FII IMPACT ON INDIAN STOCK MARKET:

Inter Period and Sectoral Analysis

ABSTRACT

For any economy to grow it is important to have a substantial amount of investments. Capital flows not only provide intensive economic growth but also provide stability in the financial system of the country. However, these capital flows are not without risk. The main risk posed by large and volatile capital flows is that they may result in crisis and destabilize the economy. One such flow is Foreign Institutional Investments (FII). Since 2000 the dealings in FII had largely increased due to more investors getting interest in the Indian economy. Given the speculative nature of these flows, it is very important to analyse the impact of FII flows on the Indian Economy in the last decade. The main purpose of this study is to investigate the co-integration, causality, and shocks analysis between the Indian stock market including different sectoral indexes and foreign institutional investment (FII) in India during three different time spans: from 2001 to 2005, 2006 to 2009 and from 2010 to 2014. Engle-Granger (1987) and Granger (1969) methodologies are used to investigate the co-integration and causal relationship. Vector Autoregressive Regression (VAR) has been used to better understand the causality, in terms of relative variance being explained and responses of shocks. Forecast Error Variance Decomposition (FEVD) and Impulse Response Function (IMF) have been used as a part of VAR model. The study found that relationship between Net FII flows and indexes are of short-term nature and are significantly affected by many major events happening in the economy. During 2006 to 2009 and 2010 to 2014, the volatility of response of shocks increases in magnitude. Much of the variation and causation is explained during these two periods. Also study has found that introduction of derivative market has significantly affected the Indian stock exchange.