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   REVIEW OF LITERATURE

   NEED/IMPORTANCE OF THE STUDY

   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

   CONCLUSIONS

   SCOPE FOR FURTHER RESEARCH

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   APPENDIX/ANNEXURE

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- Schemenner, R.W., Huber, J.C. and Cook, R.L. (1987), "Geographic Differences and the Location of New Manufacturing Facilities," Journal of Urban Economics, Vol. 21, No. 1, pp. 83-104.

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IMPACT OF MONETARY POLICY ON BSE BANK STOCKS

MANISHA LUTHRA
ASST. PROFESSOR
DYAL SINGH COLLEGE
UNIVERSITY OF DELHI
DELHI

SHIKHA MAHAJAN
ASST. PROFESSOR
DYAL SINGH COLLEGE
UNIVERSITY OF DELHI
DELHI

ABSTRACT

Monetary policy is the process by which the Central Bank or Monetary authority of a country controls the supply of money, often targeting a rate of interest. RBI functions as the monetary authority of the country and is responsible for formulating implementing and monitoring the monetary policy with the prime objective of maintaining price stability and ensuring adequate flow of credit to productive sectors. Country's banking and financial system rests on broad banking operations parameters. This paper aims to discuss about the impact of monetary policy on the share price of banking companies listed in BOMBAY Stock Exchange. The analysis of the study showed that the security prices reacted SIGNIFICANTLY to the announcements of RBI.

KEYWORDS

Monetary policy, Security Prices, RBI, Bombay Stock Exchange.

1. INTRODUCTION

The recent global financial turmoil has revealed the fact that the proper and prudential functioning of banking system is very essential for the sound financial health and the growth of the economy. Central bank being the monetary authority of the nation is responsible for the financial stability of the nation hence directly or indirectly regulates the money creation activity of the banks through monetary policy tools.

Monetary policy is a macroeconomic tool through which monetary authority of a country regulates the supply of money by frequently targeting a rate of interest aiming to promote economic growth and stability.

SECOND QUARTER REVIEW OF MONETARY POLICY 2013-2014

RBI has decided to:

- reduce the marginal standing facility (MSF) rate by 25 basis points from 9.0 per cent to 8.75 per cent with immediate effect;
- increase the policy repo rate under the liquidity adjustment facility (LAF) by 25 basis points from 7.5 per cent to 7.75 per cent with immediate effect
- keep cash reserve ratio (CRR) unchanged at 4.0 per cent of net demand and time liability (NDTL); and
- increase the liquidity provided through term repos of 7-day and 14-day tenor from 0.25 per cent of NDTL of the banking system to 0.5 per cent with immediate effect.

Consequently, the reverse repo rate under the LAF stands adjusted to 6.75 per cent and the Bank Rate stands reduced to 8.75 per cent with immediate effect. With these changes, the MSF rate and the Bank Rate are recalibrated to 100 basis points above the repo rate.[1]

The purpose of this study is to indicate the impact of these monetary policy instruments used for inflation targeting on the stock prices of the commercial banks included in BSE Bankex. RBI, being the sole monetary authority is responsible for financial stability, persistent growth and to regulate inflationary pressures in the economy. It operates through its tools and in turn signals the commercial banks to work in tandem. In this paper we would like to study the significance of changes in monetary policy tools on the stock prices of banks.

2. RESEARCH METHODOLOGY

2.1 OBJECTIVES

- To analyze the impact of monetary policy on stock prices of banks
- To determine the magnitude of the effect of monetary policy on stock prices.

2.2 SAMPLE SELECTION

All the 13 banks included in BSE Bankex are selected for the purpose of study.

2.3 SOURCE AND COLLECTION OF THE DATA

Data for stock prices of banks for 28 october 2013 and 30 october 2013 (a day before and after the announcement of RBI monetary policy) has been collected from website www.bseindia.com.

2.4 TOOLS USED FOR ANALYSIS

To test the impact of monetary policy of RBI 2013-14 (second quarter review) on stock prices of banks statistical tools used are Arithmetic Mean, Standard Deviation and Paired Sample t test using SPSS.

2.5 HYPOTHESES

H_0: Stock prices do not differed significantly before and after the announcement of RBI monetary policy

H_1: Stock prices differed significantly before and after the announcement of RBI monetary policy

3. EMPIRICAL FINDINGS

PAIRED SAMPLES STATISTICS

		Mean	N	Std. Deviation	Std. Error Mean
Pair 1	before	5.8922E2	13	468.81405	130.02562
	after	6.1235E2	13	485.15553	134.55793

[1] http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=8532&Mode=0

PAIRED SAMPLES CORRELATIONS

		N	Correlation	Sig.
Pair 1	before & after	13	.999	.000

PAIRED SAMPLES TEST

		PAIRED DIFFERENCES					t	df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	before - after	-2.31308E1	23.42303	6.49638	-37.28516	-8.97638	-3.561	12	.004

Here the p value is .004 which is less than .05 thus there is a significant difference between stock prices of banks included in BSE Bankex before and after monetary policy.

In our case, the mean stock price of banks at Time 1 was 5.892 and the mean stock price at Time 2 was 6.123. Therefore, we can conclude that there was a significant increase in average stock prices of banks included in BSE Bankex from Time 1 (prior to the intervention) to Time 2 (after the intervention). Magnitude of the intervention's effect can be found by calculating eta squared (commonly used effect size statistics)

Eta squared can be obtained using the following formula:

Eta squared $=t^2/t^2 + N - 1$

=.514

To interpret the eta squared values the following guidelines can be used (from Cohen, 1988): .01=small effect, .06=moderate effect, .14=large effect. Given our eta squared value of .514, we can conclude that there was a large effect, with a substantial difference in the stock prices obtained before and after the intervention that is second quarter review of monetary policy 2013-2014 by RBI.

4. CONCLUSION

Every year RBI changes the CRR, SLR, PLR, repo rate etc., to control the money supply of the country. This study is an effort to understand whether monetary policy changes hold any informational content for the stock market that may lead to changes in the stock price and to test the impact of these changes on the share price of Indian banking stocks. The results of the study showed that the security prices of banks reacted significantly to the SECOND QUARTER REVIEW OF MONETARY POLICY 2013-2014 by RBI. There was a substantial difference in the stock prices of banks obtained before and after the intervention.

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