**A study on “Long run and short run association between Domestic and Global factors with select Sectoral Indices of Indian Stock Markets”**

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***Abstract***

*The impact of global and domestic economic factors may not be same on all the sectoral indices, hence the present debate is made as an experiment to analyze the Long-term and short-term causality between select global and domestic economic factors with select sectoral indices of Indian stock market. Johansen co-integration test, VECM/VAR model, Wald test has been used to test the remote future and fleeting causality. The study concluded that, lag variables of respective index, NIFTY, IIP, NASDAQ and Petroleum rates posses long and short run association with Auto and Bank Index.*

**Key words:** Global and Domestic Economic Factors, Sectoral Indices, Co-integration, Causality, Lag variables.

**Introduction:**

Stock exchanges are intricately inter-woven in the fabric of nation’s economic life. Stock exchanges provide the opportunity to save the money of the community and sinews of economic progress. In the normal business conditions markets discover the prices of securities based on the demand and supply conditions prevailed, where as in specific condition such as high rate of inflation, interest rate changes, deprived currency values, global economic phenomenon etc., will show impact regarding the erratic nature of stock returns, Indian stock markets are not the exception for this phenomenon.

Plenty of studies are made to analyze the performance of Indian stock markets and found that global and domestic economic factors will show significant effect on stock markets besides the fundamentals of companies that are trading in the markets such as corporate performance, industrial growth.

The previous studies, with the help of stepwise regression analysis, identified that NIFTY, IIP and LIBOR are the good exogenous variables in order to predict the variations in Auto Index; NIFTY, MCX, FII, USD, NASDAQ and Dow Jones can be considered to observe the variability in the Bank Index; Hence the present study is aimed to analyze the long run and short run association between select global and domestic economic factors to that of select sectoral indices of Indian big market.

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**Need for the analysis**

Stock market growth will create various opportunities for both investors and entrepreneurs. The investors can get more profits, existing and prospective entrepreneurs will get required funds for the growth of the business. This will lead to the growth of the economy. Volatility is general tendency of the markets. This will arise due to various technical and fundamental factors such as performance of the firm, industry growth rate, changes in global and domestic economic factors. Among this information, some factors may have long run and some other factors will have short run effect on the markets. In order curtail the volatility, the long run and short effect should be modeled. Hence the present study is made an attempt to develop the model and analyze the long run and short run effect of select economic factors on select sectoral indices of Indian wall street.

**Review of Literature**

 (Zukarnain & Shamsuddin, 2012) Based on monthly data from January 2000 to June 2012, it was determined that only interest rate volatility was found to be a Granger cause of stock market volatility in Malaysia. The other four macroeconomic variables, inflation, GDP, interest rates, exchange rates, and money supply, were not found to be Granger causes.

 (Kumar & Padhi, 2012) studied the relationships between the Indian stock market index and five macroeconomic variables over the period 1994:04–2011:06, including the wholesale price index, industrial production index, treasury bills rates, exchange rates, and money supply, and discovered that the stock market index and macroeconomic variables are co-integrated and, therefore, a long-run equilibrium relationship exists between them. It is also observed that the stock prices positively relate to the index, which shows that the economy is growing. It is discovered that exchange rates and short-term interest rates have no bearing on forecasting stock values. The relationship between stock prices and industrial production is bidirectional, whereas the relationship between stock prices and the money supply, interest rates, and inflation is found to be unidirectional.

 (Irfan Javaid Attari & Safdar, 2013) examined the connection between stock returns and macroeconomic variables. Interest rate, inflation, and gross domestic product are three examples of macroeconomic factors that the Karachi Stock Exchange has deemed representative of the stock market. The study used monthly data for the variables from December 1991 to August 2012 and discovered that macroeconomic factors had a significant impact on stock prices, making stock markets the best predictors of future economic growth.

 (Kumari & Mahakud, 2014) uses two stage estimating methodologies to investigate the hypothesised relationship between stock market volatility and macroeconomic volatility in the developing Indian stock market. Utilizing uni-variate autoregressive conditional heteroskedasticity models, conditional volatility is extracted. The relationship between stock market volatility and macroeconomic volatility was further examined using a multivariate VAR model, impulse response function, block exogeneity, and variance decomposition, and it was discovered that there was a connection between the two.

 (Pethe & Karnik, 2015) investigated the inter-relationships between stock prices and important macro-economic variables such as prime lending rate, exchange rate of rupee vis-à-vis US dollar, broad and narrow money supply, and index of industrial production are considered and found that there is a significant relation between select variables and stock market returns.

 (Maio & Philip, 2015) attempted to decompose the stock market return by incorporating the information from 124 macroeconomic variables and these have made as 6 factors and run a VAR containing these factors and financial variables such as the T-bill rate and market dividend yield. Using the macro factors in the computation of discount rate news and cash-flow does not significantly improve the fit of a two-factor ICAPM for the cross-section of stock returns.

 (Chen, Jiang, Li, & Xu, 2016) investigated the effects of U.S. economic variables on the time variation of Chinese stock market volatility and found that U.S. economic variables such as the dividend yield, dividend price ratios, and industrial production strongly forecast the future monthly volatilities of the Chinese stock market returns.

**Research Gap**

Majority of the studies have focused on investigating the impact, co-integration, long run and short run association between economic variables on broad stock exchange indicators across the world, where as very few have focused on sectoral indices of the market. Hence the researcher found that there is a need to undergo a study on long run and short run causality between select global and domestic economic factors and select sectoral indices of Indian commodities exchange.

**Principles of the study**

1. To study the co-integration between select global and domestic economic factors with the privileged sectoral indices of Indian stock exchange.
2. To analyze the long run and short run causality between the select economic factors and sectoral indices.

**Hypothesis**

H01: There is no co-integration between select sectoral indices and select global and domestic economic factors.

H02: There is no short run causality between select sectoral indices and global and domestic factors.

**Statistical tool used for the study**

The Johansen co-integration test[[1]](#footnote-2) is performed to non-stationary data[[2]](#footnote-3) to observe the long run association between sectoral indices and the economic variables, if the variables are co-integrated then Vector Error Correction Model[[3]](#footnote-4) (VECM) has been used for correction of error variations among variables and establish the exact long run association, if the elements are are not co-integrated then it Vector Auto Regressive (VAR) model has performed to understand the long run association between variables. As an extension to Johansen co-integration and VECM/VAR models, the Wald test[[4]](#footnote-5) is performed to observe the short run impact of the variables.

**Sample Size and Period of the study**

After globalization, Indian Stock Market has been receiving foreign capital funds and the domestic players were also started showing interest to invest. In this regard, the Indian Stock Market becomes more volatile and dynamic. In India National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) are two stock exchanges. Foremost stock exchanges as majority of the share transactions are done by the investors in these two stock exchanges, Kaur (2004). These two exchanges are well equipped with electronic trading platforms.

To study the impact of Global and domestic factors influences on sectorial indices of Indian Stock Market, the researcher has considered two sectorial indices of NSE, such as NIFTY Auto and Bank indices since these indices plays vital role in NIFTY. The researcher has also considered global stock market indexes such the New York Stock Exchange (NYSE), Shanghai Stock Exchange, National Association of Securities Dealers Automated Quotations (NASDAQ), and Morgan Stanley Capital International (MSCI) Composite Index (SHCOMP), Global currency rate fluctuations such as Dollar Index, Yuan and Euro value changes, changes in the prices of Commodities like Crude Oil rates, and Gold, Global shipping index such as Baltic Dry Index (BDI), Flow of Foreign institutional Investors (FII) and Foreign Direct Investments (FDI) in India. Domestic factor include Repo rate, government bond rates, Money supply (M3), GDP growth rate, rate of inflation, Consumer Price Index (CPI), Balance of trade, and Index of Industrial Production (IIP) as global and domestic economic factors for analysis.

In order to make extensive study, the researcher has collected the statistics for ten years period from April 2006 to March 2016 for both sectorial indices as well as select global and domestic factors. The researcher has gathered day wise and monthly closing prices of sectorial indices and the same data has been used for the study to find the impact of global and domestic factors.

**Analysis of the study**

The study has planned make an analysis for sectoral indices such as Auto Index and Bank Index.

**Analysis of Auto Index**

**a. Johansen Co-integration test**

Multivariate Johansen Co-integration test is performed for Auto Index and select factors such as NIFTY, IIP, and LIBOR. The Null hypothesis statement is set as “There is no Co-integration between Auto Index and select factors”.

**Table 1: Test of Johansen Co-integration between Auto Index and select factors**

|  |
| --- |
| Series: Auto Index, NIFTY, IIP and LIBOR  |
| Lags interval: 1 to 4 (in first differences) |
| Unlimited Co-integration Rank Test (Trace) |
| Estimated number of CE (s) | Value of Eigen | Observe Statistics | 0.05Critical Value | Prob.\*\* |
| None \* |  0.414271 |  104.6823 |  47.85613 |  0.0000 |
| at most 1, |  0.179557 |  43.16907 |  29.79707 |  0.0008 |
| at most 2, |  0.103847 |  20.40934 |  15.49471 |  0.0084 |
| at most 3, |  0.065579 |  7.800205 |  3.841466 |  0.0052 |
|  At the 0.05 level, a trace test reveals 4 co-integrating equations. |
| \* indicates that the hypothesis was rejected at the 0.05 level. |
|  \*\*MacKinnon-Haug-Michelis (1999) p-values |
| Test of Unconditional Co-integration (Maximum Eigen value) |
| HypothesizedNo. of CE(s) | Eigen value | Max-Eigen Statistic | 0.05Critical Value | Prob.\*\* |
| None \* |  0.414271 |  61.51318 |  27.58434 |  0.0000 |
| at most 1, |  0.179557 |  22.75973 |  21.13162 |  0.0293 |
| at most 2, |  0.103847 |  12.60914 |  14.26460 |  0.0898 |
| at most 3, |  0.065579 |  7.800205 |  3.841466 |  0.0052 |
| At the 0.05 level, the Max-Eigen value test reveals two co-integrating equations. |
| \* indicates that the hypothesis was rejected at the 0.05 level. |
|  p-values from MacKinnon-Haug-Michelis (1999) |

Source: Compiled data

Table 1 indicates that, the null hypothesis should be rejected and there are three co-integration equations between Auto Index and select economic factors since the trace statistic values of unrestricted co-integration rank test (104.6823, 43.16907, 20.40934 and 7.8) and Max Eigen statistic values of MacKinnon-Haug-Michelis (1999) test (61.51318, 22.75973, 12.60914 and 7.8) are greater than critical values at five percent level of significance (47.85613, 29.79707, 15.49471 and 3.841466 and 27.58434, 21.13162, 14.26460 and 3.841466). The respective probability values also reveal that there is a co-integration among variables since the values are less than five per cent. Hence one can conclude that, the Auto Index has long run association with select economic factors.

**b. Vector Error Correction Model (VECM)**

A multiple time series model called the VECM is employed when the variables being studied have a long-term stochastic tendency, commonly known as co-integration. It is helpful for assessing the long- and short-term effects of one time-series-based variable on another variable of a comparable kind. The phrase "last period deviations from long run equilibrium influences its short run dynamics" is the definition of error correction. Therefore, the pace at which an endogenous variable returns to equilibrium following a change in other variables is directly estimated by the error correction model.

**Table 2 Vector Error Correction Estimates of Auto Index and Select economic factors**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Co-integrating Equation** | **Test values** | **Co-integrating Equation** | **Test values** | **Co-integrating Equation** | **Test values** |
| AUTO(-1) |  1.000000 | D(NIFTY(-1)) |  0.618854 |   | [-0.39216] |
| NIFTY(-1) |  0.000000 |   |  (0.23863) | D(LIBOR(-3)) | -0.017112 |
| IIP(-1) |  0.000000 |   | [ 2.59335] |   |  (0.02814) |
| LIBOR(-1) |  0.907264 | D(NIFTY(-2)) |  0.433544 |   | [-0.60803] |
|   |  (0.15009) |   |  (0.23214) | D(LIBOR(-4)) | -0.025735 |
|   | [ 6.04479] |   | [ 1.86762] |   |  (0.02711) |
| C | -9.29095 | D(NIFTY(-3)) |  0.628090 |   | [-0.94915] |
| Error Correction: | D(AUTO) |   |  (0.22840) | C |  0.007416 |
| Co-integration Equation 1 |  0.062556 |   | [ 2.75001] |   |  (0.00802) |
|   |  (0.04933) | D(NIFTY(-4)) |  0.462903 |   | [ 0.92510] |
|   | [ 1.26820] |   |  (0.23817) |  R-squared |  0.318050 |
| Co-integration Equation 2 | -0.132865 |   | [ 1.94360] |  Adj. R-squared |  0.181661 |
|   |  (0.09454) | D(IIP(-1)) |  0.309495 |  Sum sq. residual |  0.491580 |
|   | [-1.40544] |   |  (0.17351) |  S.E. equation |  0.071934 |
| Co-integration Equation 3 | -0.51213 |   | [ 1.78369] |  F-statistic |  2.331921 |
|   |  (0.17030) | D(IIP(-2)) |  0.492790 |  Log likelihood |  150.4882 |
|   | [-3.00726] |   |  (0.17006) |  Akaike AIC | -2.26936 |
| D(AUTO(-1)) | -0.576855 |   | [ 2.89769] |  Schwarz SC | -1.79198 |
|   |  (0.23054) | D(IIP(-3)) |  0.331295 |  Mean dependent |  0.012021 |
|   | [-2.50216] |   |  (0.16340) |  S.D. dependent |  0.079519 |
| D(AUTO(-2)) | -0.423377 |   | [ 2.02751] |  Determinant residual covariance (dof adj.) |  8.34E-10 |
|   |  (0.21647) | D(IIP(-4)) |  0.266896 |  Determinant residual covariance |  3.88E-10 |
|   | [-1.95582] |   |  (0.13212) |  Log likelihood |  593.2606 |
| D(AUTO(-3)) | -0.51423 |   | [ 2.02010] |  Akaike information criterion | -8.717575 |
|   |  (0.21023) | D(LIBOR(-1)) | -0.026176 |  Schwarz criterion | -6.52163 |
|   | [-2.44605] |   |  (0.03050) |  |  |
| D(AUTO(-4)) | -0.233145 |   | [-0.85828] |  |  |
|   |  (0.22160) | D(LIBOR(-2)) | -0.011559 |  |  |
|   | [-1.05209] |   |  (0.02947) |  |  |

Table 2 is the representation of error correction equations of Auto Index. As the Johansen co-integration test reveals that there are 3 co-integration equations between Auto index and select sectoral indices and lag selection criterion suggests considering four lags, the error correction model has considered the same order of lags and co-integration equations. The R-square value (31.8 per cent) of the model reveals that the predictive ability of lag co-efficient of select economic factors as well as Auto index lag variables is 31.8 percent. The model also provides beta coefficients, standard error and t-statistic values for lag terms of Auto index, NIFTY, IIP and LIBOR, but it will not reveal the significance of those values.

**c. Testing of hypothesis for coefficients**

In order to test the significance, one has to take the help of Traditional Least Squares (OLS) evalution technique. The following is revealed by the OLS approach for error correction model:

**Table 3 Tests of significance for Inaccuracy correction Model**

|  |
| --- |
| Dependent Variable: D(AUTO) |
| **Error Correction Model:**D(AUTO) = C(1)\*( AUTO(-1) + 0.90726394415\*LIBOR(-1) -9.29095037385 ) + C(2)\*( NIFTY(-1) + 0.475600517345\*LIBOR(-1) -9.18167571573 ) + C(3)\*( IIP(-1) + 0.0907651737148\*LIBOR(-1) -7.09912903309 ) + C(4)\*D(AUTO(-1)) + C(5)\*D(AUTO(-2)) +C(6)\*D(AUTO(-3)) + C(7)\*D(AUTO(-4)) + C(8)\*D(NIFTY(-1)) +C(9)\*D(NIFTY(-2)) + C(10)\*D(NIFTY(-3)) + C(11)\*D(NIFTY(-4)) + C(12)\*D(IIP(-1)) + C(13)\*D(IIP(-2)) + C(14)\*D(IIP(-3)) + C(15)\*D(IIP(-4)) +C(16)\*D(LIBOR(-1)) + C(17)\*D(LIBOR(-2)) + C(18)\*D(LIBOR(-3)) +C(19)\*D(LIBOR(-4)) + C(20) |
|  | **Coefficient** | **Std. Error** | **t-Statistic** | **Prob.** |
| C(1) | 0.062556 | 0.049326 | 1.268204 | 0.2078 |
| C(2) | -0.132865 | 0.094537 | -1.405438 | 0.1632 |
| C(3) | -0.512130 | 0.170298 | -3.007259 | 0.0034 |
| C(4) | -0.576855 | 0.230543 | -2.502162 | 0.0141 |
| C(5) | -0.423377 | 0.216470 | -1.955822 | 0.0534 |
| C(6) | -0.514230 | 0.210229 | -2.446049 | 0.0163 |
| C(7) | -0.233145 | 0.221601 | -1.052095 | 0.2954 |
| C(8) | 0.618854 | 0.238632 | 2.593346 | 0.0110 |
| C(9) | 0.433544 | 0.232137 | 1.867623 | 0.0649 |
| C(10) | 0.628090 | 0.228395 | 2.750011 | 0.0071 |
| C(11) | 0.462903 | 0.238168 | 1.943601 | 0.0549 |
| C(12) | 0.309495 | 0.173514 | 1.783693 | 0.0777 |
| C(13) | 0.492790 | 0.170063 | 2.897694 | 0.0047 |
| C(14) | 0.331295 | 0.163400 | 2.027510 | 0.0454 |
| C(15) | 0.266896 | 0.132121 | 2.020096 | 0.0462 |
| C(16) | -0.026176 | 0.030498 | -0.858282 | 0.3929 |
| C(17) | -0.011559 | 0.029475 | -0.392163 | 0.6958 |
| C(18) | -0.017112 | 0.028144 | -0.608031 | 0.5446 |
| C(19) | -0.025735 | 0.027113 | -0.949151 | 0.3450 |
| C(20) | 0.007416 | 0.008016 | 0.925096 | 0.3573 |
| R-squared | 0.318050 | Mean dependent | 0.012021 |
| Adjusted R-squared | 0.181661 | S.D. dependent | 0.079519 |
| S.E. of regression | 0.071934 | Akaike info criterion | -2.269360 |
| Sum squared residual | 0.491580 | Schwarz criterion | -1.791980 |
| Log likelihood | 150.4882 | Hannan-Quinn criterion | -2.075594 |
| F-statistic | 2.331921 | Durbin-Watson stat | 1.968573 |
| Probability value (F-statistic) 0.003849 |

Source: Compiled data

In the Table 3, C (1), C(2) and C(3) were explain the long run association among the variables. When the beta co-efficient values of C (1), C(2) and C(3) are negative and significant then one can conclude that variables are associated in long run. In the above table C (1) (0.062556) is having a positive sign of co-efficient and in-significant (0.2078) at 5 per cent level of significance, C (2) coefficient (-0.132865) is negative in sign but in-significant (0.1632) at 5 per cent level of significance. The third co-efficient C (3) is significant since its beta value (-0.512130) is negative in symbol and significant at (0.0034) 5 per cent level of significance. Therefore one can conclude that there exists long-term relationships between the variables.

The table also reveals that C(4) for (D(Auto(-1)), C (6) for (D(Auto(-3)),C(8) for (D(NIFTY(-1)), C(10) for (D(NIFTY(-3)), and C (15) for (D(IIP-4)) are significant at 5 per cent level of significance whereas C(5) i.e., for (D(Auto(-2)), C (9) for (D(NIFTY(-2)), C (11) for(D(NIFTY(-4)), C (12) for (D(IIP(-1)) are significant at 10 per cent level of significance. The rest of variables are in-significant at both 5 and 10 per cent level of significance.

The F statistic (2.331921) and respective probability values (0.003849) reveals that the model is significant at 5 and 1 per cent level of significance.

**d. Test of Normality for residual**

One of the criterion for a good regression model is, that the residual must be normally distributed. In order to analyze the normality of residuals, one can use the Jarque-Bera statistic and histogram. The null hypothesis that has considered here is that “The residuals are normally distributed”.

**Graph 1 Histogram and Normality test of Residual for Auto Index**

 Source: Compiled data

The graph 1 and respective table reveals that the null hypothesis should be accepted i.e., the “Residual are normally distributed” since the Jarque-Bera Statistic’s (0.773933) probability values (0.679114) is greater than 5 per cent level of significant.

**e. Wald Chi-square test or Wald Test**

Whenever a relationship within or between data items can be expressed as a statistical model with parameters to be estimated from a sample, the Wald chi-square test also known as Wald test can be used to test the true value of the parameter based on the sample estimate. After testing the long-run association among the variables with the help of Error Correction model, one can go for testing of short run association among the endogenous and exogenous variables by using Wald Test. The null hypothesis that has framed here is that the value of coefficients for lagged economic variables such as NIFTY, IIP and LIBOR are zero or there is no short run causality of lagged coefficients on Auto Index.

**Table 4: Wald Test**

|  |
| --- |
| Null Hypothesis: C(8)=C(9)=C(10)=C(11)=0 |
| **Test Statistic** | **Value** | **Df** | **Probability** |
| F-statistic |  3.334422 | (4, 95) |  0.0133 |
| Chi-square |  13.33769 |  4 |  0.0097 |
| Null Hypothesis Summary: |  |
| **Normalized Restriction (= 0)** | **Value** | **Std. Err.** |
| C(8) |  0.618854 |  0.238632 |
| C(9) |  0.433544 |  0.232137 |
| C(10) |  0.628090 |  0.228395 |
| C(11) |  0.462903 |  0.238168 |
| Null Hypothesis: C(12)=C(13)=C(14)=C(15)=0 |
| **Test Statistic** | **Value** | **Df** | **Probability** |
| F-statistic |  2.524331 | (4, 95) |  0.0459 |
| Chi-square |  10.09732 |  4 |  0.0388 |
| Null Hypothesis Summary: |  |
| **Normalized Restriction (= 0)** | **Value** | **Std. Err.** |
| C(12) |  0.309495 |  0.173514 |
| C(13) |  0.492790 |  0.170063 |
| C(14) |  0.331295 |  0.163400 |
| C(15) |  0.266896 |  0.132121 |
| Null Hypothesis: C(16)=C(17)=C(18)=C(19)=0 |
| **Test Statistic** | **Value** | **Df** | **Probability** |
| F-statistic |  0.457959 | (4, 95) |  0.7664 |
| Chi-square |  1.831836 |  4 |  0.7667 |
| Null Hypothesis Summary: |  |
| **Normalized Restriction (= 0)** | **Value** | **Std. Err.** |
| C(16) | -0.026176 |  0.030498 |
| C(17) | -0.011559 |  0.029475 |
| C(18) | -0.017112 |  0.028144 |
| C(19) | -0.025735 |  0.027113 |

Source: Compiled data

The table number 4 indicates the Wald-test results. C(8), C(9), C(10) and C(11) represents the lagged coefficients for NIFTY, C(12), C(13), C(14) and C(15) are the lagged coefficients for IIP and C(16), C(17), C(18) and C(19) represents the lagged coefficients of LIBOR. We have sufficient information to refuse the null hypothesis and obtain substitute hypothesis, i.e., C(8), C(9), C(10), C(11), C(12), C(13), C(14) and C(15) possess short run causality with Auto Index since F (0.0133, 0.0459) and Chi-square (0.0097, 0.0388) statistical probability values are less 0.05 or 5 per cent level of significance. In the case of C(16), C(17), C(18) and C(19) variables, the null hypothesis should be accepted i.e., C(16), C(17), C(18) and C(19) variables does not possess short run causality with Auto Index, since the F (0.7664) and Chi-square statistical probability values (0.7667) are more than 0.05 or 5% level of significance.

**Analysis of Bankex**

**Johansen Co-integration test**

Multivariate Johansen Co-integration test is performed for Bankex and select factors such as NIFTY, MCX, FII, USD, NASDAQ, DOWJONES. The Null hypothesis statement is set as “There is no Co-integration between Bankex and select factors”.

**Table 5: Test of Johansen Co-integration between Bankex and select factors**

|  |
| --- |
| Series: BANKEX NIFTY MCX FII USD NASDAQ DOWJONES  |
| Lags interval (in first differences): 1 to 4 |
| Unrestricted Co-integration Rank Test (Trace) |  |
| **Hypothesized****No. of CE(s)** | **Eigen value** | **Trace****Statistic** | **0.05****Critical Value** | **Prob.\*\*** |
| None \* |  0.285625 |  132.3620 |  125.6154 |  0.0182 |
| At most 1 |  0.247823 |  94.01832 |  95.75366 |  0.0655 |
| At most 2 |  0.166100 |  61.55302 |  69.81889 |  0.1908 |
| At most 3 |  0.131731 |  40.84582 |  47.85613 |  0.1936 |
| At most 4 |  0.120186 |  24.74283 |  29.79707 |  0.1708 |
| At most 5 |  0.076510 |  10.14576 |  15.49471 |  0.2697 |
| At most 6 |  0.009358 |  1.071880 |  3.841466 |  0.3005 |
|  Trace test indicates 1 co-integrating eqn(s) at the 0.05 level |
|  \* denotes rejection of the hypothesis at the 0.05 level |
|  \*\*MacKinnon-Haug-Michelis (1999) p-values |  |
| Unrestricted Co-integration Rank Test (Maximum Eigenvalue) |
| **Hypothesized****No. of CE(s)** | **Eigen value** | **Max-Eigen****Statistic** | **0.05****Critical Value** | **Prob.\*\*** |
| None |  0.285625 |  38.34363 |  46.23142 |  0.2711 |
| At most 1 |  0.247823 |  32.46531 |  40.07757 |  0.2782 |
| At most 2 |  0.166100 |  20.70720 |  33.87687 |  0.7060 |
| At most 3 |  0.131731 |  16.10298 |  27.58434 |  0.6570 |
| At most 4 |  0.120186 |  14.59707 |  21.13162 |  0.3181 |
| At most 5 |  0.076510 |  9.073885 |  14.26460 |  0.2800 |
| At most 6 |  0.009358 |  1.071880 |  3.841466 |  0.3005 |
|  Max-eigen value test indicates no co-integration at the 0.05 level |
|  \* denotes rejection of the hypothesis at the 0.05 level |
|  \*\*MacKinnon-Haug-Michelis (1999) p-values |

Source: Compiled data

Table 5 indicates that, the null hypothesis should be rejected and there is one co-integration equations between Bankex and select economic factors since the trace statistic value of unrestricted co-integration rank test (132.3620) is greater than critical values at five percent level of significance (125.6154). The respective probability value also reveals that there is a co-integration among variables since the value (0.0182) is less than five per cent. Hence one can conclude that Bankex has long run association with select economic factors.

**Table 6 Vector Error Correction Estimates of Bankex and Select economic factors**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Co-integrating****Eq:** | **CointEq1** | **Co- integrating Eq:** | **CointEq1** | **Co-integrating****Eq:** | **CointEq1** |
| BANKEX(-1) | 1.000000 | D(NIFTY(-1)) | 0.443312 | D(USD(-1)) | 0.575730 |
| NIFTY(-1) | -4.09653 |  | (0.37778) |  | (1.02487) |
|  | (0.51501) |  | [ 1.17346] |  | [ 0.56176] |
|  | [-7.95432] | D(NIFTY(-2)) | 1.255308 | D(USD(-2)) | -0.49981 |
| MCX(-1) | -2.99385 |  | (0.36845) |  | (1.03992) |
|  | (0.54050) |  | [ 3.40698] |  | [-0.48062] |
|  | [-5.53901] | D(NIFTY(-3)) | 0.646091 | D(USD(-3)) | 1.691033 |
| FII(-1) | 0.186270 |  | (0.37353) |  | (0.97018) |
|  | (0.05208) |  | [ 1.72969] |  | [ 1.74301] |
|  | [ 3.57687] | D(NIFTY(-4)) | 1.169672 | D(USD(-4)) | 4.233704 |
| USD(-1) | -10.4962 |  | (0.34398) |  | (0.80691) |
|  | (2.00655) |  | [ 3.40044] |  | [ 5.24682] |
|  | [-5.23098] | D(MCX(-1)) | -0.14294 | D(NASDAQ(-1)) | -0.45762 |
| NASDAQ(-1) | 7.719280 |  | (0.27462) |  | (0.49255) |
|  | (1.54041) |  | [-0.52051] |  | [-0.92908] |
|  | [ 5.01120] | D(MCX(-2)) | 0.081345 | D(NASDAQ(-2)) | -0.32197 |
| DOWJONES(-1) | -5.86606 |  | (0.28221) |  | (0.49059) |
|  | (1.35077) |  | [ 0.28824] |  | [-0.65628] |
|  | [-4.34275] | D(MCX(-3)) | 0.574767 | D(NASDAQ(-3)) | -0.61214 |
| C | 91.06650 |  | (0.27910) |  | (0.47800) |
| Error Correction: | D(BANKEX) |  | [ 2.05938] |  | [-1.28063] |
| CointEq1 | 0.084767 | D(MCX(-4)) | 0.446987 | D(NASDAQ(-4)) | -0.37506 |
|  | (0.05446) |  | (0.24294) |  | (0.44436) |
|  | [ 1.55656] |  | [ 1.83992] |  | [-0.84406] |
| D(BANKEX(-1)) | -0.16952 | D(FII(-1)) | -0.0094 | D(DOWJONES(-1)) | 0.415875 |
|  | (0.23917) |  | (0.01001) |  | (0.56581) |
|  | [-0.70878] |  | [-0.93906] |  | [ 0.73500] |
| D(BANKEX(-2)) | -0.85558 | D(FII(-2)) | 0.004254 | D(DOWJONES(-2)) | -0.38066 |
|  | (0.23746) |  | (0.00965) |  | (0.57019) |
|  | [-3.60298] |  | [ 0.44068] |  | [-0.66760] |
| D(BANKEX(-3)) | -0.20012 | D(FII(-3)) | 0.009064 | D(DOWJONES(-3)) | 0.433524 |
|  | (0.24372) |  | (0.00889) |  | (0.56268) |
|  | [-0.82108] |  | [ 1.02014] |  | [ 0.77046] |
| D(BANKEX(-4)) | -0.33225 | D(FII(-4)) | 0.000604 | D(DOWJONES(-4)) | 0.359419 |
|  | (0.22866) |  | (0.00720) |  | (0.52434) |
|  | [-1.45298] |  | [ 0.08392] |  | [ 0.68547] |
|  |  |  |  | C | 0.002766 |
|  |  |  |  |  | (0.00933) |
|  |  |  |  |  | [ 0.29642] |
| R-squared | 0.475265 | Log likelihood | 138.3246 |  |
| Adj. R-squared | 0.294106 | Akaike AIC | -1.90043 |
| Sum sq. residuals | 0.589532 | Schwarz SC | -1.18038 |
| S.E. equation | 0.083775 | Mean dependent | 0.009809 |
| F-statistic | 2.623471 | S.D. dependent | 0.099711 |
| Determinant residual covariance (dof adj.) | 7.09E-19 | Akaike informationcriterion | -20.2556 |
| Determinant residual covariance | 8.36E-20 | Schwarz criterion | -15.0472 |
| Log likelihood | 1371.569 |  |

Source: Compiled data

Table 6 is the representation of error correction equations of Bankex. As the Johansen co-integration test reveals that there is one co-integration equations between Bankex and select sectoral indices; lag selection criterion suggests considering four lags, the error correction model has considered the same order of lags and co-integration equations. The R-square value (47.52 per cent) of the model reveals that the predictive ability of lag co-efficient of select economic factors as well as Bankex lag variables is 47.52 percent. The model also provides beta coefficients, standard error and t-statistic values for lag terms of Bankex, NIFTY, MCX, FII, USD, NASDAQ, DOWJONES, but it will not reveal the significance of those values.

**c. Table 7 Tests of significance for Error correction Model**

|  |
| --- |
| Dependent Variable: D(BANKEX) |
| D(BANKEX) = C(1)\*( BANKEX(-1) - 4.09653034571\*NIFTY(-1) -2.99384470615\*MCX(-1) + 0.186270014852\*FII(-1) - 10.4962122477\*USD(-1) + 7.71927956669\*NASDAQ(-1) - 5.86605833038\*DOWJONES(-1) + 91.0664976114 ) + C(2)\*D(BANKEX(-1)) + C(3)\*D(BANKEX(-2)) + C(4)\*D(BANKEX(-3)) + C(5)\*D(BANKEX(-4)) + C(6)\*D(NIFTY(-1)) + C(7)\*D(NIFTY(-2)) + C(8)\*D(NIFTY(-3)) + C(9)\*D(NIFTY(-4)) + C(10)\*D(MCX(-1)) + C(11)\*D(MCX(-2)) + C(12)\*D(MCX(-3)) + C(13)\*D(MCX(-4)) + C(14)\*D(FII(-1)) + C(15)\*D(FII(-2)) + C(16)\*D(FII(-3)) + C(17)\*D(FII(-4)) + C(18)\*D(USD(-1)) + C(19)\*D(USD(-2)) + C(20)\*D(USD(-3)) + C(21)\*D(USD(-4)) + C(22)\*D(NASDAQ(-1)) + C(23)\*D(NASDAQ(-2)) + C(24)\*D(NASDAQ(-3)) + C(25)\*D(NASDAQ(-4)) + C(26)\*D(DOWJONES(-1)) + C(27)\*D(DOWJONES(-2)) + C(28)\*D(DOWJONES(-3)) + C(29)\*D(DOWJONES(-4)) + C(30) |
|
|
|
|
|   | **Coefficient** | **Std. Error** | **t-Statistic** | **Prob.** |
| c(1) | 0.084767 | 0.054458 | 1.556556 | 0.1233 |
| c(2) | -0.169522 | 0.239174 | -0.708782 | 0.4804 |
| c(3) | -0.855581 | 0.237465 | -3.602979 | 0.0005 |
| c(4) | -0.200115 | 0.24372 | -0.821085 | 0.4139 |
| c(5) | -0.332245 | 0.228665 | -1.452977 | 0.15 |
| c(6) | 0.443312 | 0.377783 | 1.173458 | 0.2439 |
| c(7) | 1.255308 | 0.368451 | 3.406985 | 0.001 |
| c(8) | 0.646091 | 0.373531 | 1.729688 | 0.0874 |
| c(9) | 1.169672 | 0.343977 | 3.400441 | 0.001 |
| c(10) | -0.14294 | 0.274616 | -0.520509 | 0.6041 |
| c(11) | 0.081345 | 0.282215 | 0.288237 | 0.7739 |
| c(12) | 0.574767 | 0.279097 | 2.059383 | 0.0426 |
| c(13) | 0.446987 | 0.242938 | 1.839923 | 0.0693 |
| c(14) | -0.009403 | 0.010014 | -0.939056 | 0.3504 |
| c(15) | 0.004254 | 0.009654 | 0.440684 | 0.6606 |
| c(16) | 0.009064 | 0.008885 | 1.020144 | 0.3106 |
| c(17) | 0.000604 | 0.007203 | 0.083925 | 0.9333 |
| c(18) | 0.57573 | 1.024871 | 0.561759 | 0.5758 |
| c(19) | -0.499809 | 1.039921 | -0.480621 | 0.632 |
| c(20) | 1.691033 | 0.97018 | 1.743008 | 0.085 |
| c(21) | 4.233704 | 0.806909 | 5.246817 | 0 |
| c(22) | -0.457621 | 0.492553 | -0.929079 | 0.3555 |
| c(23) | -0.321966 | 0.490593 | -0.656278 | 0.5134 |
| c(24) | -0.61214 | 0.478 | -1.280627 | 0.2038 |
| c(25) | -0.375062 | 0.444355 | -0.844059 | 0.401 |
| c(26) | 0.415875 | 0.565813 | 0.735005 | 0.4644 |
| c(27) | -0.380659 | 0.57019 | -0.6676 | 0.5062 |
| c(28) | 0.433524 | 0.562684 | 0.770458 | 0.4432 |
| c(29) | 0.359419 | 0.52434 | 0.685469 | 0.4949 |
| c(30) | 0.002766 | 0.009332 | 0.296421 | 0.7676 |
| R-squared | 0.475265 | Mean dependent var | 0.009809 |
| R-squared adjusted | 0.294106 | S.D. dependent var | 0.099711 |
| Rate of regression, S.E. | 0.083775 | Akaike info criterion | -1.900432 |
| Squared-sum residual | 0.589532 | Schwarz criterion | -1.18038 |
| Log probability | 138.3246 | Hannan-Quinn criter. | -1.608203 |
| F-statistic | 2.623471 | Durbin-Watson stat | 1.973797 |
| Prob(F-statistic) | 0.000329 |  |  |  |

Source: Compiled data

In the above table C (1) (0.084767) is having a positive sign and in-significant (0.1233) at 5 per cent level of significance. Therefore one can conclude that there no long run associations among the variables.

The table also reveals that C(3) for D (Bankex(-2)), c (7) for D(NIFTY(-2)), C(9) for D(NIFTY(-4)), and C(21) for (D(USD(-4)) are significant at c(13) for D(MCX(-4)) is significant at 10% level of significance compared to 5% level of significance for C(13). At both the 5% and 10% levels of significance, the remaining variables are not significant..

The F statistic (2.623471) and respective probability values (0.000329) reveals that the model is significant at 5 and 1 per cent level of significance.

**Graph 2 Histogram and Normality test of Residual for Bankex**

Source: Compiled data

The graph 2 and respective table reveals that the null hypothesis should be accepted i.e., the “Residual are normally distributed” since the Jarque-Bera Statistic’s (0.773933) probability values (0.679114) is greater than 5 per cent level of significance.

**e. Wald Chi-square test or Wald Test**

After testing the long-run union among the variables with the help of Error Correction model, one can go for testing of short run association among the endogenous and exogenous variables by using Wald Test. The null hypothesis that has framed here is that the value of coefficients for lagged economic variables such as NIFTY, MCX, FII, USD, NASDAQ, DOWZONES are zero or there is no impact of lagged coefficients on Bankex.

**Table 8: Wald Test**

|  |
| --- |
| **Wald Test: Null Hypothesis: C(2)=C(3)=C(4)=C(5)=0** |
| **Test Statistic** | **Value** | **df** | **Probability** |
| F-statistic |  3.469089 | (4, 84) |  0.0113 |
| Chi-square |  13.87636 |  4 |  0.0077 |
| **Null Hypothesis Summary:****Normalized Restriction (= 0)** | **Value** | **Std. Err.** |
| C(2) | -0.169522 |  0.239174 |
| C(3) | -0.855581 |  0.237465 |
| C(4) | -0.200115 |  0.243720 |
| C(5) | -0.332245 |  0.228665 |
| **Null Hypothesis: C(6)=C(7)=C(8)=C(9)=0** |
| **Test Statistic** | **Value** | **df** | **Probability** |
| F-statistic |  5.128504 | (4, 84) |  0.0010 |
| Chi-square |  20.51402 |  4 |  0.0004 |
| **Null Hypothesis Summary:** |  |
| **Normalized Restriction (= 0)** | **Value** | **Std. Err.** |
| C(6) |  0.443312 |  0.377783 |
| C(7) |  1.255308 |  0.368451 |
| C(8) |  0.646091 |  0.373531 |
| C(9) |  1.169672 |  0.343977 |
| **Wald Test: Null Hypothesis: C(10)=C(11)=C(12)=C(13)=0** |
| **Test Statistic** | **Value** | **df** | **Probability** |
| F-statistic |  1.871150 | (4, 84) |  0.1231 |
| Chi-square |  7.484600 |  4 |  0.1124 |
| **Null Hypothesis Summary:****Normalized Restriction (= 0)** | **Value** | **Std. Err.** |
| C(10) | -0.142940 |  0.274616 |
| C(11) |  0.081345 |  0.282215 |
| C(12) |  0.574767 |  0.279097 |
| C(13) |  0.446987 |  0.242938 |
| **Wald Test: Null Hypothesis: C(14)=C(15)=C(16)=C(17)=0** |
| **Test Statistic** | **Value** | **df** | **Probability** |
| F-statistic |  0.999691 | (4, 84) |  0.4125 |
| Chi-square |  3.998764 |  4 |  0.4062 |
| **Established Restriction (= 0)** | **Value** | **Std. Err.** |
| C(14) | -0.009403 |  0.010014 |
| C(15) |  0.004254 |  0.009654 |
| C(16) |  0.009064 |  0.008885 |
| C(17) |  0.000604 |  0.007203 |
| **Wald Test: Null Hypothesis: C(18)=C(19)=C(20)=C(21)=0** |
| **Test Statistic** | **Value** | **df** | **Probability** |
| F-statistic |  7.571164 | (4, 84) |  0.0000 |
| Chi-square |  30.28465 |  4 |  0.0000 |
| **Null Interpretation Summary:****Distributed control (= 0)** | **Value** | **Std. Err.** |
| C(18) |  0.575730 |  1.024871 |
| C(19) | -0.499809 |  1.039921 |
| C(20) |  1.691033 |  0.970180 |
| C(21) |  4.233704 |  0.806909 |
| **Wald Test: Null Hypothesis: C(22)=C(23)=C(24)=C(25)=0** |
| **Test data** | **Value** | **df** | **Probability** |
| F-statistic |  0.579084 | (4, 84) |  0.6786 |
| Summary of Chi-square |  2.316336 |  4 |  0.6778 |
| **Null Inference Summary:****Assigned Restriction (= 0)** | **Value** | **Std. Err.** |
| C(22) | -0.457621 |  0.492553 |
| C(23) | -0.321966 |  0.490593 |
| C(24) | -0.612140 |  0.478000 |
| C(25) | -0.375062 |  0.444355 |
| **Wald Test: Null Hypothesis: C(26)=C(27)=C(28)=C(29)=0** |
| **Test stats** | **Value** | **df** | **Probability** |
| F-statistic |  0.490313 | (4, 84) |  0.7428 |
| Chi-square |  1.961251 |  4 |  0.7429 |
| **Null Hypothesis Summary:** |  |
| **Plan Restriction (= 0)** | **Value** | **Std. Err.** |
| C(26) |  0.415875 |  0.565813 |
| C(27) | -0.380659 |  0.570190 |
| C(28) |  0.433524 |  0.562684 |
| C(29) |  0.359419 |  0.524340 |

Source: Compiled data

The table number 8 indicates the Wald-test results. C(2), C(3), C(4) and C(5) represents the fall off coefficients for Bankex, C(6), C(7), C(8) and C(9) are the lagged coefficients for NIFTY, C(10), C(11), C(12) and C(13) represents the lagged coefficients of MCX, C(14), C(15), C(16) and C(17) represents the lagged coefficients of FII, C(18), C(19), C(20) and C(21) represents lagged coefficients of USD, C(22), C(23), C(24) and C(25) represents lagged coefficients of NASDAQ, C(26), C(27), C(28) and C(29) represents lagged coefficients of Dowjones. We have sufficient information to dismiss the null hypothesis and obtain substitute thesis, i.e., C(2), C(3), C(4), C(5), C(6), C(7), C(8), C(9), C (18), C (19), C (20) and C(21) possess short run causality with Bankex since F (0.0133, 0.0010 and 0.00) and Chi-square (0.0077, 0.0004 and 0.00) statistical probability values are less 0.05 or 5 per cent level of significance. In the case of C(10), C(11), C(12), C(13), C(14), C(15), C(16), C(17), C(22), C(23), C(24), C(25), C(26), C(27), C(28), and C(29) variables, the null hypothesis should be accepted i.e., C(10), C(11), C(12), C(13), C(14), C(15), C(16), C(17), C(22), C(23), C(24), C(25), C(26), C(27), C(28), and C(29) variables does not possess short run causality with Bankex, since the F (0.1231, 0.4125, 0.6786 and 0.7428) and Chi-square statistical probability values (0.1124, 0.4062, 0.6778 and 0.7429 ) are more than 0.05 or 5% level of significance.

**Findings**

* Co-integration test for non-stationary data reveals that NIFTY, IIP and LIBOR will influence the Auto Index in long run. The study found three co-integration equations between Auto Index and NIFTY, IIP and LIBOR.
* Error correction mechanism for Auto Index reveals that, the lag variables of Auto index, NIFTY, IIP and LIBOR have the long run predictive ability of 31.8 per cent. Second and third lag variables of Auto index, first and third lag variables of NIFTY and first lag variable of IIP are compelling variables to predict the variations of Auto Index in long run at five per cent level of significance.
* Normality test for residual of Auto index long run model reveals that, the residual are normally distributed hence it is found that the model is free from normality problem and the predictions that are made with this model will have more accuracy.
* From Wald test, it is found that first, second, third and fourth lagged coefficients of NIFTY, IIP and LIBOR has short run causality with the returns of Auto Index. Hence it is clear that the present month auto index returns are influenced by the variations in past four month of NIFTY, IIP and LIBOR.
* The co-integration test for non- stationary data reveals that, there exist one co-integration equation between Bankex and NIFTY, MCX, FII, US dollar index, NASDAQ and DOW JONES and posse’s predictive ability of 47.52 per cent.
* The error correction mechanism for Bankex reveals that, the lag variables of Bankex, NIFTY, MCX, FII, US dollar index, NASDAQ and DOW JONES doesn’t have the long run association among the variables since the coefficient sign of C(1) is positive and not significant at five per cent level of significance. Among 28 lag variables of Bankex, NIFTY, MCX, FII, US dollar index, NASDAQ and DOW JONES, only four variables such as second lag of Bankex, NIFTY, fourth lag of NIFTY, USD are significant variables to explain the variations Bankex returns.
* Normality test for residual of Bankex long run model reveals that, the residual are normally distributed hence it is found that the model is free from normality problem and the predictions that are made with this model will have more accuracy.
* From Wald test for short run association, it is found that first, second, third and fourth lagged coefficients of Bankex, NIFTY and US dollar index has short run causality with the returns of Bankex. Hence it is clear that the present month Bankex returns are influenced by the variations in past four month of Bankex, NIFTY and USD.

**Conclusion**

 The presented study has made an attempt to analyze the long run and short run causality at intervals select global and domestic factors with select sectoral indices of Indian stock market and concludes that Auto Index has long run association with four lag variables of Auto index, NIFTY and IIP and it has short run causality with NIFTY, IIP and LIBOR. Second and fourth lag variables of Bankex, fourth lag of NIFTY has long run association with Bankex, US Dollar index has short run impact on Bankex.

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1. In statistics, the **Johansen test**,named after Soren Johansen, is a procedure for testing co-integration of several, say *k*, I(1) time series.  [↑](#footnote-ref-2)
2. The time series data, whose mean, variance and co-variance values changes over the period is called as non-stationary data. [↑](#footnote-ref-3)
3. Engle–Granger has proposed this error correction model. It is belongs to a category of multiple time series models most commonly used for data where the underlying variables have a long-run stochastic trend, also known as co-integration. [↑](#footnote-ref-4)
4. The **Wald test** is a parametric statistical test named after the statistician Abraham Wald. Whenever a relationship within or between data items can be expressed as a statistical model with parameters to be estimated from a sample, the Wald test can be used to test the true value of the parameter based on the sample estimate. [↑](#footnote-ref-5)