INVESTIGATING THE EFFECT OF ECONOMIC DETERMINANTS ON STOCK MARKET RETURNS: AN INTROSPECTION

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ABSTRACT

Similar to everything else in life, higher the risk, larger is the return. Distinct from other investment options, stock market investments are riskier but the rewards are also equally handsome and attractive. The foremost reason behind such risk is market volatility or fluctuations. By nature the stock market is exceptionally erratic. Many times for unknown reasons the shares prices can go up or come down randomly. Owing to this impulsiveness, investments in such markets are deemed to be risky proposition. Nevertheless, if time is invested in properly studying the market and its randomness in detail, rewards can be reaped substantially. The foremost step towards this is to comprehend the reasons behind stock price movements. Using step-wise regression this paper examines the impact of few macroeconomic indicators on BSE Sensex. Results suggest a model where FDI significantly influences the fluctuations in the stock market in India.

Keywords: *BSE Sensex, Stock Market, FDI, Stepwise Regression, India*

INTRODUCTION

Nearly every one of us in life, these days have countless objectives and ambitions to attain. We make efforts to make certain that we accomplish those aims. Careful financial planning remunerates us with decent returns so that items may be struck off one after another from the list of desires. Investment is believed to be one of the most important aspects of financial planning in future. With the thought that our savings will mature steadily like a well-watered plant, we put in our money in a variety of financial elements to offset inflation and to create a fund,. The most ordinary form of investment is in gold, real estate, public provident fund, mutual fund investment etc among several other investment options. There are a few assertions that such deals will be secure, although simultaneously, the expected returns are on the lesser side and hence these are typically low risk and low return investments. Nonetheless, if one is geared up to assume risks with their investments subsequently there are additional alternatives that are high risk and huge yield investment options. This merely suggests that one will get larger returns at the

cost of higher risk. Investment in the stock market is the most general and accepted way to accomplish this. The place where investors can purchase and sell bonds and shares is called a stock market. Mediators like BSE and NSE are stock exchanges that permit purchase and sale of stock. The question now is what is a stock or a share? When a company is created or established, the real owners could be that person or group of people who provide finance to the company. At this moment, if further capital is raised for the company, either for global expansion or diversification, then making their company public is one of the alternatives i.e. to offer the company to the public by asking them to buy shares of the company. People become part owners of the company in which they buy shares.

The most basic factor affecting the stock market is the forces of demand and supply. An inequality between demand and supply will increase or decrease the stock price like in case of all commodities. Supposing people have queued up to buy potatoes but there is an abrupt paucity of potato supply, then the potato price will instantly go up. Likewise, if everyone wishes to purchase a company's shares that is performing well then there will be a shortage of shares and vice versa. This leads to rising or falling stock prices of the company. If public money is involved anything that is ensuing within the company will straightforwardly have an impact on the share price of a company. Lowering debt, unbeaten product launches, rising revenue and flow of investor capital leads to increase in the stock price of the company as demand for the shares of such a company goes up. On the contrary, increasing debt, product failures, heavy losses then most of the shareholders would want to sell off their holdings thereby leading to falling stock price. Additional issues that can make stock prices fluctuate consist of mergers and acquisitions, changes in the management of the company, takeovers, etc. Investor's emotions can in addition have an impact on stock prices. The course of stock market performance is decided by the way investors invest money in the stock market. When investors take great amount of risks and invest belligerently the price of stocks tends to rise. The prices will go south if investors are more passive and restrained and prefer protection to risk. In this aspect there are two market forms: bullish market and bearish market. When investor confidence is at its high he chooses to invest aggressively. When this happens, stock prices go up flowing increased demand. This is known as a bullish market. When investor is more troubled about taking risks, losing the investment and investing with lower confidence keeping safety in mind the stock price sooner or later comes down. Such a market is called a bearish market.

The policy decisions of RBI affect stock prices directly. In India, interest rates are fixed by RBI which keeps varying at usual intervals to even out disturbances in the economy. Logically, higher the rate of interest more will be the loans that the companies will have to pay which will be followed by reduced profits. This will result in lowering of stock prices. On the contrary, falling interest rates mean increased corporate borrowings. Borrowings at lower cost are as good as saving money which leads to earning higher profit. Hence the stock will experience rising prices. One of the main issues influencing

Indian stock market is the country's political environment. The stock price will drop if the investors find the political climate ominous, government looking frail, posing war risk or if the public opinion concerning the present government is not fine. The stock price soars if the government emerges out to be sturdy with sufficient support from the public. Investors invest enthusiastically when government has aggressive developmental policies, whereas government with a frail developmental program could result in decreasing stock prices. Stock market is also affected by news and further by current events. Political uproar, civil riots, wars, terrorist attacks are examples of few such current events. These events drastically push the stock prices down and have an effect on the market instability. Floods, earthquakes and other natural calamities considerably reduce the stock price. Devastation of assets and other properties force companies to sustain huge losses that lead to fall in prices of stock. Sales drop owing to collapse in the manufacturing and transport support system. Consequently stock prices clearly descend with the occurrence of natural disasters. In addition the exchange rates between Indian rupee and other countries 'currency is one of the aspects concerning stock prices. A sturdy rupee signifies growing economy leading to higher stock prices. On the other hand, there are diverse consequences for various people in conditions where INR's performance is apprehended. With rupee moving up, Indian commodities' prices in foreign countries shoot up. This leads to falling demand, decreasing sales, increasing losses and increased exporters' suffer, pushing the stock prices to go down. However when goods are bought by importers at lower prices and their cost of production goes down it leads to increased revenue and finally upward moving stock prices. On the contrary, when the rupee grows weaker, precisely the exporters' stock price moves up, and that of importers fall. Hence, stock market investments can produce high returns in contrast to other investment options. But it also brings with it considerable risks. It cannot be refuted that calculated risks will yield substantial returns that will certainly be consistent with the risks. Timing of investment is most important factor while making investment in any market.

LITERATURE REVIEW

Variety of factors influencing the securities market can be categorized into a range of groups. Different authors attempt to outline stock price behaviour theories with the purpose of demonstrating intricacy of occurrence. Tvaronaviciene Manuela et al (2006) tested the impact of certain factors on stock prices practically. Stock prices of Lithuanian companies and few macroeconomic variables like gross domestic product, inflation, foreign direct investment, consumer price index, broad money, state budget revenue and expenditure, average profitability of governmental bonds have been used. Mondal Md. Saheb Ali et al (2010) intended to analyze effect of profitability, liquidity, dividend rate, leverage, firm size and growth on stock price of some companies listed on stock exchange of Dhaka. Qualitative factors like goodwill of the company; company announcements; market emotion; Annual General Meeting; technical influence; report given by analysts ;unanticipated situations;

international circumstances; media; publicity; amendments in government policies; political commotion have an impact on pricing of stocks. EPS; net income; dividend; market capitalization; PE ratio; ROI; merger; stock split; retained earnings; demand and supply of stock; margin loan; inflation; interest rates and exchange rates affect the stock price.

Narayan Paresh et al (2014) inspect the stock price determinants using panel data modeling techniques of few Indian banks. Granger causality test on the selected banks disclosed the causality path and sign. They found evidence of panel cointegration among stock prices, economic activity, interest rates, and exchange rates for thirteen banks. Results advocated a rise in share prices of banks because of economic activity and depreciation of currency and vice versa with an increase in the interest rate. In the long run only economic activity Granger-caused stock prices. Sharif Taimur (2015) et al identified the key factors affecting Bahrain stock prices by analyzing panel data set of 41 companies from 2006 to 2010. Variables like earnings per share, dividend yield, return on equity, dividend per share, price earnings, debt to assets, book value per share and firm size were considered for the study. Bahrain market share prices were majorly affected by dividend per share, price earnings, book value per share, dividend yield, return on equity and firm size.

Shafiqul Alam et al (2016) Md. Rubel Miah and Md. Abdul Karim spotted the major force that affects share prices in the capital market of Bangladesh. Panel data of seven cement companies listed on the Dhaka Stock Exchange (DSE) was considered for a period 2006 to 2015. Gross Domestic Production, Consumer Price Index, Earning per Share, Net Asset Value per Share, Price Earnings Ratio and Interest Rate Spread (IRS) have been found to be the key determinants of stock prices in cement industry. Fouzan Al Qaisi et al (2016) investigated twenty insurance companies listed on Amman stock exchange for factors like Return on Equity (ROE), Debt Ratio, age of the company, size of the company and Return on Asset (ROA) for the period 2011 to 2015. Results found that age of company, Return on Asset, Debt Ratio and the size of the company have an impact on the stock prices. Bhargava Arpit et al (2016) used time series regression to study the relationship between macro variables and stock prices for the period 2004-2013 on quarterly data. Exchange rate, oil prices and inflation were found to have significant impact over stock prices. Whereas inflation and exchange rate were negatively related to stock prices, there was a positive relation with oil price and gold price did not have any significant effect on the stock prices. Further a study by Om Hari et al (2017) analyzed the factors affecting market price of shares the impact of various factors namely, Dividend per Share, Earning per Share, Return on Equity, dividend payout ratio, Debt equity Ratio, Total asset turnover ratio and Dividend Yield on the market price of shares. The results would further help in analyzing how the Market Price per Share is affecting the dividend policy. Correlation, Muticollinearity and regression Analysis were carried out on 4 industries comprising of pharmacy, automobile, textile and software industries of which 31 companies were selected for a period of 5 years from 2012 to 2016. Findings suggest that all the selected

independent variables have an impact on the market price per share and industries bearing high dividend payout ratio have more market price per share.

Singh Dharmendra (2018) attempted to explain the determinants of twenty-six non-financial companies share prices of Muscat Securities Market, Oman for a period ranging from 2011 to 2016. Random effect model regression analysis revealed a significant positive effect of EPS on stock price and so is Debt ratio (leverage). The firm size and dividend payout were found to be not significant whereas inflation is negatively related to stock prices. Factors affecting stock price of Ho Chi Minh Stock Exchange listed companies (HOSE) were analyzed by Hung Nguyen Khac et al (2019). Linear regression results of data collected from the financial statements of 100 companies listed on HOSE from 2015 to 2018 came up with five factors namely inflation rate, earnings per share, interest rate, gold price, exchange rate having an effect on stock price. The results showed that EPS, interest rate and USD/VND exchange rate had a positive relationship with stock price. However gold price and CPI had a negative correlation with stock price. A review study was carried out on the determinants of stock prices of developed and developing economies. Of the various internal and external factors found to be influencing the prices of shares from the review of various research papers Almashaqbeh Mohammad et al (2021) concluded few factors namely ownership structures, value relevance of accounting information, audit quality and relationship between them to be the most imperative determinants of share prices. According to Sukesti Fatmasari et al (2021) size of the company does not affect the stock price whereas stock prices were positively affected by Debt Equity Ratio and Net Profit Margin. As far as constructs were concerned ROA was found to be a good mediator in the relationship among constructs. 136 listed manufacturing companies of Indonesia Stock Exchange (IDX) were considered for the study period ranging from 2014-2018. Test used was Warp PLS statistical test tool to prove the proposed hypothesis. Stock market is impulsive and to find out the stock prices one has to keep abreast of various internal & external factors affect the stock prices. Multiple regression test established significant and positive relationship between price earnings ratio, price book value and exchange rate with stock prices of NSE 100 and exchange rate and dividend yield ratio had a negative relationship with the same. Quarterly time series data of the variables were considered from 2003-04 to 2013-14. (Nathani Navita et al)

OBJECTIVE OF THE STUDY

In the times of yore, India has surfaced as one of the investment haven in the opinion of different foreign nations. The reasons are thriving economic growth and altering and comparatively more attractive foreign investment policies structured by the government. Due to the changed circumstances, where massive foreign investment has flooded the Indian market followed by improved probability of susceptibility and destabilization of an economy, a need was sensed to inspect the cause effect relationship between macroeconomic indicators on the Indian stock market movement. Again the paper intends to explore

the best fitted research model representing the explanatory relationship among economic and financial market indicators.

FORMULATED HYPOTHESES

H1: Causal effect of GDP per person employed is significant on BSE 500.
H2: Industry (including construction) value added has major contribution on variance of BSE 500.
H3: Infant Mortality rate explains most of BSE 500.
H4: Gross savings has significant effect on BSE 500.
H5: Cause effect relationship between Broad money and BSE 500 is significant.
H6: Significant causality exists between Foreign direct investment, net inflows and BSE 500.
H7: Causal effect of Foreign direct investment, net outflows is significantly present on BSE 500
H8: Final consumption expenditure explains most of BSE 500

DESIGN AND METHODOLOGY

The present study is an effort to examine statistical data concerning the selected macroeconomic variables acting as independent variables namely GDP per person employed, Industry (including construction) value added (% of GDP), Mortality rate infant (per 1,000 live births), Gross savings (% of GDP), Broad money (% of GDP), Foreign direct investment, net inflows (% of GDP), Foreign direct investment, net outflows (% of GDP), Final consumption expenditure (% of GDP) and the response variable i.e. BSE 500. Literature review revealed number of variables in the realm of stock market. Data for the variables used in the study have been collected from secondary sources like www.bseindia.com and www.worldbank.org for the period 1999 to 2018. In order to be able to select maximum number of variables only those variables have been considered which were had an annual frequency.BSE 500 was incorporated in the study, as it is the only index that confines data of its stock positions on annual basis.

Evaluation of the data in the current study was done through Step-wise Regression technique. SPSS was meticulously employed. In this method independent variables are introduced or taken out from the regression equation one by one. The rationale of this technique is to choose a subset of variables from among many independent variables which explain a major portion of variation in the dependent variable.

RESULTS AND DISCUSSION

Step-wise regression analysis was carried out on the data. Stepwise regression is a statistical technique to build a model by adding or removing predictor variables based solely on the t-statistics of their estimated coefficients. It either adds the most significant variable or eliminates the least significant variable. It does not consider all possible models, but produces a single regression model when the algorithm ends. Results indicated that all the variables excepting FDI (net inflows and net outflows) were found to be insignificant in predicting the dependent variable. A detailed explanation of the data analysis is presented below.

Table 1: Model Summary.

Model	R-square	Adjusted R Square	R-square change	F change	Sig F change
1.	.899	.893	.899	159.605	.000
2.	.901	.889	.002	.426	.523
3.	.903	.885	.002	.388	.542
4.	.921	.900	.017	3.308	.089
5.	.930	.905	.009	1.862	.194
6.	.930	.898	.000	.042	.842
7.	.966	.946	.035	12.451	.004*
8.	.967	.944	.002	.518	.487

The R square values of all possible regression models are on the higher side. However the change in R square from one model to another was found to be significant while moving from the sixth model to the seventh model (F change=12.451, $p<0.01$). In this regard it may be concluded that the seventh model is the best fitted model. R square is known as coefficient of determination. It determines the amount of variance explained by causal variables of outcome variable.

Table2: Stepwise Models of Impact of Independent Variables on Sensex.

Model	Independent Variable Introduced	Value of 'Constant' term	Standardized β Coefficients
1.	GDP	-1.726E-016 (p>0.05)	β_1= .948 (p<0.05)
2.	GDP, Industry	-1.444E-016 (p>0.05)	β_1= .957 (p<0.05), β_2= .051 (p>0.05)
3.	GDP, Industry, Infant Mortality rate	-3.707E-016 (p>0.05)	β_1= 1.381 (p>0.05), β_2= .118 (p>0.05), β_3= .421 (p>0.05)
4.	GDP, Industry, Infant Mortality rate, Gross savings	-3.704E-016 (p>0.05)	β_1= 2.453 (p<0.05), β_2= -.297 (p>0.05) β_3= 1.799 (p>0.05), β_4= .693 (p>0.05)
5.	GDP, Industry, Infant Mortality rate, Gross savings, Broad money	-3.443E-016 (p>0.05)	β_1= 1.465 (p>0.05), β_2= -.010 (p>0.05) β_3= .303 (p>0.05) β_4= .418 (p>0.05) β_5= -.467 (p>0.05)
6.	GDP, Industry, Infant Mortality rate, Gross savings, Broad money, Foreign direct investment,(NI)	-3.451E-016 (p>0.05)	β_1= 1.483 (p>0.05), β_2= -.040 (p>0.05),β_3= .334 (p>0.05), β_4= .448 (p>0.05), β_5= -.482 (p>0.05), β_6= .026 (p>0.05)

7.	GDP, Industry, Infant Mortality rate, Gross savings, Broad money, Foreign direct investment (NI), Foreign direct investment (N0)	-3.196E-016 (p>0.05)	β_1= 1.155 (p>0.05), β_2= -.297 (p>0.05), β_3= .107 (p>0.05), β_4= .196 (p>0.05), β_5= -.084 (p>0.05), β_6= -.403 (p>0.05), β_7= .588 (p<0.05)
8.	GDP, Industry, Infant Mortality rate, Gross savings, Broad money, Foreign direct investment (NI), Foreign direct investment (N0), Final consumption expenditure (FCE)	-1.904E-015 (p>0.05)	β_1= 1.054 (p>0.05), β_2= -.329 (p>0.05), β_3= .156 (p>0.05), β_4= -.415 (p>0.05), β_5= .044 (p>0.05),β_6= -.385 (p<0.05), β_7= .602 (p<0.05), β_8= -.574 (p>0.05)

a. Dependent Variable: BSE500

b. All values of IV and DV are standardized

c. β_1= GDP, β_2= Industry, β_3= Infant Mortality rate, β_4= Gross savings, β_5= Broad money, β_6= Foreign direct investment (NI), β_7= Foreign direct investment (N0), β_8= Final consumption expenditure (FCE)

A restricted set of regressors in the joint model were identified by stepwise regression model that was estimated with the most prominent factors. This technique permits a few or all of the independent variables from a set of variables in a standard linear regression to be selected mechanically. The estimated coefficients with corresponding p-values and adjusted R-squares are reported in Table 1 and 2 achieved from stepwise regression models to check the effect of independent variables chosen for the study in India on the benchmark index.

The regression equation for the same is:

$$Y_1 = a + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + \beta_8 X_8 + u$$

Where Y= BSE SENSEX, X_1= GDP, X_2= Industry, X_3= Infant Mortality rate, X_4= Gross savings, X_5= Broad money, X_6= Foreign direct investment (NI), X_7= Foreign direct investment (N0), X_8= Final consumption expenditure (FCE); a= intercept (constant), β=regression parameter; u= standard error.

It can be observed that FDI has a significant impact on performance of the BSE Sensex. The stepwise regression picks up only FDI as the key factor responsible for fluctuations in the dependent variable thereby making FDI the most dominant variable affecting BSE Sensex. . Again, FDI has a positive bearing on performance of Sensex. The result corresponds to the findings of Claessens, Klingebiel, & Schmukler (2001), Baker, Foley and Wurgler, 2004, Desaiat el (2005), Adam & Tweneboah (2009), and Kalim & Shahbaz (2009), Adam & Tweneboah (2009) and I.Al-Halameh and Sayah (2010).

CONCLUSION

Investing in stock markets with accurate research and right perceptive can help one make consequential gains. Stock market is a risky option to invest for the reason that markets respond to a mixture of internal as well as external factors. In addition, nearly all of these factors are afar the control of investors. Unpredictability of the stock market is an essential element which if not dealt with suitably, can cause losses. There are a host of variables that affect stock price movement. Yet the finest of analysts in the field cannot precisely foresee the behavior of stock price that would change now and then. If long run investment is desired then daily unexpected price movements should not be a worry. On the other hand when one is intending for short run profits then several factors affecting stock market should be properly evaluated.

A rich store of literature exists on impact of various factors on stock market returns; still the world lacks any consensus on same. In order to examine the same step-wise regression was carried out in the present study. The results revealed significant and strong positive correlation between BSE Sensex and FDI (Net outflows) and negative correlation with FDI (Net inflows). When a company takes control over ownership in a business entity in another country then it is known as Foreign Direct Investment (FDI). Here foreign companies are directly engaged in routine operations of the business entity in the other country. The intention of making this investment is establishing a lasting interest. This long-term interest separates FDI from foreign portfolio investments, where investors inertly hold securities from a foreign country. A lasting interest starts when an investor acquires a minimum of 10% voting power in a firm. This connotes FDI do not just bring money with them, but also technical know-how, knowledge and dexterity. In general, FDI is said to have occurred when an investor starts business operations in a foreign country or obtains foreign business assets together with creating ownership or controlling interest in the foreign company.

Investment coming into the domestic country or reporting economy is known as Foreign direct investment net inflow. Investments made by the residents of the domestic country or reporting economy to businesses based in foreign economies is FDI net outflow. When more capital flows into foreign companies the markets become larger and there is efficient allocation of funds. The reason behind the negative correlation between BSE Sensex and FDI (net inflows) is perhaps FDI inflows into the private companies existing in India that are traded on the stock exchange. This leads to dwindling market share of public companies which will simultaneously translate in reduced market capitalization of the stock market. Consequently this can be seen having an unfavorable impact on BSE Sensex. The analysis points out that FDI (net outflows) have a significant positive link with stock market returns. The results are consistent with the findings of Sahoo Pravakar et al (2021), Tsagkanos Athanasios et al (2019), Jan Knoerich (2017), Sadig Ali J. Al (2013). Supply chain linkages could be a major reason behind this favourable impact of FDI (net outflows) on BSE Sensex. Once firms start FDI abroad, they may restructure their home country strategies in sales and procurement. Few of their suppliers in turn

may go well with them and start investments in foreign companies. The newly created demand due to increased production abroad is likely to raise the domestic suppliers' demand. This shall pass from tier-1 suppliers to tier-2 and so on and so forth. Throughout such input-output linkages, FDI positively affects the performance of stock markets. Looking at the findings of the study the study recommends more policy changes relating to various groups of investors and suppliers of materials at various tiers for increased participation in FDI and recognition of India in the international financial market. This is because increase in FDI also will have positive influence on several other sectors of the country.

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