

Stability of the Indian Economy: A Study

¹Riya Gupta, ²Dr. Veena Taneja

¹Research Scholar, Department of Business Management, Tania University, Sri Ganganagar

²Assistant Professor, Department of Business Management, Tania University, Sri Ganganagar

INTRODUCTION

The extensive repercussions of the global financial crisis that occurred in 2008–2009 in the developed economies, as well as its following spillover effects on the emerging market economies (EMEs), have brought to light the necessity of conducting a more accurate examination of the connections that exist between the macroeconomy and the financial sector. To improve the accuracy of macroeconomic forecasts, select the best policy tools for intervention, and create the fiscal, monetary, and financial policies, it is of the utmost importance to have a solid understanding of the nature and size of these links. Therefore, researchers have started looking into the links between credit, asset values, and economic activities using a variety of different methodologies. In their research published in 2011 and 2012, Claessens and colleagues discovered that there is a significant connection between the business cycle and the financial cycle.

LITERATURE REVIEW

Kose, M. A., Prasad, E. S., & Terrones, M. E. (2003). This study investigates the influence that international financial integration has on the volatility of the macroeconomic environment. Given that economic theory does not offer a definitive guide to the impacts of financial integration on volatility, it can be inferred that this is primarily a subject that has to be answered through empirical research. Over the course of the years 1960-1999, we present a comprehensive analysis of the changes that occurred in the level of macroeconomic volatility in a large group of various industrial and developing economies. Two main findings are presented here: For starters, although the volatility of output growth has, on average, decreased in the 1990s in comparison to the three decades that came before it, we also document that, on average, the volatility of consumption growth in comparison to that of income growth has increased for more financially integrated developing economies in the 1990s. Secondly, there is a correlation between increased financial openness and rising relative volatility of spending, although this relationship is only observed up to a specific threshold. Beyond this threshold, it appears that the benefits of financial integration, which include improved risk-sharing and consumption-smoothing possibilities, begin to accrue.

Kose, M. A., Prasad, E., Rogoff, K., & Wei, S. J. (2010). We examine the extensive body of research on different economic strategies that could aid developing nations in successfully navigating the financial globalization process. Our main conclusions suggest that measures supporting trade openness, institutional quality, and finance sector development may aid developing nations in reaping the rewards of globalization. Similar to this, good macroeconomic policies are a necessary precondition for guaranteeing the advantages of financial integration. Our research also indicates that there are inescapable inherent contradictions when weighing the advantages and disadvantages of financial globalization, and that the relationship between financial integration and economic policies is complicated. Given these tensions, it is frequently necessary to modify structural and macroeconomic policies to account for unique national characteristics in order to optimize the risk-benefit trade-offs associated with financial integration. In the end, it is critical to consider financial integration as a component of a larger set of reforms and advantageous macroeconomic policies rather than merely as a stand-alone policy objective.

R. D. Gay Jr. (2008). For the US and other large economies, the correlation between share prices and macroeconomic indicators is well established. But how do share prices and economic activity relate to each other in emerging economies? This study uses the Box-Jenkins ARIMA model to examine the time-series relationship between stock market index prices and the macroeconomic variables of oil price and exchange rate for Brazil, Russia, India, and China (BRIC). Even though there was no discernible correlation between the oil price and the respective exchange rate and the stock market index prices of either BRIC countries, more research is necessary since macroeconomic factors both domestically and internationally may have an impact on stock market returns. Furthermore, no discernible correlation was seen between historical and current stock market returns, indicating that the markets in Brazil, Russia, India, and China demonstrate a feeble type of market efficiency.

R. Levine (2001). In order to determine if international financial liberalization speeds up economic growth by enhancing the efficiency of local banks and financial markets, this article compiles the available data and theory. According to the analysis, the response is "yes." First, easing limitations on foreign portfolio flows generally improves the liquidity of the stock market. Increased stock market liquidity, in turn, spurs economic expansion mainly through raising productivity growth. Second, permitting a larger presence of foreign banks often improves the effectiveness of the home banking sector. Better-developed banks, on the other hand, mainly accelerate productivity growth to drive economic expansion. Thus, by fostering advancements in the home financial system, global financial integration can support economic growth.

Padhan, R., &Prabheesh, K. P. (2020). The study empirically investigates the effect of financial integration (FI) on business cycle synchronization (BCS) in the Indian context. Using concordance index, dynamic conditional correlation, and 3SLS, we find: (1) India's business cycle is significantly synchronized with nine economies (2) The evaluation of BCS shows a higher synchronization with the five economies (3) FI, directly and indirectly, reduces BCS (4) The direct effect of FI occurs through wealth effect, in most cases, indicating dominance of portfolio diversification against portfolio rebalancing associated with balance sheet effect (5) FI reduces the BCS, indirectly through intra-industry trade and differences in economic specialization.

SCOPE

This study focuses on investigating the impact of macroeconomic factors, including GDP growth, inflation, exchange rate volatility, fiscal policy, and monetary policy, on financial integration specifically within the context of India. It examines both the level of integration with global financial markets and the degree of integration among domestic financial markets. Utilizing quantitative methods, the analysis aims to provide insights into the relationship between these macroeconomic variables and financial integration, offering recommendations for policymakers, regulators, and market participants in India based on empirical findings. Additionally, the study aims to contribute to the existing literature by offering context-specific insights into the dynamics of financial integration in India.

LIMITATIONS

Despite the thorough investigation, this study has certain limitations. Firstly, it relies on secondary data sources for macroeconomic indicators and financial integration measures, which might be subject to limitations such as data accuracy and availability. Secondly, while the analysis focuses on macroeconomic factors, it excludes other potential determinants such as institutional factors, legal frameworks, and technological advancements, which could also influence financial integration. Thirdly, the findings may be influenced by the chosen time period and might not capture long-term trends or structural changes in the relationship between macroeconomic factors and financial integration. Furthermore, due to the complexity of the financial system, the study might not capture all possible channels through

which macroeconomic factors influence financial integration. Lastly, the recommendations provided may need to be adapted to specific institutional contexts and may not be universally applicable across different countries or regions.

CONCEPTS PERTAINING TO THE STABILITY OF THE INDIAN ECONOMY:

Central banks all throughout the world, including the Reserve Bank of India, are now focusing their attention on the issue of financial stability as their key concern. Countries and central banks around the world have diverse ways of defining what constitutes financial stability. Because of this, the text is extremely contextualized. The textualization (universalization) of these teachings is accomplished by drawing inferences from the surrounding experiences that are being discussed. Since the beginning of time, central banks have been concerned with maintaining price stability and then, later on, with maintaining financial stability, although they have not done so simultaneously with the same level of consistency. At the same time, however, central banks have been working toward both of these goals simultaneously since the 1990s. **IN ORDER TO MAINTAIN FINANCIAL STABILITY, MACROECONOMIC FRAMEWORKS:**

It is necessary to enhance the structures that govern financial stability. It is imperative that central banks have a significant say in the policy that governs financial stability, which is intimately connected to monetary policy. Naturally, the official institution that is most closely connected to the financial markets is the central bank. On the other hand, the duty for maintaining financial stability will virtually always be collaborative with other organizations. The manner in which this is carried out will vary from nation to nation. Nevertheless, supervisors require the autonomy and the authority to respond in a prompt and impartial manner, regardless of the circumstances. The complex relationship that exists between macroeconomic and financial policy, both on a national and international scale, has come to the forefront of public discourse as a direct result of the financial crisis. It is possible for financial progress to be hampered when there is a lack of stable macroeconomic policy. In addition, financial systems that are inefficient and have inadequate supervision can hinder the efficacy of policy transmission mechanisms and make it more difficult to maintain stable policies. Capital accounts that are becoming more open in both de jure and de facto terms provide an additional layer of complexity to the process of selecting the appropriate structure for macroeconomic frameworks.

REGULATORY CHANGES IN THE INDIAN BANKING AND FINANCIAL SECTOR:

Economic integration is a concept that refers to the unification of economic policies (the coordination of monetary and fiscal policies) between several nations through the complete or partial abolition of tariff and non-tariff limitations on trade between those nations. "a decision or process whereby two or more countries combine into a larger economic region by removing discontinuities and discriminations existing along national frontiers, and by establishing certain elements of cooperation and co-ordination between them," as stated by Jhingan (2009), is what is meant by the term "economic integration." A free trade area, a customs union, a common market, and an economic union are the various stages of economic integration that are associated with the concept. The establishment of closer cultural, economic, and political ties among the member states is one of the potential benefits of economic integration. Other potential benefits include the better allocation of resources, the improvement in the quality and quantity of factor inputs, the increase in productivity, the increase in economic efficiency and improvement in trade, the better exploitation of economies of scale, and the improvement in standard of living.

INTEGRATION OF THE ECONOMY AND EXPANSION OF THE ECONOMY

This section provides an overview of the most recent empirical literature examining the influence that economic integration could have on economic growth. Additionally, it investigates the various routes via which economic integration exerts its influence on economic growth. These channels include the rise of productivity, the accumulation of capital, the integration of commerce, and the integration of financial markets. Based on empirical studies that indicated either significantly favorable or insignificant effects of integration on growth, it classifies the studies that have been published in the literature. Additionally, it investigates the empirical literature addressing the influence that the adoption of a common currency has on the expansion of the economy. Figure illustrates the conceptual framework of the various conceivable patterns of linkage between economic integration, financial integration, and economic growth.

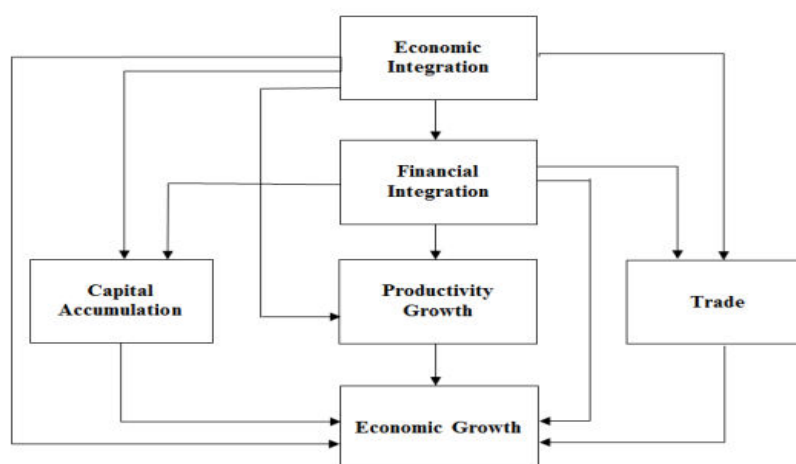


Figure: The conceptual framework of the possible patterns of relationship among economic integration, financial integration, and economic growth

STUDIES THAT FOUND SIGNIFICANT EFFECTS OF ECONOMIC INTEGRATION ON ECONOMIC GROWTH

A number of empirical studies that investigated the connection between economic integration and economic growth found that there were positive links between the two. Using cross-sectional and time series data using a non-linear Ordinary Least Squares estimator, Jones (2002) explored the relationship between economic integration and convergence of per capita income in the Economic Community of West African States (ECOWAS). This was done in order to determine whether or not there was a correlation between the two measures. There is a tendency for the per capita income to converge and lower its standard deviation with time, as demonstrated by the fact that the countries that make up the Economic Community of West African States (ECOWAS) constitute a convergence club. Anyanwu (2003) estimated a pooled regression to investigate the relationship between integration and trade and output during the period of 1990–2000. He did this by utilizing the West African Economic and Monetary Union (WAEMU) and the Economic Community of West African States (ECOWAS), which are both monetary unions in the West African region. According to the findings of the study, monetary unity has positive effects on economic growth and bilateral commerce. This finding lends credence to the premise that the primary advantages of monetary union are the enhancement of trade and the credibility of central banks.

RESEARCH THAT IS UNABLE TO IDENTIFY ANY MAJOR BENEFITS OF ECONOMIC INTEGRATION ON THE EXPANSION OF THE ECONOMY

All of the empirical research that falls under this category came to the conclusion that economic integration does not have a major positive impact on economic growth. On the contrary, a number of the empirical research that were conducted provided evidence that

economic integration has a negative impact on income disparity. As an illustration, Bertola (2010) conducted research to determine how the integration of European economies and monetary systems affects the disparity in discretionary income. They contended that a straightforward theoretical argument shows that economic integration may or may not exacerbate income inequality and volatility, but that it hinders the capacity of national governments to carry out autonomous fiscal policies and implement income redistribution schemes. This was one of the arguments that they presented.

RESEARCH METHODOLOGY

The empirical framework that was developed by Kari (2004) was applied in the research in order to measure the degree of instability that is linked with the macroeconomic system. This was done in order to facilitate quantitative analysis. This framework is solely responsible for conducting an analysis of the economic conditions of developing countries, in contrast to other studies that focus on both developing economies and economies that have already been formed. When used to the field of macroeconomics, the term "macroeconomic instability" refers to the volatility of aggregate macroeconomic indicators from one period to the next. This is what is meant by the phrase "macroeconomic instability." When attempting to define it, the usual approach that is typically utilized is the standard deviation, which is a statistical metric that determines the degree to which a variable deviates from its mean. The approach that is typically used to determine its value is the one that is detailed here. Despite the fact that the variables are expressed as percentages, the standard errors that are indicated are likewise expressed in percentage form. In order to accomplish the objective of determining the cointegrating relationship that exists between the variables, the error-correction cointegration technique that was developed by Johansen and Juselius (1990) has been utilized. In addition, the vector error correction model, which is also referred to as VECM, has been utilized in order to investigate the empirical connection that revealed itself during the research.

RESULT AND DISCUSSION

In the long term, it has been proved through the utilization of Johansen's maximum and the trace statistics that there is a relationship that exists between the variables that are being investigated. This link has been shown to exist at all times. As a result of this observation, which provides support for the notion, the application of VECM for the analysis of short-run dynamics is supported. The results of the Johansen–Juselius Cointegration test that was carried out in 1990, which provides an overview of the findings collected. It would appear that the trace and maximum eigenvalue statistics reflect distinct findings, based on the observations that have been made. The max-eigen test is statistically significant in rejecting the null hypothesis of $r = 0$ at the 0.05 percent level of significance, but the trace test is statistically significant in rejecting the null hypothesis of $r = 2$ at the same level of significance. Both tests are statistically significant in rejecting an alternative hypothesis. Both of these tests have yielded results that are statistically significant when taken as a whole.

According to the results of the trace test, which revealed three cointegrating equations, and the max-eigenvalue test, which suggested that there was only one cointegrating equation, it has been established that a long cointegrating equation does in fact exist. These two tests were carried out simultaneously.

Table Johansen–Juselius Cointegration Test

Hypothesised No of CE (s)	Trace	Max-eigen	Critical Values (5%)	
	Statistic	Statistic	Trace	Max-eigen
$r = 0$	172.7628**	61.43667**	125.6154	46.23142
$r \leq 1$	111.3261**	36.61778	95.75366	40.07757
$r \leq 2$	74.70835**	28.18093	69.81889	33.87687
$r \leq 3$	46.52742	24.29224	47.85613	27.58434
$r \leq 4$	22.23518	12.53089	29.79707	21.13162
$r \leq 5$	9.704288	9.113306	15.49471	14.26460
$r \leq 6$	0.590981	0.590981	3.841466	3.841466

Source: Author's estimation

CONCLUSION

Specifically, this is because the development of output and consumption is the fundamental issue itself, which is the primary reason for this consequence. Before moving on to the next stage of the investigation, the major purpose of the investigation is to determine the consequences that partial financial integration has on the macroeconomic environment as a whole. The inquiry that is being carried out largely is centered on this particular aspect of the situation. Furthermore, the idea that there is a relationship between the two is something that could be considered a fascinating topic of conversation. This is something that could be considered a topic of discussion. The supplemental viewpoint that is presented here is one that should be taken into consideration. Throughout the course of its investigation, the study lays a significant amount of stress on the increase of both output and consumption as its principal areas of inquiry through the course of its examination. The study lays a substantial emphasis on the expansion of each of these categories, and it does so in a manner that is more explicit. The data also reveals that the degree of financial integration has a considerable and beneficial influence on the degree to which output is unpredictable in compared to the degree to which consumption is irregular.

REFERENCES

- [1] Verma, D. S., & Kumar, K. A. (2015). IMPACT OF MACROECONOMIC FACTORS ON BANKING INDEX IN INDIA. *Asia Pacific Journal of Research*, 1.
- [2] Le, H. (2020). The impact of financial integration on the labor share of income: An empirical evidence from a panel dataset. *The Indian Journal of Labour Economics*, 63(3), 597-627.
- [3] Ahmed, A. D., & Mmolainyane, K. K. (2014). Financial integration, capital market development and economic performance: Empirical evidence from Botswana. *Economic Modelling*, 42, 1-14.
- [4] Narayan, S., Srikanthakumar, S., & Islam, S. Z. (2014). Stock market integration of emerging Asian economies: Patterns and causes. *Economic Modelling*, 39, 19-31.
- [5] Mazumdar, D., Bhattacharjee, M., & Chowdhury, J. R. (2019). Financial Development and Financial Market Integration in India: A Post-reform Scenario. In *The Gains and Pains of Financial Integration and Trade Liberalization* (pp. 141-153). Emerald Publishing Limited.
- [6] Mathew, B., & Sivaraman, S. (2017). Cointegration and causality between macroeconomic variables and life insurance demand in India. *International Journal of Emerging Markets*, 12(4), 727-741.
- [7] Lane, P. R., & Schmukler, S. L. (2007). The international financial integration of China and India. *World Bank Policy Research Working Paper*, (4132).
- [8] Agarwal, R. N. (1997). Foreign portfolio investment in some developing countries: A study of determinants and macroeconomic impact. *Indian economic review*, 217-229.
- [9] Singh, V. K., & Ghosh, S. (2021). Financial inclusion and economic growth in India amid demonetization: A case study based on panel cointegration and causality. *Economic Analysis and Policy*, 71, 674-693.

- [10] MISRA, A. K., & RAMANATHAN, A. (2005). INTEGRATION OF FINANCIAL MARKETS IN INDIA. *Leading Issues in Indian Economy*, 80.
- [11] Tripathi, V., Seth, R., & Bhandari, V. (2015). Foreign direct investment and macroeconomic factors: Evidence from the Indian economy. *Asia-Pacific Journal of Management Research and Innovation*, 11(1), 46-56.
- [12] Panda, R. (2020). *Financial Integration of Corporate Bond Markets in India: Empirical Evidences* (Doctoral dissertation).
- [13] Singh, G. (2016). The impact of macroeconomic fundamentals on stock prices revised: A study of Indian stock market. *Journal of International Economics*, 7(1), 76-91.
- [14] Parrikar, J. G. P. (2019). The influence of macroeconomic factors on housing prices in India: an empirical study. *Indian Journal of Economics and Development*, 1-7.
- [15] Lenka, S. K. (2015). Does financial development influence economic growth in India?. *Theoretical & Applied Economics*, 22(4).