

Macroeconomic Variables and Stock Market Behaviour: An Indian Experience

Hirak Ray*

Bondage between macroeconomic variables and stock market activities is a long debated, yet unsettled issue. Relying on robust econometric tools the present paper adds to this debate in trying to answer: Is there any relationship between macroeconomic indicators and stock market behaviour? Findings suggest that except Index of Industrial Production all other macroeconomic variables have little or no impact on stock market activities in India. The findings of this study are important on two counts – it challenges the much acclaimed theory of market efficiency and disapproves the claim of allocative efficiency of stock market.

I Introduction

The influence of macroeconomic variables on aggregate stock return has been an issue of intense debate for the last few years in the empirical research in finance and economics. Any definitive answer is important in the sense that it may help to monitor and manage financial risk, price derivatives, and find more exact solutions to the problems of optimal portfolio selection (Cochrane 1999). From policy perspective, macroeconomic variables that mostly capture business cycle fluctuations may help to forecast stock market returns and/or volatility. It may help to develop a better understanding of the potential macroeconomic determinants of systematic financial risk (Dopke *et al* 2006).

There exists a significant volume of literature examining the link between stock market returns and a range of macroeconomic and financial variables over a number of countries on a variety of time-horizons. A number of studies attest the hypothesis that macroeconomic variables influence stock returns (Fama 1981, Shen 1998, Bilson *et al* 2000, Chancharoenchai *et al* 2005, Rapach *et al* 2005, Paye 2006). But, many scholars from Keynes (1936) to Aivazian(1998) and specifically the behaviouralists from Tversky and Kahneman (1986) to Hirshleifer (2001), Barberis (2003), Ritter (2003) and others argue that stock market prices:

* Reader, Department of Commerce, University of North Bengal, P.O. North Bengal University, Dist. Darjeeling 734 013.