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The Bubble, the Recession and the Bull Phase : 2020, A Year of Unprecedented Indian Stock Market Movements

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ABSTRACT

The Indian stock markets are witnessing a year that is completely filled with bewilderment. In the beginning of the year, Indian stock markets saw its maximum and then within a few months, as Covid 19 pandemic distended and the Indian economy shut down for the first time in history as did all the economies around the world; it swiftly tumbled down shifting towards its lowest in no time. However, at the moment the stock markets are mounting up once again, making record highs.

The objective of this paper is to study the reasons behind the steep fall in the stock markets in India after the Pandemic outbreak, and the factors responsible for the current ascendant trend. We will also study the effect of creeping recession, as the economic activities came to a standstill due to the lockdown in the economy, on the current stock market trends.

We conclude that there is always a relationship between the GDP rate and the stock market movements. Also from the analysis it is apparent that in the short run there may be a disconnection between the two, however in the long run there is always a positive correlation between GDP growth and the stock market movement.

Keywords: Stock Market, Covid 19, Bubble, Recession, Bull Market.

INTRODUCTION

We're in the early recovery phase of the cycle following the COVID-19 recession. In fact the GDP for the coming year implies an extended period of low-inflation, low-interest-rate growth, an environment that usually favours equities over bonds. But after such a rapid rebound from lower economic growth indicators to an optimistic market looking forward, an equity market pullback would not be surprising. This leaves us neutral on the near-term outlook, but moderately positive for the medium-term with slightly expensive valuations offset by the positive cycle outlook.

This early-cycle economy will succeed later-cycle valuations for the next year or two. The turning point could occur when economies hit full capacity. This will be when unemployment has fallen as far as possible and inflation pressures start to rise. Central banks will signal that higher interest rates are on the way and bond yields will move higher. The pandemic-driven decline in bond yields below 1% has allowed equity markets to trade at more expensive valuations in terms of price-to-earnings ratios. Rising bond yields will eventually place lofty equity market valuations under pressure.

March 12, 2020, is called the 'Black Thursday' because on this day financial markets across the world reported the greatest fall. The fall as measured in a single-day percentage was the highest since the stock market crash in 1987. The Indian market also reacted sharply to the crash, and the Nifty fell by around 8%. The next day, however, Nifty bounced back by around 5%.

REVIEW OF LITERATURE

Olokoyo FO. (2020) studies the impact of economic factors on the movement in stock market. He says that GDP growth rate has a positive correlation with the stock market and stock market performance and that both are linked in the long run. He says that when there is a deviation from the long-run relationship, it is the stock market, interest rate and foreign capital flows that adjust to ensure that the long-run link is restored.

In a study conducted by Mandal & Bhattachargee (2012) about the impact of 2007-08 recession on the behaviour of SENSEX, they said there existed substantial volatility after the recession though there was not much difference in average returns. After the recession they found a strong correlation between stock market returns and global business cycle fluctuations. The stock market volatility is so much affected by the international factors.

Another study conducted by Paramati & Gupta (2011) aimed at investigating whether the stock market performance leads to economic growth or vice versa, suggested that there is a long-run relationship between the stock market performance and economic growth. Findings of the study suggest that the economic growth plays an important role in determining the stock price movements and economic growth also tends to be more likely to stimulate and promote stock market development by adopting appropriate reallocation of resources.

Bhatt (2011) conducted a study to analyze the impact of recent global financial crisis on Indian economy. He said that the role of government is so crucial in maintaining the equilibrium in the economy. Also the RBI played an important role during the crises, providing sufficient liquidity in the market to manage the situation.

Reddy (2012) studied the relation between economic factors i.e. interest rate and inflation and the stock market movements. He said that a reduction in interest and inflation rate resulted in increased stock price and so the government should try to control inflation and improve the standard of living of its citizens.

The encumbering Recession

A recession is typically described as 2 consecutive quarters of negative growth. The National Bureau of Economic Research defines a recession as "a significant decline in economic activity spread across the country lasting more than a few months visible in real GDP, real income, employment, industrial production, and wholesale-retail sale".

The World Bank said in its 'Global Economic Prospects' report of June 2020 that the world economy was facing its worst recession since World War II and that the growth was expected to shrink (negative) by 5.2% in 2021. It also pointed out that "the largest fraction of economies experiencing declines in per capita output since 1870". It projected that Indian economy will shrink by 3.2% in FY21.

Statement 1: Quarterly Estimates of GVA at Basic Prices in Q1 (April-June) of 2020-21 (at 2011-12 Prices)

(₹ in crore)

Industry	April-June (Q1)				
	2018-19	2019-20	2020-21	Percentage Change Over Previous Year	
				2019-20	2020-21
1. Agriculture, Forestry & Fishing	4,27,177	4,39,843	4,54,658	3.0	3.4
2. Mining & Quarrying	88,634	92,807	71,209	4.7	-23.3
3. Manufacturing	5,61,875	5,78,936	3,51,396	3.0	-39.3
4. Electricity, Gas, Water Supply & Other Utility Services	74,998	81,628	75,877	8.8	-7.0
5. Construction	2,49,913	2,62,828	1,30,750	5.2	-50.3
6. Trade, Hotels, Transport, Communication & Services related to Broadcasting	6,09,330	6,30,860	3,34,284	3.5	-47.0
7. Financial, Real Estate & Professional Services	7,57,850	8,03,322	7,60,491	6.0	-5.3
8. Public Administration, Defence & Other Services	3,87,589	4,17,483	3,74,656	7.7	-10.3
GVA at Basic Prices	**31,57,366**	**33,07,707**	**25,53,320**	**4.8**	**-22.8**

Source: National Satistical Office, MOSPI, GOI, Press note on estimates of GDP for the first quarter.

As per NSO, GDP at Constant (2011-12) Prices in Q1 of 2020-21 is estimated at 26.90 lakh crore, as against 35.35 lakh crore in Q1 of 2019-20, showing a contraction of 23.9 percent as compared to 5.2 percent growth in Q1 2019-20. It is the biggest contraction on record, as India imposed a corona virus lockdown in late March and extended it several times, halting most economic activities. Still, India remains the third worst-affected country in the world by the pandemic. Construction (-50.3%), hotels and transportation (-47%) and manufacturing (-39.3%) recorded the biggest falls. Mining and quarrying (-23.3%); finance, real estate and business services (-5.3%); and utilities (-7%) also declined while the farm sector grew 3.4%. On the expenditure side, gross fixed capital formation recorded the biggest decrease (-47.1%). Private spending shrank 26.7%, inventories fell 20.8%, exports went down 19.8% and imports sank 40.4%. In contrast, government consumption jumped 16.4% as the government implemented relief measures to help curb the impact of the pandemic. The first quarter saw an unprecedented closure of shops, markets, and industries, which forced the wheels of the economy to a standstill. Except for agriculture, almost all the corners of the economy were severely hit.

The GDP annual growth rate for the year 2019 as per World Bank records was 5%. GDP Annual Growth Rate in India for the year 2020 is expected to be -10.00 percent according to Trading Economics global macro models and analysts expectations. The State Bank of India has revised its projections about the GDP growth rate from a decline of 6.8 per cent to 10.9 per cent in the financial year 2020-21. This is the worst performance on record for GDP because of the countrywide lockdown imposed by the Centre on March 25, 2020 to staunch the spread of corona virus.

To control the economy going into deep recession, efforts by the government began. The Finance Minister announced a financial relief package of Rs 170,000 crores. In addition, the Finance Minister also announced that the Center will pay the Provident Fund requirements on behalf of both the employer and also the employee. The RBI announced a moratorium on EMI for the next 3 months and also cut the Repo rate by 0.75% to 4.4%. All this was aimed at increasing cash in the hand of an individual resulting in an increased demand which in turn may lead to stimulating the economy.

The Bubble Burst:

In the beginning of the year, when the Pandemic was in its initial stage, markets remained unaffected by the Coronavirus, despite the World Health Organisation (WHO) declaring it as an international emergency. Global market indices, including Sensex and Nifty were robust. It was because of the inordinate delay in considering the magnitude and effect of the pandemic over the society as none of us had seen such a situation in their lifetime. Markets all over the world failed to factor the standstill in the economies.

Both global production and consumption were negatively impacted by the crisis. Unexpectedly, as the circumstances became acute, stock markets entered the phase of panic selling. This downward spiral resulted in a sudden market crash. As a result, Sensex crashed by approx. 40% within a short span of 2 months. The Sensex was enjoying the benefits of a bullish market when it reached its maximum 42273.87 points in January and suddenly as the effects of Coronavirus spread began to increase, there was a steep crash and the Sensex was ranging at its 5 years low at 25638.9 in March 2020.

A stock market crash reduces the investors' confidence in the economy as the falling shares slowly wipe out investor wealth. Investors resort to selling off their holding at minimal costs. Due to lack of confidence investors also refuse to partake in the purchase of shares. With the diminished wealth of investors and the valuations of companies dropping, it makes harder for companies to raise capital and secure debt. Companies in bad financial shape lead to layoffs resulting in a fall in demand in the economy. As the decline continues, the economy contracts which results into recession.

Stock Market & Economy

The stock market movements never follow economic downturn or recovery. The disengagement between rallying stock prices and gloomy economic data is most noticeable in India. While the Indian stock market has been rising despite Covid pandemic in the present times, the economic data shows a grim inclination for the country.

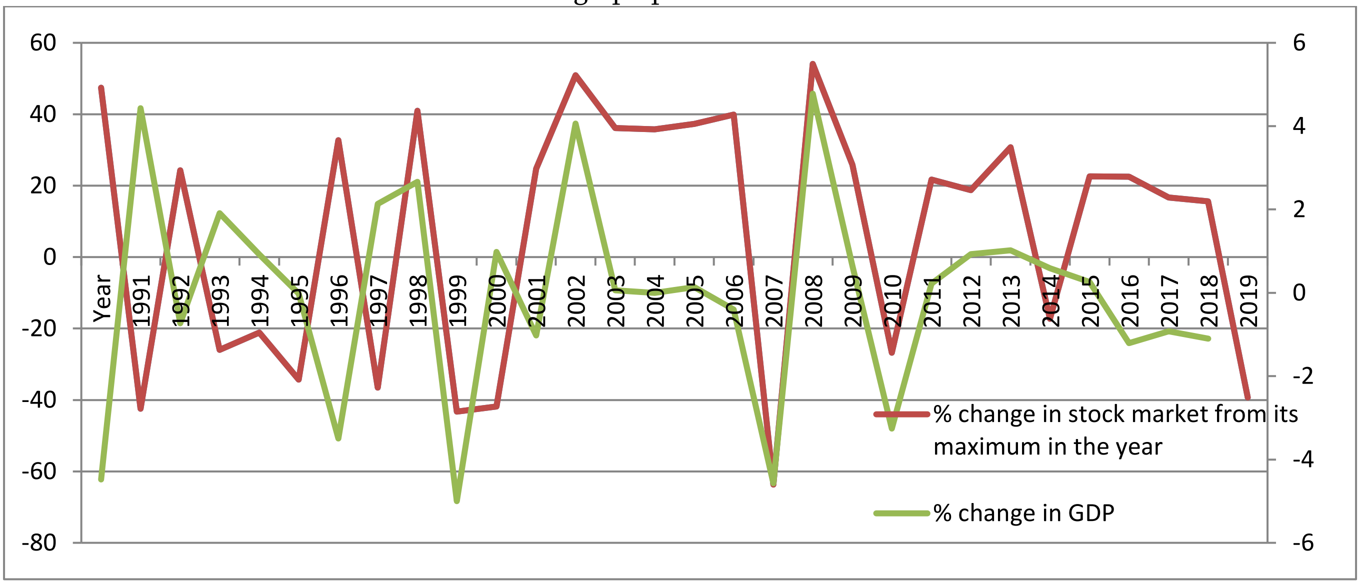
GROWTH RATES AND COMPOSITION OF REAL GROSS DOMESTIC PRODUCT				
(At 2011-12 Prices)				
Sector	**Percentage**			
	2016-17	**2017-18**	**2018-19**	**2019-20**
GDP Growth Rate	**8.26%S**	**7.04%**	**6.12%**	**5.02%**
Expenditure Side GDP				
1. Private Final Consumption Expenditure	8.2	7.4	8.1	5.3
2. Government Final Consumption Expenditure	5.8	15.0	9.2	11.8
3. Gross Fixed Capital Formation	8.3	9.3	10.0	-2.8
4. Change in Stocks	-48.2	21.2	4.8	1.9
5. Valuables	-18.9	27.4	-9.0	13.5
6. Net Exports	7.2	-263.1	-31.0	29.2
a) Exports	5.1	4.7	12.5	-3.6
b) Less Imports	4.4	17.6	15.4	-6.8
7. Discrepancies	239.7	42.3	-21.8	-25.6
8. GDP	8.2	7.2	6.8	4.2
GVA at Basic Prices (Supply Side)				
1. Agriculture, forestry and fishing	6.3	5.0	2.9	4.0
2. Industry	8.3	6.1	6.2	0.8
of which :				
a) Mining and quarrying	9.5	5.1	1.3	3.1
b) Manufacturing	7.9	5.9	6.9	0.0
c) Electricity, gas, water supply and other utility services	10.0	8.6	7.0	4.1
3. Services	8.1	7.8	7.7	5.0
of which :				
a) Construction	6.1	5.6	8.7	1.3
b) Trade, hotels, transport, communication and services related to broadcasting	7.7	7.8	6.9	3.6
c) Financial, real estate and professional services	8.7	6.2	7.4	4.6
d) Public Administration, defence and other services	9.2	11.9	8.6	10.0
4. GVA at basic prices	7.9	6.9	6.6	3.9
Source: National Statistical Office (NSO).				

The above table clearly explains that the fundamentals of Indian economy are strong enough in the long run. The results are positive on the expenditure side as well as exports. The construction, Manufacturing and service sectors are all flourishing. It is only because the last quarter of 2019 was affected by the Pandemic that the growth rates are on a declining trend.

However, stock markets are always futuristic in nature. In simple terms, this means that the stock markets always crash at the slightest indication of economic downturn and latches on any positive sentiment/news to move towards recovery. As the lockdown was imposed on March 25, the economic activities came to a halt. Due to steep decline in manufacturing and services, the growth rate declined immensely. However, what followed this decline was completely ironical as Indian stock markets witnessed a rise after a sharp decline. It means that markets respond immediately only to surprises and they have already responded to the "Bad News" in March.

Therefore the current rise in stock market is firstly due to strong fundamentals of the companies. As we can see in the above table the performance of different sectors is randomly changing and there is not much change in growth rates in different sectors. Secondly, the decline was primarily due to unprecedented circumstances that arose in the beginning of the year and even positive news such as introduction of vaccine can create optimism. Another major reason for the sudden recovery was the injection of liquidity by the government into the economy and the lowering of interest rates.

From the given chart it is very much clear that the GDP rates and the stock market movements are interrelated. Although at times there may not be a visible direct relationship, however there is always a positive association between the two. A stock market crash does not necessarily result in recession but a recession always results in a stock market crash and this is clear from the graph presented below.



When the global economy is sinking due to the pandemic shutdown, the stock markets are booming. This has allowed those at the top of the economic pyramid make wealth when billions of people are losing their money.

CONCLUSION

Historical trend suggests that we are still in a bear phase as the economy is still under downturns. However, the current economic recovery factors, government intervention and medical advancements suggest that the current downturn will not last like the earlier ones.

It is equally important to have a sector specific and a stock specific view rather than assuming that the recessionary trend has inverted. It is particularly feasible that hospitality or entertainment industry will take time to revive. Similarly, banking and financial sector may have higher NPAs that may impact their future profits. Hence, it is imperative to adopt a combination of fundamental and technical parameters while making new investments and not just a number driven technical view.

The GDP of an economy and the stock market gains are incompatible in the short run and, in fact, there is little comparison between the two. The major reason for this discrepancy is the difference in the size of the two markets. The economy depends on millions of factors that can have both a positive and negative impact, while the stock market is only affected by one factor, the supply and demand of stocks. Therefore the investors in the stock market should focus on fundamentals and invest with a long term perspective.

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