Bulletin of Monetary Economics and Banking

Manuscript 2330

EDITORIAL (Domestic Policies (and Shocks), Macroeconomic Stability, and Economic Growth BMEB India Special Issue)

Yoga Affandi

Solikin M. Juhro

Paresh Kumar Narayan

EDITORIAL

Domestic Policies (and Shocks), Macroeconomic Stability, and Economic Growth BMEB India Special Issue

Yoga Affandi (Head of the BI Institute, Bank Indonesia), Solikin M. Juhro (Bank Indonesia), and Paresh Kumar Narayan (Monash Business School, Monash University)

India is one of the fastest growing economies in the world. The IMF (2023) argues that India's impressive growth has been achieved as a result of prudent macroeconomic policies. We argue that India's growth story is built on the foundations of both fiscal and monetary policy discipline. India's service sector has been instrumental also (see Padmapriya and Vidya, 2024)

Given the importance of the Indian economy to the global economic and financial landscape and geopolitical progress, the Bulletin of Monetary Economics and Banking has embarked on a series of special issues on India. This Volume, Volume 27 (Issue 3), is dedicated to emerging issues that matter to India's economic growth and sustainability. These seven papers were selected from a call for papers on the Indian economy. These papers were then on April 27, 2024, presented at an online workshop. Each paper was assigned a discussant. The papers were revised and submitted to BMEB where the standard editorial process was applied to all seven papers. These papers are not only timely because of the current policy discourse on India but they also set the foundation for future studies, aimed at aiding both the design and effectiveness of policies.

The seven papers in this issue represent an amalgam of policy issues pertinent to sustainable economic growth of India. The paper by Devpura, Narayan and Perera, for instance, examines how monetary policy affects stock returns. By showing how stock returns respond to short term interest rate is important for two reasons. First, given the global economic climate where inflation and interest rates are at the forefront of macroeconomic challenges and exerting ramifications for fiscal policy design, the response of the stock market is important from a financial stability viewpoint. Second, the performance of the stock market not only dictates financial stability (or otherwise) but has implications for wealth management and income generation. It is a major source of financing. Devpura et al show that while short term Treasury bill rate influences stock returns, it does not affect stock market volatility. That domestic short term interest rate is an influential factor should be treated with care when it comes to forecasting short rates and understanding the evolution of inflation. For a recent read about India's inflation, see Deheri (2023).

The second paper by Ranjan and Nath analyses how policy communications (by the Ministry of Commerce and Industry of India) have evolved in India that has been influencing public policy discourse. The key takeaway from their work is that while in the pre-global financial crisis period, policy communications had focused on international trade, post the crisis, the focus shifted to entail innovation and competitiveness. This is an important information because communication is key to optimal decision making and policy design success stories revolve around effective and timely communications.

The third paper by Kumar, which complements the work of Saroy *et al*. (2022), focuses on the effect of digital payments on goods and services tax revenue in India. They show that digital transactions have boosted India's tax revenue. The key proposal is that enhancing digital business models are likely to be beneficial to developing India's tax revenue base.

Kumar and Rao in their paper evaluate the impact of geopolitical risk uncertainty on the Indian financial sector. Their results show that the currency and banking sectors are most sensitive to geopolitical risk uncertainty. The implication of their results is that management systems and risk management strategies are needed to dampen the effects of geopolitical risk. The key feature of their results is the heterogenous nature of the response of the financial market—that is, some sectors are more sensitive than others. Identifying sectors most sensitive to geopolitical risks is paramount in devising a strategic policy response. The paper alludes to this fact.

Goel and Kumar take issue with the Indian mutual fund industry. In their analysis what is clear is that the mutual fund industry has grown impressively surpassing those of the USA, Europe and the BRICS. The authors attribute this performance to inflows of equity and hybrid funds. They also discuss the role and effectiveness of regulatory authorities, highlighting that policies aimed at promoting a formal economy and stance against black money have likely prompted a preference towards more liquid and transparent asset such as the mutual fund.

The work of Dua and Tuteja undertakes a comprehensive analysis of crises (COVID-19 pandemic, the Eurozone sovereign debt crisis, and the global financial crisis) on stock market returns and their volatility. This is important because crises such as these wipe out a large share of asset wealth. They show, using robust econometric techniques, that the COVID-19 pandemic and the global financial crisis had reduced returns and heightened volatility of the Indian stock market. These findings call into question: (a) the role of the central bank, which the authors argue was effective during the pandemic, and (b) the effectiveness of fiscal-monetary policy coordination. Their findings are consistent with the bulk of the COVID-19 pandemic literature; see Phan and Narayan (2020), Narayan (2021) and Prabheesh *et al*. (2021). While this feature is granted what is different in the work of Dua and Tuteja is their comparison of the effects of different crises. A comparative analysis is informative for both policy design and additional work.

In this issue's last paper, Salisu employs a GVAR model to understand international monetary policy spillovers. He shows that a US monetary policy shock results in the depreciation of the Indian rupee while the Eurozone monetary policy shock has no effect on the Indian currency. His results inform of the investor behavior and how the central bank can politically tackle any currency misalignments and/or volatility which maybe in excess of expectations.

These seven papers open up several avenues for future research. The first relates to the Indian stock market. Two papers in this issue (Devpura *et al*.; and Dua and Tuteja) focus on the Indian stock market. They show respectively that short term interest rate matters to returns and crises influence returns negatively. While

DOI: 10.59091/2460-9196.2330

both studies point out the ramifications for monetary policy, the effectiveness of monetary and/or fiscal policies (or their coordination) are not evaluated. Future studies should extend these works by specifically developing hypotheses around the role of institutions in mitigating the effects of rate rises and crises on returns and indeed on return volatility. Future studies could extend these works by also focussing on how the stock market return predictability can be influenced by these crises. Some useful econometric models to consider in enhancing the predictability story are Karavias *et al.* (2023) and Westerlund and Narayan (2012, 2015), amongst others.

The second avenue for additional research relates to the mutual fund industry. The work of Goel and Kumar while informative is descriptive and sets the foundation for research to branch out and tackle more quantitative issues grappling the mutual fund industry. Amongst other issues, we propose looking at (a) how the mutual fund industry is influenced by monetary policy decisions? (b) the determinants of the industry's performance; and (c) how effective are regulations in the impressive performance of the Indian mutual fund industry?

Ranjan and Nath's analysis of policy communications opens another channel of research that can potentially focus on multiple aspects of communications. Studies can, for instance, focus on understanding which types of communications are most effective in influencing public sentiments and policy outcomes. There is currently limited work on this. Another sub-theme of research can evaluate the strength of policy communications by conditioning on "who is the communicator?" For example, certain institutions are more powerful than others at least by name and scope to influence policy. But does this translate into institutional power when it comes to communicating policy? This is a subject for scrutiny.

We would also like to highlight that the work related to COVID-19 and results presented in this special issue can be extended to examine the different aspects of the pandemic and how monetary policy has been reshaped as a result. In this regard, a new dataset on COVID-19 has been proposed by Narayan *et al*. (2021) which can become a foundation for future studies.

Our final note is about digital growth in India, connected to the Kumar paper. India's digital transformation is impressive and represents a structural change in the economic and financial landscape of the country. India's digital journey has important lessons and implications for other emerging markets and developing countries in particular. Our message is similar to the one that emerges strongly in the work of Alonso *et al*. (2023), who argue that India will play a significant role in global economy due to its digital advancement.

REFERENCES

Alonso, C., Bhojwani, T., Hanedar, E., Prihardini, D., Una., G., & Zhabska, K. (2023). Stacking up the Benefits: Lessons from India's Digital Journey. *IMF Working Paper* No. 23/78. International Monetary Fund. Washington DC.

Deheri, A. (2023). The Nexus between Inflation and Inflation Uncertainty in India: Evidence from CPI Data. *Asian Economics Letters,* 5. https:/doi.org/10.46557/001c.74558

IMF. (2023). *IMF Executive Board Concludes 2023 Article IV Cinsultation with India*. Press Release No.23/458. https://www.imf.org/en/News/Articles/2023/12/18/pr23458-india-imf-exec-board-concludes-2023-art-iv-consult

Karavias, Y., Narayan, P. K., & Westerlund, J. (2022). Structural Breaks in Interactive Effects Panels and the Stock Market Reaction to COVID-19. *Journal of Business & Economic Statistics*. DOI: 10.1080/07350015.2022.2053690

Narayan, P. K. (2021). COVID-19 Research Outcomes: An Agenda for Future Research. *Economic Analysis and Policy*, 71, 419-445. https://doi.org/10.1016/j.eap.2021.06.006

Narayan, P. K., Iyke, B. N., & Sharma, S. S. (2021). New Measures of the COVID-19 Pandemic: A New Time-series Dataset. *Asian Economics Letters*, 2. https://doi.org/10.46557/001c.23491

Padmapriya, B., & Vidya, C. T. (2024). Assessing the Resilience of India's Service Sector to Shocks and Fluctuations. *Asian Economics Letters*, 5. https:/doi.org/10.46557/001c.117126

Phan, D. H. B., & Narayan, P. K. (2020). Country Responses and the Reaction of the Stock Market to COVID-19—A Preliminary Exposition. *Emerging Markets Finance and Trade*, 56, 2138-2150. DOI: 10.1080/1540496X.2020.1784719

Prabheesh, K. P., Juhro, S. M., & Harun, C. A. (2021). COVID-19 Uncertainty and Monetary Policy Responses: Evidence from Emerging Market Economies. *Bulletin of Monetary Economics and Banking*, 24, 489-516.

Saroy, R., Awasthy, S., Singh, N. K., Adki, S. M., & Dhal, S. (2022). The Impact of COVID-19 on Digital Payment Habits on Indian Households. *Bulletin of Monetary Economics and Banking*, 25, 19-42.

Westerlund, J., & Narayan, P. (2012). Does the Choice of Estimator Matter when Forecasting Returns? *Journal of Banking and Finance*, 36, 2632–2640.

Westerlund, J., & Narayan, P. (2015). Testing for Predictability in Conditionally Heteroskedastic Stock Returns. *Journal of Financial Econometrics*, 13, 342-375.