Abstract

This study focuses on one of the vexing puzzles in the area of finance and economics, the equity premium puzzle. The puzzle was proposed by Mehra and Prescott (1985) when they could not explain high historical average equity risk premium in the United States with the parameters consistent with the theoretical Consumption based Capital Asset Pricing Model. The paper, following Mehra (2003), attempts two distinct approaches to calculate the risk aversion coefficient using historical data. The first approach uses a calibration of parameters to find the risk aversion coefficient while the second estimates the parameter via Generalized Method of Moments as given by Gomes, Costa and Pupo (2013). The study has been conducted for the sample period 1992-2011 with annual data, and for the sample period 1996Q3-2011Q4 with quarterly data. The results indicate high risk aversion coefficients suggesting the existence of Equity Premium Puzzle in India.