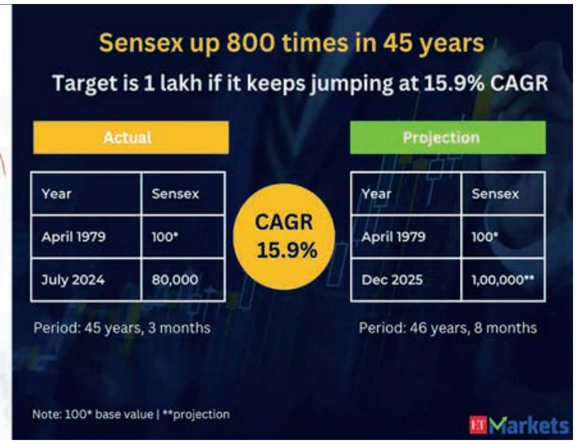
India's Stock Market Performance and Economic Growth

A Note of Warning from the Official Economic Survey 2023-24

Dr. T. K. Jayaraman



The Economic Survey (the Survey) of Fiscal Year (FY) 2023-24 was submitted to the Parliament on July 22, a day ahead of presentation of the Annual Budget for the FY2024-25. The Survey did not create any stir in the House. It was a near academic study as expected from the experts. It did not indulge in any self-praise when everyone knew that India did well when compared to other economies of the world soon after the end of the Covid pandemic in late 2021 and especially in the just ended FY24.

India recorded economic growth at 8.2% in 2023-24. The Reserve Bank India (RBI) recently forecasted the growth rate for the FY 2025, at 7.2%. International funding organizations, including Asian Development Bank and International Monetary Fund MF (7.0%) and World Bank (6.6%); and private agencies such as Fitch (7.2%) were equally optimistic.

The Survey, however, forecasted growth rate for FY 202 would be in the range of 6.5% -7.0%, slightly below RBI. It seems the Survey was careful in hinting to the all stakeholders that the probability of lower growth at 6.5% cannot be ruled out. The reasons are based on a cautious assessment of challenges confronting the economy. They include unpredictable weather conditions, consequences of the geo-political disputes and shooting wars which would seriously hurt the normal international trade patterns. Added to these, there appeared to be a possibility of return to protectionism. The likely re-imposition of tariffs, and restrictions on free trade in the form of quotas would destroy efforts to promote globalization. All these uncertainties might adversely impact growth.

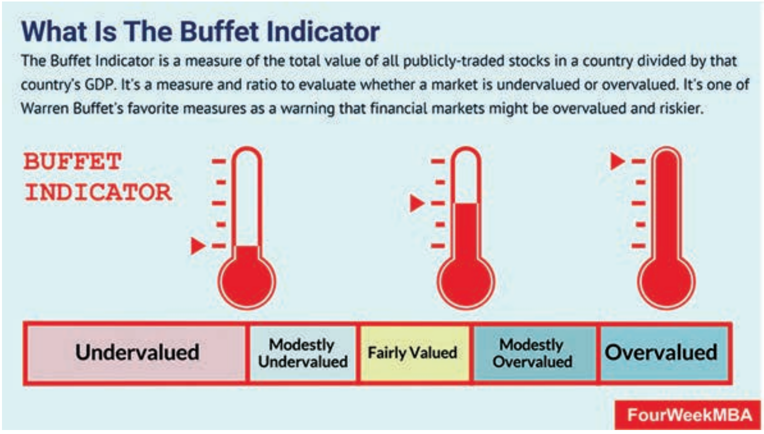
In the midst of these uncertainties, it is not strange that stock markets all the world over have been overly optimistic. Their view is influenced in the short-run by sentiments rather by careful assessment of the future, always on the look for making quick immediate gains by selling when prices are high. The profit selling as we see at the end of each market day, when bearish sentiments tend to creep in. The optimistic (bullish) and pessimistic (bearish) sentiments are sometime compounded by "the herd behaviour."

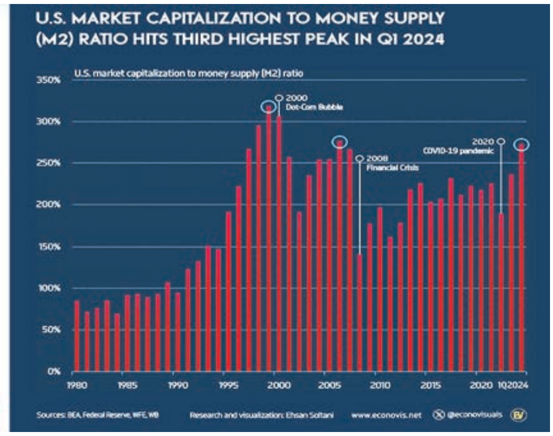
Irrational exuberance is also a factor, a term, which was used by a former Federal Reserve Chairman Allan Greenspan to describe unprecedented dot.com bubble. A very recent experience is that of June 1, this year. On that day, India's Sensex and Nifty indices rose to new heights, never known before, hearing the "fake election results", only to literally collapse the very next day when the "real news" came by hour by hour, from the official counting centres.

Stock market and economic growth

Market sentiments are fostered by daily news on market capitalization to GDP ratio (MC/GDP), where MC is market capitalisation in current prices of value of shares traded and GDP is the gross domestic product of the country of the year just ended in current prices, This ratio is popularly known as Buffett Indicator, named after the stock market Guru, Warren Buffet.

The rise in market capitalization is often given rise due to high expectations as investors (domestic and overseas) pour funds





in stock markets for short term gains by buying at low prices and selling when prices shoot us as part of herd behaviour. The Sensex and Nifty Indices do not reflect real economic growth in terms of output of goods and services (GDP). The stock market is that of financial assets. The Survey 2023-24 cautions the investors, the rise in market capitalization to GDP ratio is not necessarily a sign of economic advancement. Financial assets are claims on real goods and services. If equity market claims on the real economy are excessively high, it is a harbinger of market instability rather than market resilience.

A real world example is drawn was from the US data of May 31, 2024.

The ratio values are:

Total US Stock Market Value = $55.81 trillion

US GDP = $28.38 trillion

The Buffett Indicator = $55.81T$/28.38T = 197%

This ratio is never stable. The numerator fluctuates daily, and throughout the day from the morning to the end of the market day, as the value of the stock market is volatile. But the denominator GDP used is that of the past year or at least of the latest quarter, hence stable for the present, or tending s to grow much more predictably. The ratio of 197% is approximately 59.23% (or about 1.9 standard deviations) above the US historical trend line, suggesting that the stock market is overvalued.

One would infer as the Buffett Indicator expresses the value of the US stock market in terms of the size of the US economy, and if the stock market value is growing much faster than the actual economy, then it may be in a bubble.

In the case of India, we have the latest data for the first half of 2024: January to June,. Indian Stock Market saw a bull run in the first half of 2024. The market capitalization hit a record ₹461 lakh crore. The GDP in current prices is estimated to be ₹295.36 lakh crore in the year 2023-24.

The ratio values of July 29 are:

Total Indian Stock Market Value = ₹ 461 lakh crore

India's GDP = ₹ 295.36 lakh crore

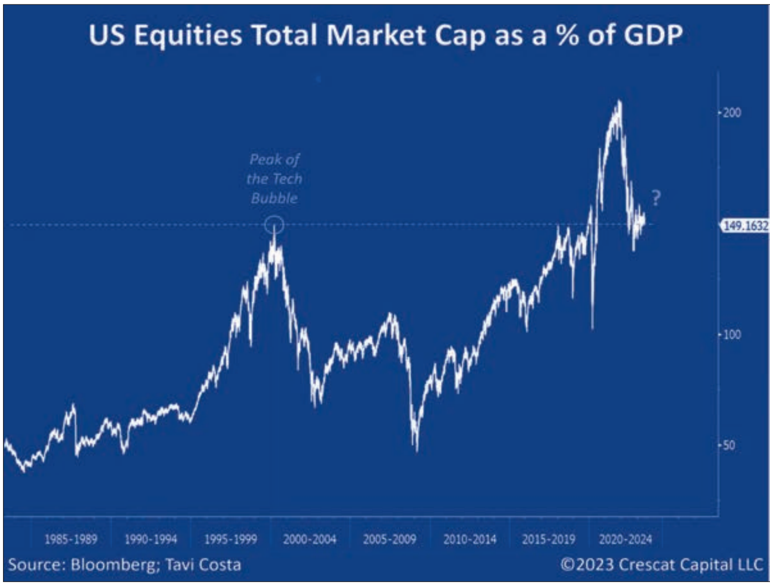
The Buffett Indicator = $461 lakh crore/₹ 295.36 =156%

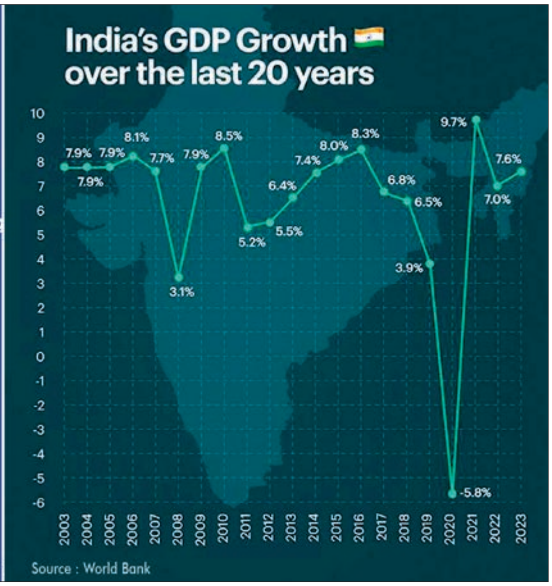
Table presents a comparative picture of market capitalization ratios for last five years.

Market Capitalization to GDP Ratio of Selected Countries: 2019-2023 (percent)

Month	Year	USA	UK	China	Brazil	Japan	Korea	India
December	2019	159	106	60	65	121	89	77
December	2020	107	92	79	68	129	122	95
December	2021	208	108	80	50	136	127	113
December	2022	158	91	65	42	126	96	105
December	2023	179	71	61	44	147	114	124
July	2024	NA	NA	NA	NA	NA	NA	156

Source: Economic Survey 2023-24 | ***For India, July, 2024: Livemint, July 31, 2024***





Hari Vishwanath of the Hindu Business Line Research Bureau informs us that according to Buffett, in the context of the US economy, if the percentage falls to the 70-80 per cent levels, it's a good time to buy. When the ratio approaches 200 per cent as it did in 1999-2000, the dotcom bubble burst happened. In recent times, when the US market/GDP reached around 200 per cent by end 2021, another crash occurred in 2022.

In India, the number on July 29 was 156, higher than the 141% it touched in end-December 2007. Hari Viswanath says measured on a quarterly basis, the ratio has ranged between a low of 53% in March 2009 and a high of 152%.

Note of Warning from the Survey

When the fundamentals (reflected in high growth and strong all-around performance, comprising low fiscal deficit, comfortable level of foreign exchange reserves, enough to

Growth in value of financial assets cannot forever outpace growth in the real economy. There will be phases in future when market capitalization /GDP ratio will also decline from current high levels, implying growth in value of stocks turning out to be lower than growth in GDP current prices.

cover trade deficits of nine or more number of months) are high, sentiments were high. It is the sentiment that pushes the ratio to extreme levels. If numerator becomes higher, the denominator GDP remaining constant, the Buffett indicator bulges. "Euphoric sentiment overvaluing assets linked to the real economy can result in disappointing returns or even sudden crashes in sentiment are impacted sometime in the future, whatever the cause may be. This does not only affect the investors but can also have collateral damage on the economy", says the Survey.

Growth in value of financial assets cannot forever outpace growth in the real economy. There will be phases in future when market capitalization /GDP ratio will also decline from current high levels, implying growth in value of stocks turning out to be lower than growth in GDP current prices.

No bubble ever stays long.

— Dr TK Jayaraman, was a former Professor of Economics, Fiji National University, Fiji Islands and earlier a Senior Economist, Asian Development Bank, Manila. Presently, he is now a Honorary Adjunct Professor, Amrrita School of Business, Sarjapur Campus, Bengaluru and an International Research Associate, University of Tunku Abdul Rahman, Kampar Campus, Perak State, Malaysia. Views expressed are the author's own. Website: www.tkjayaraman.com.