the economy. The capital and valuation of a public company would go downwards, affecting the total spending of that company. With the fall in the stock market the currency of a country would weaken. But on the brighter side the exports are cheaper, which would help in the growth and profit making of the exporters of a country. But it may not always be the same case that the rise in stock market is influenced by the economic growth. India noticed the largest rise in the opening of millions of new demat accounts opening during the 2021-2022 period. The stock market breached all-time highs. But the growth measured by GDP fell by every quarter. All because of the Covid-19 pandemic.

II. Objectives

1) Role of the Indian Economy in the stock market.
2) Influence of the economy on the stock market.

III. Methodology and Data Source

This study is based on the data collected from the secondary sources available on the internet, YouTube videos, research paper, books and magazines. YouTube videos used in this study are authentic.

IV. Limitations of the Study

No primary data has been used in this study. That is why few current data and information may remain excluded.

V. History of the Indian stock market

The Indian Stock market in the second week of march 2022 entered the top five clubs of the world in terms of market capitalization for the first time over $3.21 trillion. Indian stock market achieved its boom, months after the march crash of 2020. Most of the Indian stock market trading are taken place in the Bombay Stock Exchange (BSE) started in 1875 and the National Stock Exchange (NSE) started in 1994. Sensex the market index of the BSE is the oldest index of the world. The BSE was established by a cotton merchant Premchand Roychand. And the Indian Stock market reacts very well to the government body that comes in power every after four year, for example the Sensex falling in 2004 after the Congress government came into power witnessed a downfall of 11.14% and in the contrary the stock market witnessed a rally in 2014 after the Bharatiya Janata Party (BJP) came into power had hit record highs. Over the past 20 years the Nifty and Sensex has given well over 14% CAGR returns.

VI. ECONOMIC GROWTH OF INDIA 2022 AND THE INDIAN STOCK MARKET

The Indian economy started to stabilize in 2022 after the covid hit. The Indian economy expanded 4.1% year-on-year in the first three months of 2022, which was slightly higher than the forecasted 4% but least due to the rise in Omicron virus and its fears. Resulting in the increase of energy prices and so strained the ongoing supply chain. A slowdown in mining and quarrying 6.7% and communication 5.3% in respect to the Quarter 4 0f 2021. On the consumption side the household spending slowed sharply to 1.8% vs 7.4% in the quarter 4 of 2021. This may be due to the fear of the return of covid, people are agitated towards spending. The Indian economy may face a burden as the global economy is only projected to grow by only 3.1 % in 2022. Where the global inflation is projected to reach 6.7% in 2022 twice the average a decade ago from 2.9%. The rise in prices of food and energy will constrain the growth of the economy. Moreover the projected growth of the developed nations like the United States of America and the China shows a lower economic growth. Mainly because of the Russia – Ukraine war, the growing covid-19 cases in China and mainly because of the rise in inflation. All these factors will definitely affect the growth. But the main question is, will there be a recession in the coming future? And if, will the stock market will witness a downfall? It's highly debatable whether the stock market will be affected because for the last two years the Indian stock market has been working completely opposite accordance to the economy. The Indian economy was at its lowest during the 2020 and 2021, still the stock market was breaking record highs. It is well recognised that stock markets influence economic activity through the creation of liquidity. Liquid financial market which was an important enabling factor behind most of the early innovations that characterised the early phases of the Industrial Revolution. The factors which will definitely form a barrier in the economic growth are the rise in inflation all over the world, volatile interest rates, the China-Us trade will affect the supply chain. Considering all of the above reason the foreign portfolio investors (FPI) are pulling out their capitals from India stock market. They pulled out 1.65 lakh crore Rupees by the end of April 22 and by the end of May they pulled more 25,000 crore Rupees. Their retreat will definitely affect the stock market due to high liquidation in a short period of time. More over the capitals (fundings) by the foreign venture capitalist are slowing down by the end of April to the startups in India. All these factors may result into a downfall or correction in the stock market by the end of 2022.

VII. INFLUENCE OF THE INDIAN ECONOMY IN INFLUENCING THE STOCK MARKET

The role of economy of a nation can widely effect the growth of the stock market of that nation and its connected nation. But the role of the stock effecting the economic growth is debatable. It can well be said that the economy effects the stock market under various situations. The Securities and Exchange Board of India (SEBI) is the regulatory board of the stock market.

A. *Inflation:*

Inflation in an economy can variedly affect the stock market. Inflation results in the increase of prices of goods and services. The annual inflation rate in India increased to 7.79% in April of 2022, the highest since May of 2014. Whereas the Fixed Deposits rate of State Bank of India provides an interest rate of 2.90% to 5.50% and for the senior citizens 3.40% to 6.30 % in 2022. Since and the rates of Fixed Deposits are low people tend to move towards more to the stock market. Where the Indian Stock market has provided the investors with well over 10% returns over the years. Because of this, the stock prices started to rise as the demand increases. Now we can also look at the other side of the picture. Because of the lucrative returns of the stock market, people generally invest there. But if the Reserve Bank of India (RBI) increases the interest rates of the Fixed Deposits, there would be a great shift among the investors. The investors many shift their money from the stock market to the Fixed Deposits and other debt free instruments which are risk free. As the investors may not risk their capital for any losses. Therefore there must be a downward movement in the stock market.

B. *Elected Political Party:*

Having a strong government body leads to stable economic growth. Increase in the government consumption can contribute to the economy. The belief that masses put in a governmental body is seen on the stock market. For example: The equity market on May 16, 2014 the Indian equity indices Sensex and Nifty hit a record high and the Sensex crossed the level of 25,000, in the similar fashion Nifty closed at its highest as it was known that Narendra Modi would be elected as the next Prime Minister of the nation. It infused hopes among the investors that the newly formed Bharatiya Janata Party (BJP) would fast track reforms and accelerate economic activity. As again a similar trend was seen as the market hit a record high again after the 2019 election win of Bharatiya Janata Party (BJP). And same can be considered after the 2009 election after Congress won the election and the Sensex jumped to 17% within 2 months.

C. *Employment:*

Employment is also a signal of the stock market. As a business grows it becomes more robust. The revenue, cash flow and profit margin of the business increases. With that increases the profit the general reserve of that business increases too. The hiring spree of that business increases. As a result, the business hires more employees. Eventually the stock of that business increases as the investors expects the business to grow more in the future. The stock of that business rallies and vice versa. The stock market reaction to unemployment can be understood as the masses loses job. Their financial constrains allows them to liquidate their investment portfolio. They liquidate their stocks, which will create a downward trend in the stock market.

D. *Crude Oil:*

Crude Oil prices does have a definite impact on the stock market. When the prices of the crude oil increase's the cost of input factors and cost of manufacturing increases. It affects the profit margin of the company as the profit margin of a company decreases. Which affects the stock price of that company and vice-versa. It also leads to the growth of inflation of the country's economy. It affects the spending of the people and people tend to spend less and save more. Therefore people invest less money on stocks. The whole stock market may not be affected by the increase in price of oil. But some heavy oil dependent companies may be affected adversely. Companies of airline sector, oil refinery sector, logistic sector etc.

The effect on Indian Stock market returns on increase in Crude Oil prices in India

Year	Crude Oil Prices	Sensex Annual Rolling Returns
2016	46.17	-9%
2017	47.56	17%
2018	56.43	11%

E. *Currency Fluctuation:*

The fluctuations in the currency rates affects the nation in various ways. A weaker currency affects the import of a nation as because the import becomes very expensive but on the contrary the export becomes cheaper overseas. The currency fluctuations can contribute to a nation's trade deficit or trade surplus over time. India is trying to reduce its imports from other nations by introduction policies like the 'Atmanirbhar Bharat' to promote home grown products. Which would even be exported to other nations over time. Indian largest imports are being done with the United States of America and China. With the weakening of its currency the nation has to pay more for the same amount of goods which will result into a severe wealth flow and increase in inflation. Which would affect the nation's stock market as many people would be fearful and not invest in stock market and vice-versa.

F. *Gross Domestic Product (GDP):*

The GDP of a nation is the total value of goods and services produced during a specific period of time. It is a potential indicator of the health of a nation. It shows the growth rate and the contraction of a nation's economy. The GDP of India affects the stock market. It is a sign to tell the investors that the nation's economy is growing and showing healthy results. The GDP of a nation shows long term vision. The Indian GDP has been growing steadily over the years (2010-2018) until the arrival of Covid-19. The steady growth in the economy ensures investors a brighter future for India, where they can invest and receive better returns than bonds or fixed deposits. This will create much more liquidity in the stock market and provide companies with much more capital which will be beneficial for the economy in the end. The positive growth will ensure other investors to take part in the stock market as well.

G. *Repo Rate:*

Repo rate is the change in interest by the Reserve Bank of India (RBI) when the commercial banks borrow for a short period of time from them by selling their securities to the central bank. Change in repo rate has an inverse relation with the stock market. The increase in repo rate strains companies to limit their ability to take loan due to high interest rates, which prompts companies to also cut back on spending on the expansion. It leads to a dip in growth and affects the profits and future cash flows, resulting in fall in stock prices. An increase in interest rates means an increase in savings and a reduction in the flow of capital to the economy, which results in slump in stock markets. BY the mid of 2022, Government of India increased the repo rate by 50 basis points to 4.9%. The Indian stock market on 8 June 2022 opened with a positive trend and slowed down towards the end of the day. As the Indian stock market showed unpredictable trend after the start of the Russia-Ukraine war. It would not be wrong to predict that the investors are confused about the understanding of the stock market in 2022. Though increase in the repo rate would eventually put a halt in the rising inflation, which would be a healthy environment for the Indian stock market in the long term.

VIII. CONCLUSION

Stock markets are one of the indicators of the economy and the potential of the economy also defines the performance of the stock market. All the factors of economy such as the interest rates, consumer spending, business investment slowdown affects the economy, which also affect the working of the stock market. Economy acts as an indicator of the stock market because a slow performing economy creates fear among investors which restricts themselves to invest in the stock market. Even though the economy doesn't completely affect's the rise and fall of the market, other factors like the fake news and sudden changes in policies with a vision for short term effect also affects the short-term trend of prices. We all can summarise that psychology and speculations of the traders affect the short-term movement in stock prices which are generally not justified. But in the long-term; Inflation, Gross Domestic Product, Political Party in power, Employment and Unemployment rates, crude Oil Prices, Currency Fluctuations, Repo Rates etc. are several economic factors which influences the ideology of investors.

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