Prof. Ashok Banerjee

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The reaction of stock market to publicly available information is well researched. Researchers have looked into the aspect of stock market reaction to a variety of information generating events. For example, studies have shown that stock market react positively to corporate strategic investment decisions, dividend increasing announcements etc. The stock prices are said to underreact when prices keep trending up (down) after initial reaction to a positive (negative) news. On the other hand, investors tend to overreact to recent good or bad news- leading to excessive optimism to good news and excessive pessimism to bad news[1]. Such reactions question the validity of the Efficient Market Hypothesis

looked at market reaction to some such stories over the last couple of months. The stock reaction on the day following the release of the news is captured. Excess return is estimated as the difference between one-day stock return and the market (Nifty) return for the same day. Results

Prof. Partha Ray

Partha Ray, Ph.D., is Professor, Economics, Indian Institute of Management Calcutta (IIM-C). Prior to joining IIM -C, Prof. Ray, a career central banker, was the adviser to Executive Director, International Monetary Fund, Washington D.C. during 2007-2011.

The emphasis on "Macrofinancial Risks" is a recent addition to the bankers' toolkit. Even to the academia, till the last decade macroeconomic risks and financial risks were often thought as distinct and these were conceptualized as silos. It was widely believed that macroeconomic risks provide the backdrop or the canvas while financial risks are the day-to-day existential question facing the banker – their independence was hardly considered. The global financial crisis changed all that! It is now widely believed there is a new class of risks called macrofinancial risks that affect the financial sector immensely across the class and that any stake-holder in the financial sector can neglect it at her own risk and peril.

But what constitutes the essential ingredients of a macrofinancial risk assessment framework? It is widely believed that a three stage framework whereby solvency risks, funding liquidity risks (including interbank spillover risks) and banking sector risks tend to emerge sequentially can characterize such a framework (Chart 1). Note that any macroeconomic shock tends to affect each of these three types of risks and interbank spillover risk adversely.

Chart 1: Basic structure of the Macrofinancial Risk Assessment Framework

It is in this context that the recently released Financial Stability Report (FER) of the Reserve Bank of India (No.6 of December 2012) gives an interesting perspective. Of the various issues that the FSR has flagged, those relating to global growth, downside risks associated with prolonged accommodative policies of the major central banks, concerns on domestic growth, systemic liquidity, fiscal consolidation, external sector vulnerabilities, gold imports and credit cycles in the Indian Economy deserve special mention. Illustratively in the domestic front the report categorically notes, "Amidst this global slowdown and uncertainty, the Indian economy remains sluggish, held down by slowing investment, weakening consumption and declining exports. The loss of growth momentum which started in 2011-12, extended in the current year with growth remaining below the trend, however, inflation continued to remain above the Reserve Bank's comfort zone. On the external front, the current account deficit (CAD) remains above the comfort level and the Indian rupee witnessed depreciation pressure. Another worrying development has been the reduction in the share of financial assets in household savings as households' preference for physical assets and valuables like gold seem to be rising, which is also adding to the pressure on the CAD". Thus, going forward there are four threats to Indian financial stability: (a) lower growth, (b) elevated inflation, (c) high fiscal deficit; and (d) current account deficit. Apart from the well-known fiscal risks, corporate sector risks (reflecting *inter alia* their high exposure to infrastructure sector) also seems to have gone up in recent period.

Figure 2: Macro Stability Map and Financial Market Stability Map

Source: Financial Stability Report, December 2012, RBI

Interestingly, Indian banking sector have very little to do with the genesis and containment of these risks and they are at the receiving end. Thus, no matter what happenr .02 Tl.741210( )]TET

and CCIL-MIBOR. By comparing MIBOR with the weighted average overnight rate (WAONR) at various times, we can see which MIBOR is closer to the dealt rate.

Table – 1: Descriptive Statistics of Rates and Spread of MIBOR over WAONR