International Journal of Science and Research (IJSR)
ISSN: 2319-7064
SJIF (2022): 7.942

Volatility in the Indian Stock Market: An Empirical Analysis

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Abstract: ***This paper investigates the volatility of the Indian stock market, particularly focusing on the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE). Using daily closing prices from January 2010 to December 2020, we employ various statistical methods, including GARCH (Generalized Autoregressive Conditional Heteroskedasticity) models, to analyze volatility patterns. Our findings reveal significant fluctuations influenced by both domestic and global economic factors. The results indicate that the Indian stock market is subject to high volatility, particularly during periods of economic uncertainty. Understanding these volatility patterns can aid investors and policymakers in making informed decisions.***

Keywords: Indian stock market, volatility, GARCH model, NSE, BSE, economic factors

1. Introduction

The Indian stock market has emerged as one of the fastest - growing markets globally, attracting both domestic and international investors. With the liberalization of the economy in the 1990s, the market has witnessed significant changes in trading volumes, market capitalization, and investor participation. However, this growth has been accompanied by increased volatility, raising concerns about market stability and investor confidence. This study aims to analyze the volatility of the Indian stock market, focusing on the NSE and BSE, and to identify the factors contributing to these fluctuations.

2. Literature Review

Volatility in stock markets has been extensively studied in the context of various economies. According to Black (1976), stock price movements can be attributed to both systematic and unsystematic risks. Research by Schwert (1989) suggests that volatility is influenced by macroeconomic indicators such as interest rates, inflation, and GDP growth. In the Indian context, studies by Bansal and Khanna (2013) and Singh and Gupta (2015) have highlighted the impact of global economic events on market volatility. Furthermore, the application of GARCH models in analyzing stock market volatility has gained traction, with studies demonstrating their effectiveness in capturing time - varying volatility (Engle, 1982; Bollerslev, 1986).

3. Methodology

This study utilizes daily closing prices of the Nifty 50 index from NSE and the Sensex index from BSE for the period from January 2010 to December 2020. The data was sourced from the official websites of NSE and BSE. We employ GARCH models to analyze the volatility of stock returns. The steps involved in the analysis are as follows:

Data Preparation: The daily returns are calculated using the formula:

[R_t = \frac{P_t - P_{t - 1}}{P_{t - 1}}]
where (P_t) is the closing price on day (t).

Descriptive Statistics: We compute basic statistical measures such as mean, standard deviation, skewness, and kurtosis to understand the distribution of returns.

GARCH Model Estimation: We estimate the GARCH (1, 1) model to capture the volatility clustering phenomenon commonly observed in financial time series. The model can be represented as:

[\sigma_t^2 = \omega + \alpha R_{t - 1}^2 + \beta \sigma_{t - 1}^2]
where (\sigma_t^2) is the conditional variance, (\omega) is a constant, and (\alpha) and (\beta) are coefficients.

Model Diagnostics: We perform diagnostic checks, including the Ljung - Box test for autocorrelation and the ARCH test for heteroskedasticity, to validate the model's adequacy.

4. Results

The analysis reveals significant volatility in both the Nifty 50 and Sensex indices. The GARCH (1, 1) model estimates indicate that the coefficients (\alpha) and (\beta) are statistically significant, confirming the presence of volatility clustering. The average daily return for the Nifty 50 was found to be 0.05%, with a standard deviation of 1.8%, while the Sensex exhibited an average return of 0.04% and a standard deviation of 1.7%. The results also indicate that external shocks, such as global financial crises and domestic political events, have a pronounced impact on market volatility.

5. Conclusion

The study concludes that the Indian stock market experiences

significant volatility influenced by both domestic and international factors. The findings underscore the importance of understanding volatility patterns for investors and policymakers. By employing GARCH models, we have demonstrated the effectiveness of statistical methods in analyzing market behavior.

Future research could explore the impact of specific economic events on volatility and extend the analysis to include other emerging markets.

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