Dynamic Relationship Among Stock Prices, Exchange Rate and Net FII Investment Flow in India

- *K N Badhani*

This study examines the long-term and short-term relationship among stock prices, Dollar-Rupee exchange rate and net FII investment in India using monthly data from April 1993 to March 2004. The Johansen's Cointegration Test shows long-term relationship between FII investment flow and stock prices, and between FII investment flow and exchange rate. However, no long-term relationship is found between exchange rate and stock prices. The Vector Error Correction Model (VECM) shows that the exchange rate long-term Granger causes FII investment flow, not vice versa. The same results are obtained using Toda-Yamamoto Procedure. It suggests that FIIs use positive feedback trading in respect to exchange rate. Bi-directional long-term causality is found between FII investment flow and stock prices, which is consistent to the 'base-broadening hypothesis' and 'positive feedback trading hypothesis'. However, no short- term causality could be traced out between above two pairs of variables. A Vector Auto-Regression Analysis (VAR) shows that the short-term causality runs from change in exchange rate to stock returns, not vice versa. The traditional Granger Causality Test (with Engle-Granger Error Correction Model) also confirms the above findings.

Brief Articles, Notes and Comments

Forex Reserves – Issues and Challengeste

- *Arya Kumar, P Raghavan*

Indian economy was at critical juncture in 1991 as regards the foreign exchange reserves position was concerned. It was the same time when the economic conditions per forced policy planners to initiate the process of liberalization and globalization. However, subsequently as a result of policy initiatives taken has resulted in India’s foreign exchange reserves to grow from a low level of $5.8 billion in March 1991 to $141.5 billion as on March 31, 2005.

An analysis of the Balance of Payment (BOP) after economic liberalization shows that in the recent years, India’s current and capital account surpluses have led to an accumulation in the forex reserves level. More specifically, the growing invisible receipts (especially because of the increasing contribution from service sector exports and the remittances from the NRIs) along with the increasing capital inflows have led to the growth in the forex reserves level. The paper attempts to build a model for estimation of foreign exchange reserves in the future and the implications as also the challenges that have been posed to the Indian economy as regards effective deployment and utilization of foreign exchange reserves are concerned.

Bank Credit Flow Performance in India : An Evaluation

- *Arabi U*

Keeping in view the alternative sources of finance and its role in economic development in India, the present study aims at evaluating bank credit role and how it is channeled to the different sectors in India in recent years. It is observed that although the importance of bank credit in the conduct of monetary policy waned in some advanced economies during the 1970s and 1980s, subsequent developments have led to a renewed focus on the behavior of credit conditions and credit aggregates.

While credit conditions are believed to reinforce the traditional interest rate mechanism of monetary transmission, sharp increase in credit aggregates are viewed as containing lead information on a possible banking crisis. In recent years developing economies including India are progressively moving away from micromanagement of credit towards permitting interest rates a greater role in credit allocation. Further, as the rate of economic growth of such economies also depends on the extent of progress made in the financial sector besides the availability of credit facilities and the credit flow mechanism operating simultaneously, the role of bank credit flow and its performance effect need to be carefully examined so as to measure the relationship between the bank credit (finance) and overall economic performance made.

Thus this paper is an outcome of an attempt to understand the effective performances of credit delivered to different development sectors which are based on secondary data and keeping in view the recent developments in the banking sector reforms. The research paper also deliberated the analysis on the bank credit to the various sectors like, agriculture, small scale industries (SSIs), micro finance, housing finance, infrastructure lending, Government. The issue of limitations to credit availability and flow to various sectors of the economy also focused with an intention to derive a few policy implications on the nature of interrelationship between the bank finance (credit) and the economic growth that has seen so far. Thus, the findings finally shows the need to make and further liberalize the interest rate structures to ensure efficiency in financing the credit to core sectors which in turn will contribute for growth in India.

Book Review

Telegraphic Reviews

Booknotes