CHAPTER 3

INDIAN CAPITAL MARKETS: AN OVERVIEW

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3.1 INTRODUCTION

A country's financial system is critical to its economic development. It acts as a conduit for resources flowing from people who save a portion of their income to those who invest in productive assets. It mobilises and effectively allocates a country's limited financial resources. Any country's economic development is contingent on the existence of a well-organized financial system. A financial system is a sophisticated, well-integrated system of financial institutions, markets, instruments, and services that permits the effective and efficient transmission and allocation of cash. It is the financial system that provides the required financial inputs for the production of products and services, ultimately assisting in the promotion of a country's people's well-being and level of living.

The financial sector is considered to play a significant influence in promoting and stabilising an economy's growth. A well-functioning financial sector mobilises savings and distributes them efficiently across the economy's many sectors. Developed countries have stable financial systems that provide services that contribute to their economies' growth. Jha & Longjam (2006) attributes finance's importance to the economy's growth to three important areas: (a) mobilising savings, (b) allocating capital funds, and (d) risk transformation. According to empirical studies, countries that have an advanced financial systems grow quicker than countries with less developed financial systems. Many studies have demonstrated a positive link between financial sector expansion and economic growth (Goldsmith, 1969; King and Levine, 1993). The importance of financial systems in capital formation cannot be overstated. It goes without saying that substantial capital generation is critical for rapid and stable economic growth.

The chapter is further divided into three section. The first section discusses the structure of financial system, the second section discusses the relationship between financial development and economic growth. The third section presents the history of the two major stock indices of the country viz, Bombay stock exchange and National stock exchange along with the trend of price movements of the broad market indices of the two major stock exchanges over a period of time.

3.2 STRUCTURE OF INDIAN FINANCIAL SYSTEM

Establishing the organisational structure of financial markets is critical for determining the market's limitations and potential in terms of efficiency, integration, and stability. The credit market, money market, foreign exchange market, debt market, and capital market are the primary financial markets in India. Until the early 1990s, most financial markets were characterised by price controls on financial assets, limits on flows or transactions, entrance hurdles, poor liquidity, and high transaction costs. These features hampered market developments and the efficient allocation of resources channelled through them. In the early 1990s, financial sector reforms were launched with the goal of transforming the structure, efficiency, and stability of financial markets, as well as bringing them together. Introduction of free pricing of financial assets in almost all segments, relaxation of quantitative restrictions, removal of entry barriers, new methods of floatation/issuance of securities, increase in the number of instruments and enlarged participation, improvement in trading, clearing and settlement practises, improvement in informational flows, transparency and disclosure are some of the important structural changes enabled by financial sector reforms. By allocating resources and producing liquidity for businesses and entrepreneurs, financial markets play a critical role in facilitating the smooth operation of economies.

Financial markets can be categorized into four categories by virtue of nature of claim, maturity of claim, timing of delivery, and organisational structure. The equity and debt market fall under the category of nature of claim viz, fixed claim and residual claim. Secondly, the time period is significant when making an investment since the quantity of money invested is determined by the investment's time horizon. The time period also influences the risk profile of the investment. When compared to a longer-term investment (capital market), a shorter-term investment (money market) carries a smaller risk. Capital market is further categorised into primary (IPO) and secondary markets (or stock markets). The cash and future market based on time of delivery is another type of financial market. Finally, the exchange traded market and over the counter market are the types of market with specified organisational structure.

The Indian financial market has had a remarkable decade in many ways. The amount of money raised from the market has increased substantially, as has the number of stock exchanges and other institutions, the number of stocks listed, market capitalization, trading volumes and turnover on stock exchanges, and finally the number of investors. Investors, issuers, and intermediaries have all altered dramatically as a result of this expansion. Several institutional changes have occurred in the market, resulting in considerable reductions in transaction costs as well as major gains in efficiency, transparency, liquidity, and safety. We'll begin by looking at the history of India's two most significant stock markets, the Bombay Stock Exchange and the

National Stock Exchange. Following that, the trends of various stock exchanges' benchmark indices are discussed.

3.3 RELATIONSHIP BETWEEN THE FINANCIAL SYSTEM AND ECONOMIC GROWTH

Economic activity and growth are aided by a well-functioning financial system. The three major activities of the financial system, namely the mobilisation of savings, capital allocation, and risk management vehicles, are critical to the economic growth process. The primary drivers of economic growth are financial markets, institutions, and instruments. A country's financial system directs the country's savings to more productive uses. It contributes to a growth in the economy's production. The mechanisms used by different financial systems around the world to carry out their functions differ. It might operate through banks or financial markets. As a result, economists have divided financial systems into two types: bank-based and market-based. Germany and Japan have bank-based financial systems, whereas England and the United States have market-based financial systems in which securities markets play an important role in fulfilling financial system functions.

Through intermediaries, the financial system also aids in the acceleration of savings volume and rate by providing a diverse range of financial services and financial products. As a result, the financial system becomes more competitive, channelling resources toward the highest-return investment for a given level of risk. This reduces the cost of financial intermediation and boosts economic growth. A comprehensive financial system reduces the cost of innovation and increases its profitability, allowing for faster economic growth. Financial markets are the backbone of the financial system, contributing to its stability and resilience. A well-developed money and government securities market aids the central bank in effectively implementing monetary policy using market-based tools. A balanced financial system, in which financial markets and financial institutions play key roles, requires well-developed financial markets.

Financial markets, which serve as a link between the domestic and international financial systems, aid in improving capital flow which helps to accelerate economic growth by reducing risk through portfolio diversity. Economic progress prepared the way for debt financing and equity markets for raising foreign finance, according to findings by Gurley and Shaw (1955) and Goldsmith (1969). Their research suggests that as economies evolve, the needs of both customers and producers of financial services shift. According to the studies, informal finance becomes less relevant when self-financed capital investment gives way to bankintermediated debt financing and then to the introduction of equity markets as supplementary sources of external funding.

King and Levine (1993) investigated the empirical relationship between a variety of financial development indicators and economic growth. Four indices of financial development and four indicators of growth were developed in the study. The ratios of (I) liquid liabilities to GDP, (ii) claims on the non-financial private sector to total domestic credit (iii) ratio of claims on the non-financial private sector to GDP, and (iv) deposit money bank domestic credit divided by deposit money bank plus central bank domestic credit were used as indicators of financial development. Real per capita GDP growth, the rate of physical capital accumulation, the ration of domestic investment to GDP, and a residual measure of gains in physical capital allocation efficiency were the growth indicators. The study discovered that measures of financial development are highly linked to growth, the pace of physical capital accumulation, and improvements in capital allocation efficiency. Levine and Zervos (1996) used the size, liquidity, and risk diversification of stock markets to investigate whether there is a link between stock market development and long-run economic growth. The study's key finding was that stock market growth is positively related to economic growth. However, the study did not look at the influence of stock market volatility on economic growth.

Though there are numerous indicators of financial sector development and a wide range of stock market development indicators in the literature, it is difficult to discover a "single indicator" that can be used to directly measure the development of the financial sector or stock market.

3.4 HISTORY AND TREND OF BOMBAY STOCK EXCHANGE AND NATIONAL STOCK EXCHANGE

The stock market in India has vast and a rich history. Trading can be traced back to the 18th century when the East India Company traded in loan securities and some corporate shares of the bank as well as cotton presses during the 1830s in Bombay and Kolkata. The majority of trade was done in shares, debentures, and bonds establishing rights to assets or guarantees to pay certificates issued on the precondition of transfer from one organisation to another, as stockbroking was not very widespread at the time. Trading in corporate securities began in the 1850s as a result of the passage of the Firms Act, which established joint-stock organizations with limited liability. Besides, as a result of the American civil war (1860-61), the cotton industry experienced a boom in cotton exports to Europe which brought in a lot of gold and silver. This encouraged new ventures, while banks started following a reckless lending policy giving rise to a stock market boom. However, as the war ended, it had a disastrous impact on India and the market experienced its first shock. On the contrary, the crash led to an establishment of a liquid market structure by the formation of formal institutions.

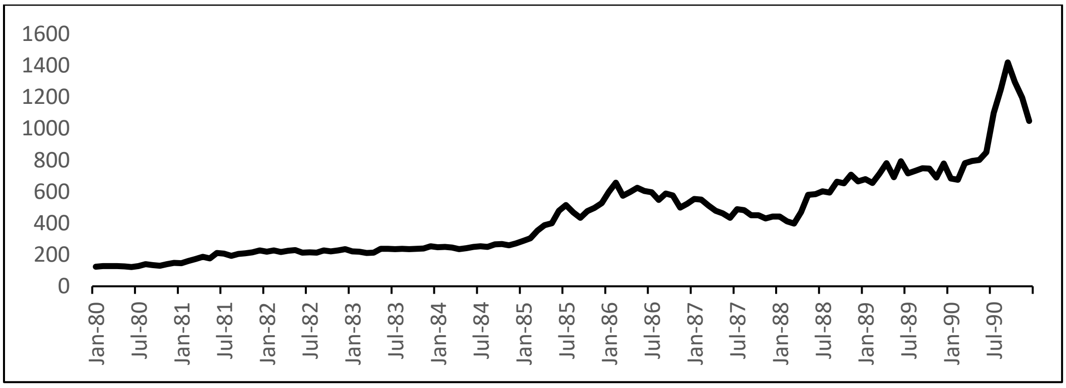
Meanwhile, during the same period, the simple and informal gathering started under a banyan tree opposite Mumbai Town Hall during 1850's where 4 Gujrati and a Parsi man started trading in cotton. As the group grew because of the 'share mania' an association was formed called "The Native Share and Stock Broker's Association". This led to the formation of the first official stock exchange renamed as the Bombay Stock Exchange in 1875. Situated in Dalal street. BSE is the oldest stock exchange in Asia and the first to be granted permanent recognition under the Securities Contract regulation act, 1956. The founder of the Bombay Stock exchange was an influential trader also known as the cotton king of Big Bull. He had provided certain rules and regulations that are still followed.

Later on, many regional stock exchanges were developed to support trade and business carried out in their area. For instance. In 1894, Ahmedabad Stock Exchange was developed to support the textile mills by dealing in shares. Similarly, in 1908 Calcutta Stock exchange was formed to enhance the market of shares to support the plantations and jute mills followed by the Madras Stock exchange in 1920.

Since independence, the Indian economy has been through a myriad of crises due to internal as well as external factors that have created havoc in the economy. The inward-looking/oriented strategy of development during 1951-1990 led to a grave economic crisis that erupted in the late 1980s & culminated in mid-1991. The 1960s decade was engulfed with two wars, two droughts, and deaths of two prime ministers followed by a decade of reforms in the banking sector, coal industry, curbing the growth of monopoly via the MRTP act. Despite the fact that the economy had severe structural issues, India had a developed equity culture, with four functional stock exchanges, clearly defined regulations regulating listing, trading, and settlement, and 1119 listed businesses with a market capitalization of Rs 971 crores. It also had better corporate laws and financial system than other developing countries. However, the financial sector's function in terms of providing incentives for saving and capital accumulation, as well as mobilisation and allocation of funds, was restricted during this time period. Moreover, since the interest rate structure was administered credit in the industries depended less on shares, debentures; while, the credit provisions by the banks were also low (Jalan,2002).

The Capital Issues (Control) Act of 1947, the Securities Contracts (Regulation) Act of 1956, the Companies Act of 1956, and the Foreign Exchange Regulation Act (FERA) of 1975 were all enacted in the 1950s and 1960s, addressing various sectors of the securities industry. The passage of FERA permitted several well-managed international corporations to offer their stock to the public, encouraging more domestic public limited corporations to do the same. The BSE was recognized by the government of India in 1957 under the Securities Contracts Regulations act, whereas Sensex was launched in 1986 followed by BSE National Index in 1989. BSE Sensex which is S&P Bombay Stock Exchange Sensitive Index is based on a free-float capitalization index. It consists of 30 well-established and financially sound companies. These companies which are listed on the index are representative of their respective industries. The performance of the index is shown below in figure 1 from January 1980 to December 1990. Here, it can be seen that the market was quite stable until 1984 after which it experienced ups and down until 1990.

Figure 3.1: BSE Sensex (1980-1990)



Source: Historical data of Sensex from Bombay stock exchange website

3.4.1 The 1990s

In the wake of the 1990s, India experienced an external payment crisis and devaluation of the rupee in two stages, for which the government set up a committee to suggest reforms. This committee came up with various infamous reforms in support of marketization, liberalization, and privatization among others forming a New Economic Policy. It had a deep-rooted impact on the stock market which had already shown an upward trend by the end of 1980 as depicted in figure 1. In 1995, the trading of BSE was taken online and it underwent its first major revamp.

The market grew to 1000 points in July 1990 and 4000 after the introduction of various liberal economic policies. This was the first time a source of higher earnings was realized by the investors as compared to other forms of investment. It led to further widening and deepening of the capital markets especially during the period from 1980 to 1992. This phase also saw an emergence of debentures as powerful instruments followed by public sector bonds and the mutual funds market. All of this resulted in the stock market expanding dramatically in terms of the number of exchanges, listed businesses, and market capitalization. Following that, the Securities and Exchange Board of India (regulatory body), CRISIL, CARE, and ICRA (credit rating agencies), OTCEI (screen-based stock exchange), mutual funds, and venture capital all emerged in the 1990s.

3.4.2 The reforms period

Several committees were established for the development and working of the capital market, including the Committee on the Organization and Management of the Stock Exchange, 1986; the Working Group on the Development of the Capital Market, 1989; the High Powered Study Group on the Establishment of a New Stock Exchange, 1991; and the Committee in Trading in Public Sector Bonds and Units of Mutual Funds, 1992. These committees recommended various reform measures to streamline the stock market's operations. Although there were inefficiencies in the market's functioning, particularly because the Bombay Stock Exchange (BSE) monopolised the Indian stock market, as well as in clearing and settlement procedures. To address this, a number of governmental efforts aimed at improving the stock market's structure and operations were implemented. The Securities and Exchange Board of India Act, 1992, gave the SEBI statutory status, allowing private financial institutions to establish mutual funds and foreign institutional investors to play an active role in the stock market; the National Stock Exchange was established in 1993; the Depository Act of 1996; and amendments to the Securities Contracts Regulation Act, 1956, which allowed futures and options to be introduced.

NSE was recognized as a stock exchange in 1993 and the next year it launched its electronic/screen-based trading in equity and debt market segments. The benchmark index of NSE, Nifty50 consisting of 50 companies was launched in the year 1996 which covers 14 sectors of the Indian economy. It is a free-float market capitalization-weighted index just like Sensex and the base value set in the year 1995 was 1000.

The 1990s decade witnessed two stock market booms one 1992-93 and the other in 1999-2000. The first occurred as a result of liberalisation, when enterprises discovered that it was cheaper to raise funds through the stock market; however, this did not continue long as investors understood that such prices were overvalued. Furthermore, a series of scams and malpractices eroded public faith in the stock market, which was exacerbated by the Mexican and South Asian crises. The second boom was due to the Information Technology boom in 1999. It led to an increase in the percentage of market capitalization in GDP. In the meanwhile, during the same decade, the market experienced three scams. The first fraud was perpetrated by Harshad Mehta in 1992, the second by the UTI debacle in 2000, and the third by yet another broker called Ketan Parikh in 2002.

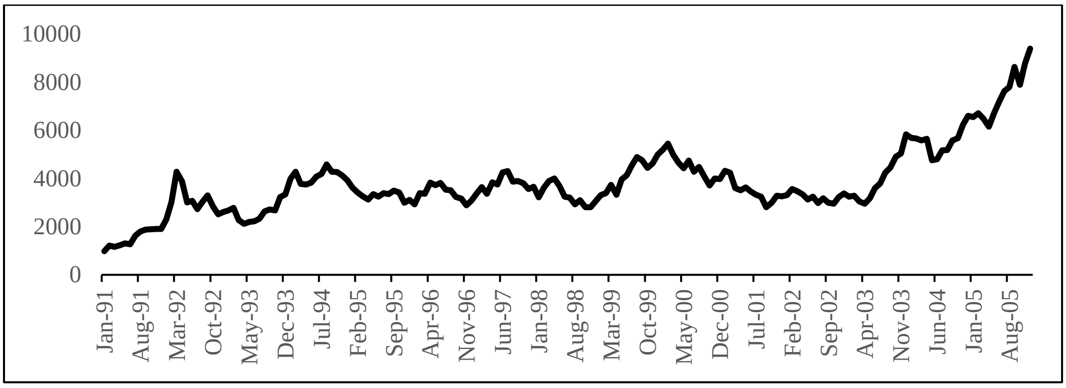
The first scam was carried out by stockbroker Harshad Mehta and some bankers by issuing fake bank receipts and taking advantage of market loopholes to drive the prices of the stocks up to 40 times the original prices. When the scam was uncovered in April 1992, the Indian stock market collapsed from 4500 to 2500 with the loss of INR 1000 billion in market cap and the banks involved in the fraud fell into humongous debts. This systematic stock fraud was the biggest stock market scam ever committed in India.

The formation of NSE and SEBI to monitor, regulate, develop the functioning of stock exchanges was as a result of the scams. Apart from this, there were many structural changes in the equity market as well as banks. The operations of the BSE and NSE shifted to electronic mode with the online trading & dematerialization which poised enormous advantages to the investors from ease to trading to transparency crisis during the Asian currency. Moreover, because of the reforms of 1991 such as stringent capital flows, weak economic linkages with affected countries, and the stabilization policies in the foreign exchange market and monetary policy the Indian economy was insulated from the crisis. Therefore not much was felt by the stock markets. Both the exchanges grew with a few corrections owing to the booming information technology and rally in infrastructure.

The figures below represent the fluctuations in the indices during the 1990s decade up until 2005. The crashes and the booms are clearly visible especially after 2000 owing to the information technology revolution. Thus, in order to improve market efficiency, enhance transparency, prevent unfair trade practices, and raise the Indian securities market standard at par with that of the international market a series of reforms were undertaken during the initiation of the financial liberalization program in 1992. The main goal of the reforms was to make significant changes to the Indian financial markets' regulatory, institutional, and operational frameworks. The reforms include:

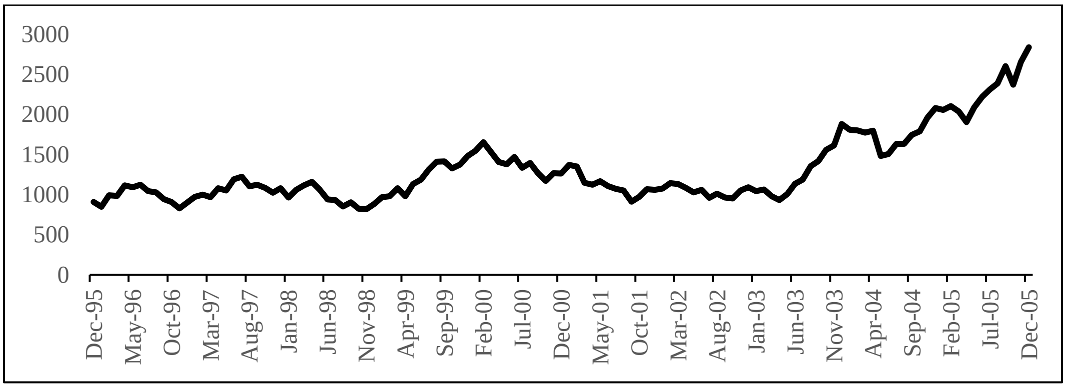
1. Formation of SEBI as a statutory body
2. Introduction of screen-based trading
3. Involvement of Foreign Institutional Investment
4. Introduction of the depository system
5. Derivative trading
6. Demutualization of stock exchanges
7. Mechanism of risk management and investor protection
8. Rolling settlements
9. Reduction in transaction cost

Figure 3.2: BSE Sensex (1990-2005)



Source: Historical data of Sensex from Bombay stock exchange website

Figure 3.3: NSE Nifty50 (1995-2005)

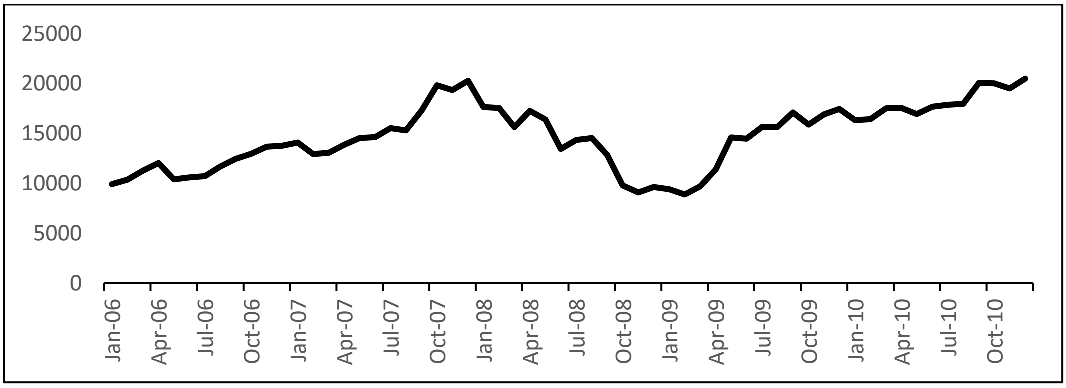


Source: Historical data of Nifty50 from National stock exchange website

3.4.3 Global recession

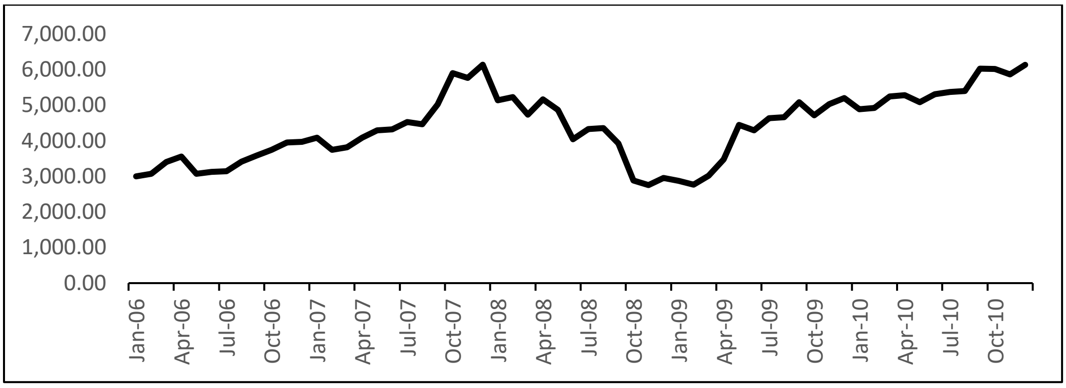
By the 2000s, Sensex rose to 6000 owing to the information technology boom and continued to rise to 2000 in 2007 as a result of an increase in foreign institutional investors. Another blow to the market was felt during the Global recession when the market fell significantly and could reach its 2007 value i.e. 20000 points in 2019. Nifty50 grew at 6000 points during January 2008 after which it fell drastically owing to the global recession as shown in the below figure.

Figure 3.4: BSE Sensex (2006-2010)



Source: Historical data of Sensex from Bombay stock exchange website

Figure 3.5: NSE Nifty50 (2006-2010)



Source: Historical data of Nifty50 from National stock exchange website

Various factors influence the prices of the stock indices. These are from specific industry-specific and economics specific. Economic factors that affect the markets are the macroeconomic variables, policies, and natural or manmade calamities. Apart from economic factors, political factors play a vital role in affecting the market and one of the very common instances is elections. During the 2004 election coma which was won by the National Congress lead the markets by almost 15%. It was the largest fall in the history in terms of percentage in those times. After the incident, the market corrected itself and continued to grow until the effects of the global recession started flowing into the economy.

The global recession was the most severe economic and financial meltdown which shook the world at different scales and timings. It began in 2005-06, when the US housing bubble burst, resulting in a drop in property values and, eventually, people abandoning their mortgages. Consequently, the investment banks that possessed the mortgage-backed securities collapsed, and this phase of 2007-08 was known as the subprime mortgage crisis. The crises also led to a tremendous fall in the stock markets around the world and the flow of international trade was disrupted. Since India is highly integrated with the US, therefore, the effects of the crises were also felt in the Indian stock markets.

The series of falls started in 2007 until it accentuated in early 2008 where trading had to be stopped for two consecutive days. After reaching the day's circuit on 21st and 22nd January the fall continued for the rest of the year attributable to large sales by FIIs, and withdrawals of money by the insurance sector. Gradually, as the recession East out from the western countries, the FIIs started flowing back into the market and eventually regaining their position.

The crises had not affected India as much because Indian banks and financial institutions had almost entirely avoided buying the mortgage-backed securities. This was the major factor along with others that cushioned the shock on the Indian economy.

3.4.4 Taper Tantrum

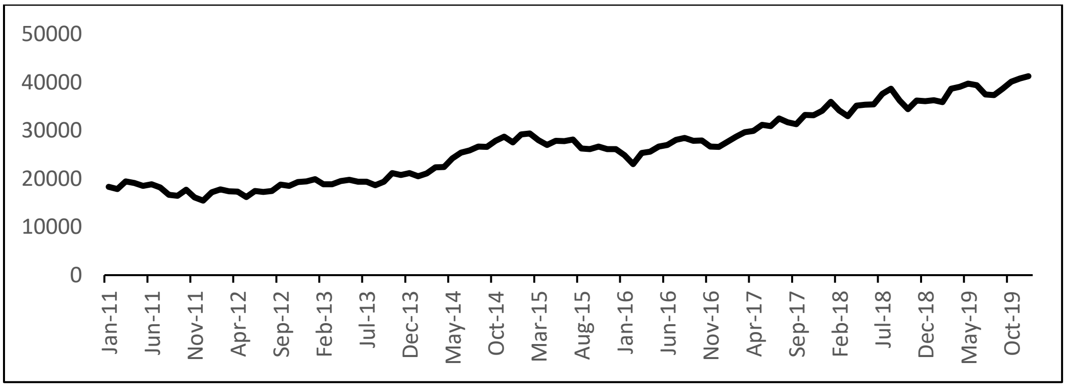
The global recession sucked a lot of liquidity out of the US economy, and thus Federal Reserve initiated Quantitative easing to pump liquidity by purchasing longer-term securities like Government securities and other securities from the open market. Eventually, when the economy started looking good the Fed decided to reduce the quantitative easing which did not go well with the investors and they went into a selling spree. The side effect of quantitative easing was felt worldwide especially, in the emerging markets which received the maximum capital inflows.

It had a huge impact on India's fiscal deficit as well as on the stock exchanges. However, the markets got back to their feet sooner. Indian currency saw a high depreciation. In the year 2015, when the Chinese economy faced a slowdown and the Shanghai stock exchange fell by 805%, its effect was felt in the Indian economy when our exchanges also registered a fall in the market. this could be also due to disappointing earnings in the first quarter for many Indian industries complemented by a below-average rainfall. The events of crashes in the market continued for consecutive the year following global factors and weakness accompanied with higher NPAs in the Indian banking system. At the same time, there was also a huge sell out in the foreign constitutional investors along with the fall in crude oil prices globally.

In the same year, in November there was frantic selling in the market due to demonetization drive by the Modi government. This was also coupled with the weakening of the rupee and the US presidential election with the victory of Donald Trump. Since these events, markets have reformed themselves with a few corrections and achieved heights. Although the year 2018, was marked with uncertainty in the tariff, federal reserves, interest rate hikes inflated company earnings and tax cuts gained record high since 2013. The economy saw an unforeseen boom in the textile sector and the US economy's moderate pace of expansion set an optimistic run in the market among other internal factors. It was expected that in the next year economic growth will continue, especially with diminishing tariff pressures, recession fears will dampen with growth in stocks and the market would be boosted by more stable economic growth. On the contrary, the year 2020 was every bit of a wild dream recording the fastest fall in the global stock markets in financial history. It is regarded as the most devastating crash since the Wall Street crash in 1929. The crash was because of the coronavirus pandemic which led to a nationwide shutdown for most of the year. All the economic, productive activities were put at a halt which caused a frenzy in the market.

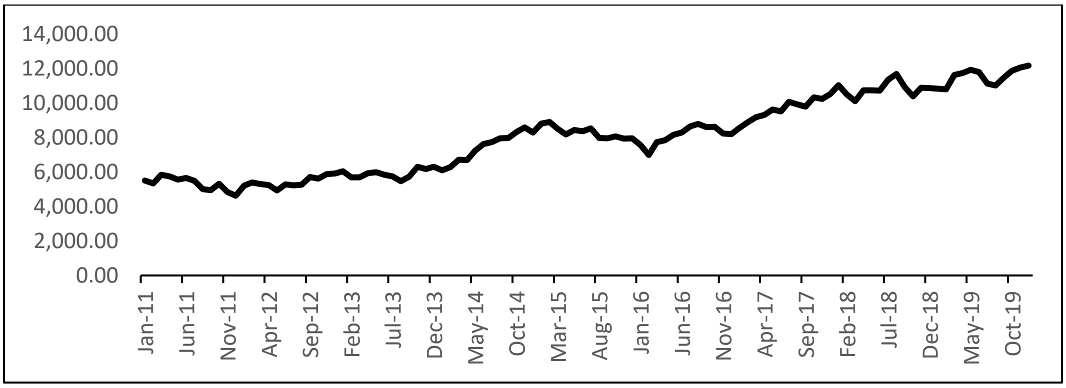
The entire period from 2011 to 2019 is depicted in the figure below which highlight the fluctuation in the markets. The effects of taper tantrum on the Indian market can be seen during 2013 after which both the indices grew steadily. It was only in 2016 that we see a dear fall in the indices owing to oil price concerns, slow growth in China and Fed interest rate policy that created a short term uncertainty in the market. However, looking forward, there was an improvement in the movements of the prices which kept on rising with a few hiccups until 2020.

Figure 3.6: BSE Sensex (2011-2019)



Source: Historical data of Sensex from Bombay stock exchange website

Figure 3.7: NSE Nifty50 (2011-2019)



Source: Historical data of Nifty50 from National stock exchange website

3.4.5 The pandemic

The Indian economy was already going through a tough time last year with its real GDP growth being the lowest in six years and to make the matters worse the outbreak of COVID-19 posed fresh challenges for the economy in terms of higher uncertainty and fear of global recession. The shock of COVID-19 was severe compared to the financial crisis in 2007-08 and the rapid spread of the disease had a dramatic impact on financial markets all over the world.

As the COVID 19 spread from a regional crisis to a global pandemic, it not only affected economic activities and production but also impacted financial markets worldwide. Equities plummeted and market volatility shot upwards the world over. In the United States, the stock market hit the circuit breaker mechanism four times in ten days and the volatility levels had surpassed those last seen in December 2008, October 1987, and early 1930s. While the U.S. market fell 14% and the European market fell 20%, China where the virus originated fell just 3% from February to April. Therefore, the governments across these countries had initiated fiscal and monetary stimulus programs to cope with the detrimental impact of the circumstances on their economies. For instance, China government announced special purposed loans to companies facing liquidity constraints and financial support to sectors hit by the virus. In the same lines, U.S. Federal Reserve cut rates to zero and followed a quantitative easing program. Alternatively, the European Central Bank announced measures to support bank lending and expand its asset purchase program while holding its rates.

Likewise, the Indian stock market hit the circuit breaker twice in March and the market fell sharply first after almost twelve years. Both the indices of the Indian stock market's – BSE & NSE benchmark indices S&P Sensex and Nifty50 saw their worst decline in March as they tumbled by 28.57% and 29.3% respectively. As a result, the pandemic caught market players off guard and produced an unprecedented level of risk in the short term. Consequently, the investors suffered massive losses in a short period of time. The long-term consequences however may see mass unemployment, business failures, and huge debt. The adverse effects are to be seen more in certain sectors like the aviation and tourism industry. In the short term, however, the actual impact of the pandemic on the international economy is unknown, with the exception of financial markets' significant changes.

To meet the crisis following from the COVID 19 pandemic, the Central bank of India, the RBI announced measures to conduct targeted long-term repo operations (TLTRO) of Rs 50,000 crore to refinance small and medium-sized financial institutions, NBFCs, MFIs to maintain a healthy cash flow. Along with these measures its infused liquidity by reducing the liquidity coverage ratio for scheduled commercial banks from 100% to 80% and reduced the fixed repo rate under liquidity adjustment facility by 25 basis points from 4% to 3.75%.

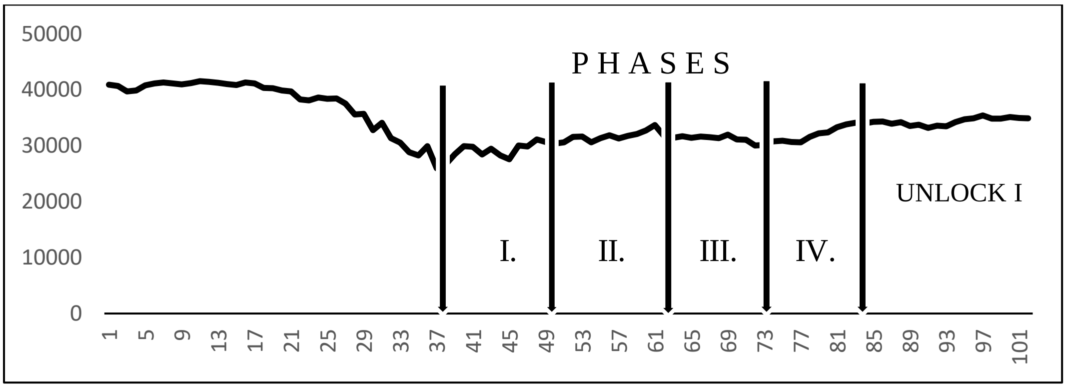
These were not the only measures taken by the RBI, there was a further reduction in the repo rate by 40 basis points in May, and the three-month moratorium on repayment of loans to the bank which was initially extended for up to three months was again extended until the end of August 2020. In conjunction with the RBI, the government of India in May 2020 announced a five-part package of 20.97 lakh crore. At as much as 10% of GDP, the package did not appear to leave any major sphere untouched as the Indian Government brought out the fiscal artillery to complement RBI's monetary ballast, putting India firmly in the league of biggies that have gone all out against the virus. This package aims at focusing on land, labor, liquidity, and laws, and deal with such sectors as cottage industries, MSMEs, the working class, middle class, and industry.

Along with the above-cited stimulus package, on March 24, 2020, the government of India under Prime Minister Narendra Modi ordered a nationwide lockdown for 21 days, limiting the movement of the entire 1.3 billion population of India as a preventive measure against the COVID-19 pandemic in India. The lockdown was placed when the number of confirmed positive coronavirus cases in India was approximately 500.

As the end of the primary lockdown, period approached, state governments and other advisory committees recommended extending the lockdown. On April 14, Prime Minister Narendra Modi extended the nationwide lockdown until May 3, with a conditional relaxation after April 20 for the regions where the spread had been contained or was minimal. On May 1, the government of India extended the nationwide lockdown further by fortnight until May 17. Accordingly, on May 17, the lockdown was further extended till May 31 by the National Disaster Management Authority. On May 30, it was announced that the ongoing lockdown would be further extended till June 30 in containment zones, with services resuming in a phased manner starting from June 8. It is termed "Unlock 1". Thus, in all, there were four phases of lockdown followed by phase unlock I.

The trends in the movement of the Indian stock markets from the time the first case of coronavirus was identified in the country are depicted in figure 1 and figure 2. The first figure shows the trend in Sensex, which is the market index for the Bombay stock exchange, and the second figure shows the trend in the Nifty50, the market index of the National stock exchange.

Figure 3.8: BSE Sensex during the various phases of lockdown (January 2020-September 2020)



Source: Historical data of Sensex from Bombay stock exchange website

Figure 3.9: NSE Nifty50 during the various phases of lockdown (January 2020-September 2020)

Source: Historical data of Nifty50 from National stock exchange website

A perusal of the above figure 3.8 and 3.9 reveals that the stock market in India reacted more quickly to the outbreak as compared to other developed countries. Investors seem to be responding not to the total number of cases as along with the increase in the number of coronavirus cases in India, and there has been a gradual recovery in the stock market viz. BSE Sensex and NSE Nifty50, especially after the end of the 3rd lockdown.

When the lockdown was imposed in the country, the Sensex and Nifty50 had already reacted and reached the lowest losing around 25 percent in March 2020. This fall was majorly due to fears over the global recession triggered by COVID-19, the highest-ever selling by foreign institutional investments (FIIs), uncertainty and lower sentiments of the investors, and the sharp decline in the U.S and European stock markets. After the imposition of lockdowns, the investor sentiments recouped, and the market marched further higher with fewer and smaller downfalls even though the coronavirus cases in the country kept on increasing from hundreds to thousands to lakhs.

The extent of the fall for Sensex as well as Nifty50 was nearly the same. This decline can further be attributed to a plunge in production, consumption, and investment activities in various sectors of the economy which were severely affected by the global fears of the pandemic and the lockdown. Among all the sectors, the worst hit was the bank, auto, consumer durables, finance, metal, realty, and information technology. However, lately, the stock markets have begun reviving. Few factors enumerated below are the likely cause for the same.

The steps taken by the Indian government in conjunction with the RBI were welcomed by the investors. Further, unlocking has put the people back to work, and green shoots are visible. Thus, monetary and fiscal actions made an enormous contribution to the market's return to normalcy. In general, central banks the world over have reduced interest rates in the recent past to soften the blow to the global economy from the coronavirus pandemic and to keep markets functioning.

The worst fears- like massive shortages of hospital beds and PPE, and an immediate "second wave" as soon as reopening began to recede. People have become comfortable looking past the pandemic, considering it one-of-a-kind and thus not fundamental. Rising optimism concerning vaccines, tests, and treatment added to investors' willingness to write off the present episode. About economic and corporate developments, investors concluded that it is heading in the right direction

FOMO (fear of missing out), seemed to take over from the prior fear of losing money, a transition that's always vital in determining the mood of the market. This has led to the return of retail investors, which has contributed to a significant rise in stock prices. This is evident with some of the irrational aspects, like the considerable gain in the stock price of some poorly performing companies.

Thus, overall, the market has witnessed the power rally at the back of positive expectations and overlooked potential negatives. Nevertheless, still, there exists a great deal of uncertainty in consideration of the continuing pandemic.

Conclusion –

The chapter discusses in detail about the structure of financial system of the country while establishing the importance of financial development for stable economic growth. It further discusses the strong relationship between financial development with emphasis on stock market development and economic growth. To elaborate on this, the movement of BSE Sensex and Nifty50 is shown from the time each were established. These movements are divided into various phases according to the economic situations prevailing in the country at that point in time. The phases as discussed in the chapter are the 1990's reforms, Global recession, Taper tantrum and the pandemic.