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Testing Index Volatility of Indian Stock Market in the Context of Foreign Institutional Investor's Investment

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Abstract

Phenomenal growth has been observed in the Indian Stock Market because of domestic and international investments much to the credit of first and the second phase of reforms in the financial sector. The study tests the volatility of the Indian Stock Markets to foreign institutional flows in equity markets using two indices of the country largest and prominent stock exchnages viz. BSE and NSE. The indices so chosen are S & P CNX Sensex and Nifty. The assessment is made for a period of eleven years from January 2000 to December 2011. Findings indicate significant impact of FII flows on the Indian stock market. It is found that FIIS were net sellers in year 2008 and 2011 and these were the worst years for the stock markets. FIIs remained the key mover and shakers of the market especially on account of the global financial crisis.

I. Introduction

A WELL-DEVELOPED STOCK market has its impact on the development of economy. It provides investors with an array of assets with varying degree of risk, return and liquidity. This increased choice of assets and the existence of a vibrant stock market provide savers with more liquidity and options, thereby inducing more savings.

Increased competition from foreign financial institutions also paves the way for the derivatives' market. All this, according to the mainstream belief, encourages more savings in equity related instruments. This, in turn, raises the domestic savings rate and improves capital formation.

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in the Indian Capital Market. The other factors that are also influencing on movement of the stock exchanges. The macro factors in the form of the change in the interest rate, inflation and demand and supply in the global market which Indian market has faced in year 2011. Moreover the sovereign debt crisis in Europe took the center stage in pulling the global market down. The factor might be micro in terms to relating profitability and operations of the listed companies or the economic health of the nation. While exploring the impact on volatility in the stock exchanges it should be kept in mind that FII flows are major drivers of stock markets in India and hence a sudden reversal of flows may harm the stability of its markets it was seen in financial recession in year 2007 and 2011 where the FII is the net buyer from 2000 to 2011 excluding two years 2008 and 2011 which leads the heavy investment and selling attitude of FII's causing a major hurdle in stabilization of market sentiments.

VI. Suggestions

The investment scenario in India has been witnessing turbulent times due to high inflation, poor policy implementation by the government. The problems were further accentuated by the Euro zone crisis and pull backed investment by the FIIs leading to a more than 24% decline in Indian Equities in 2011. Strong policy decisions from the government's side will make India an attractive investment destination which may attract more FII investments for growth of Indian stock market and making the rupee stronger. There is no doubt FIIs are influencing the volatility on indices of stock exchanges to a greater extent. But the role and effect of the FII on the Indian economy should be duly monitored and regulated by government agencies as our economy is still in the developing stage. It is imperative to ensure that the domestic investors are protected from the established foreign players.

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