Introduction to Securities Market in India

Section I: Macroeconomic Developments

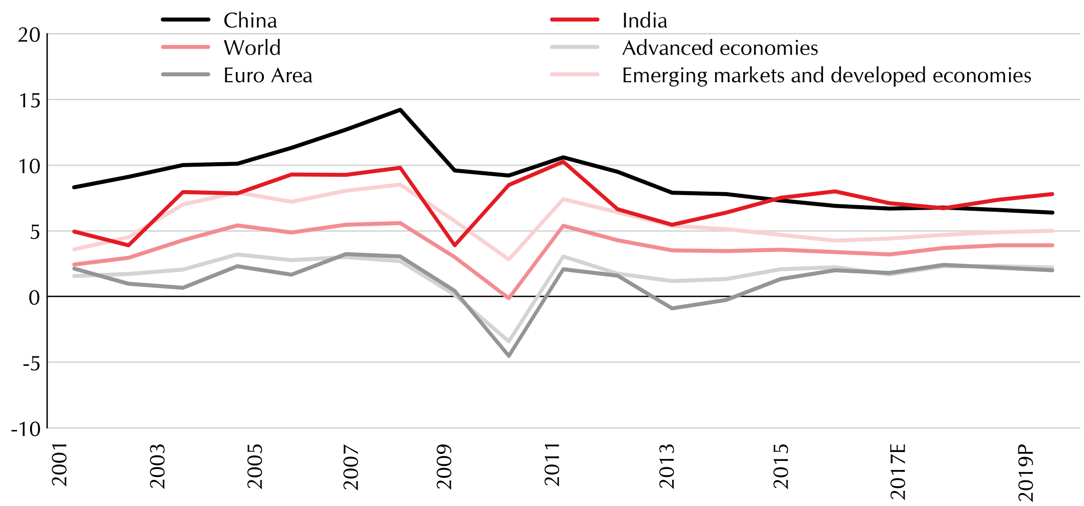
1.1. Global Environment

1.1.1. Output Growth

Global economic activity, after remaining 'too low for too long' following the global financial crisis that began in 2008 and after a particularly uninspiring 2016, began to pick up in the first quarter of 2017 and has continued to strengthen as the year progressed. The global output growth seen in 2017 is considered firm and the recovery decisive. According to the IMF's World Economic Outlook January 2018 data, the estimate for global output growth in 2017 is 3.7 percent, which is 0.5 percentage point higher than in 2016, indicating that the cyclical upswing underway since mid-2016 has continued to strengthen. The pickup in growth has been broad based: according to the IMF, "some 120 economies, accounting for three quarters of world GDP, have seen a pickup in growth in year-on-year terms in 2017, the broadest synchronized global growth upsurge since 2010".

Among the advanced economies, the upswing has been spectacular for quite a few. The US economy, for example, is projected to expand at 2.3 percent in 2017, up from 1.5 percent in 2016. The euro area recovery too has gathered strength in 2017, with growth projected to rise to 2.4 percent in 2017 from 1.8 percent in 2016, reflecting mostly acceleration in exports due to pick-up in global trade and continued strength in domestic demand growth. In Japan, the projected growth for 2017 (1.8 percent) is double that of 2016, partly due to strengthening global demand and policy actions to sustain a supportive fiscal stance. United Kingdom, however, is a notable exception, with growth expected to subside to 1.7 percent in 2017 from 1.9 percent in 2016, driven mainly by softer than expected growth in private consumption.

Chart 1.1: GDP Growth of major global economies

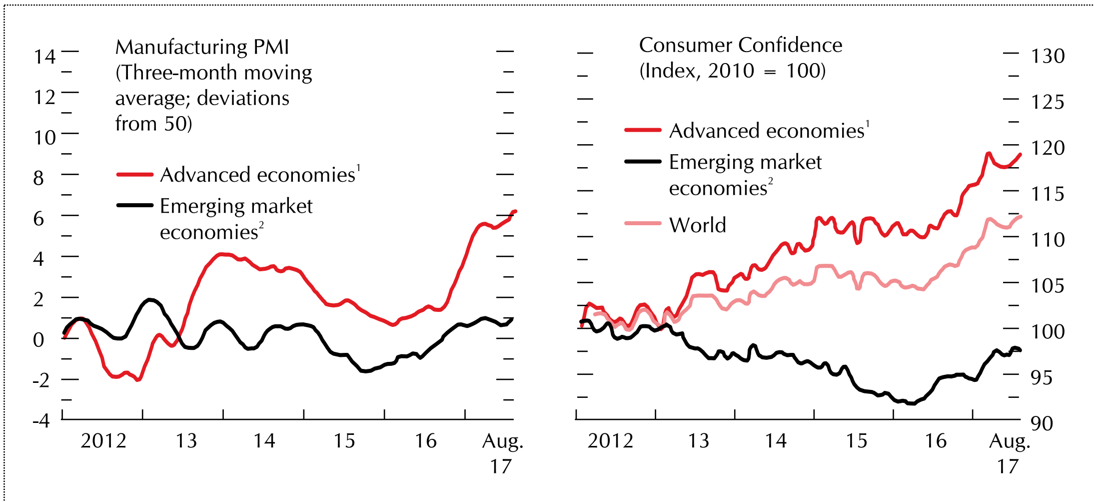


Source: World Economic Outlook Database (updated to January 2018)
Note: E= Estimate, P=Projection

The emerging and developing economies are projected to grow at 4.7 percent in 2017, more than double the rate at which the advanced economies are expected to grow. Among the major emerging market economies, China's estimated growth for 2017 (6.8 percent) is broadly at the same level as in 2016. While the services sector was the main driver of growth in China in 2017, real estate and construction activity remained a drag on growth. The South African economy (projected to grow at 0.9 percent in 2017) continued to face risks from weak manufacturing activity, high unemployment and political instability. In Brazil, strong export performance and a diminished pace of contraction in domestic demand allowed the economy to return to positive growth in the first quarter of 2017, after eight quarters of decline. Incoming data suggest that the recovery gained further momentum as the year progressed, with unemployment reaching an intra-year low in September. The projected growth of Brazil for the year as a whole is 1.1 percent, up from (-) 3.5 percent in 2016. Russia also saw a swift recovery from (-) 0.2 percent in 2016 to 1.8 percent in 2017, despite weakness in industrial production in the second half of the year.

What has aided global recovery from the financial crisis of 2008? Over the years, the positive cross-country spill-overs from fiscal policy actions helped the global economy recover from the crisis. In more recent years, the global growth has been strengthening due to recovery in investment, trade and industrial activity, coupled with improvements in business and consumer confidence. Notably, the continued recovery in global investment spurred stronger manufacturing activity which is reflected in a sharp increase in the Purchasing Managers' Index (PMI) for both advanced and emerging economies in the first half of 2017 (Chart 1.2). The Consumer Confidence has also improved during the period (Chart 1.2).

Chart 1.2: Purchasing Managers' Index (PMI) and Consumer Confidence improved in H1 of 2017



Source: World Economic Outlook: Seeking Sustainable Growth—Short-Term Recovery, Long-Term Challenges.
Note: CC = consumer confidence; PMI = purchasing managers' index; WEO = World Economic Outlook.

1 *Australia, Canada (PMI only), Czech Republic, Denmark, euro area, Hong Kong SAR (CC only), Israel, Japan, Korea, New Zealand (PMI only), Norway (CC only), Singapore (PMI only), Sweden (CC only), Switzerland, Taiwan Province of China, United Kingdom, United States.*

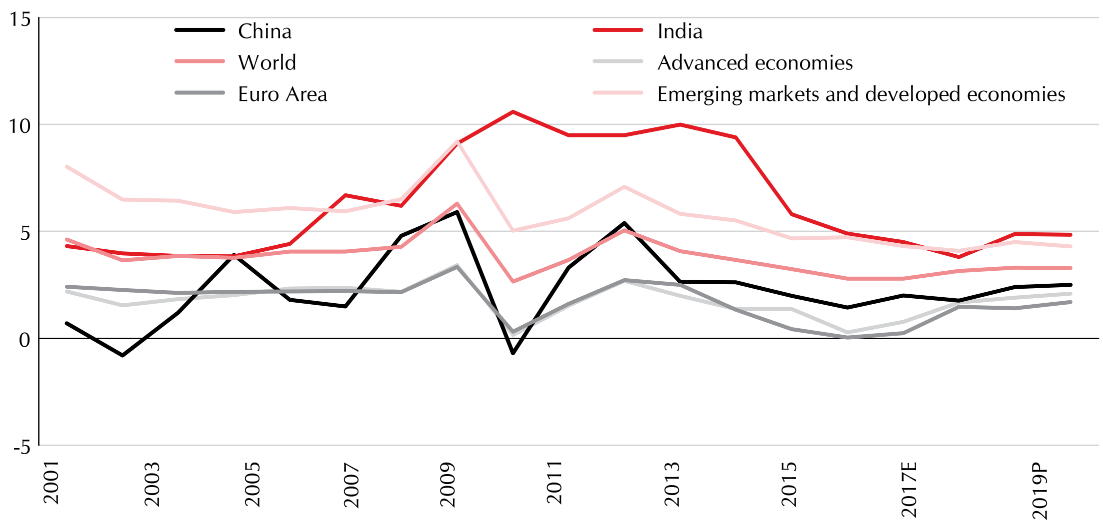
2 *Argentina (CC only), Brazil, China, Colombia (CC only), Hungary, India (PMI only), Indonesia, Latvia (CC only), Malaysia (PMI only), Mexico (PMI only), Philippines (CC only), Poland, Russia, South Africa, Thailand (CC only), Turkey, Ukraine (CC only).*

1.1.2. Inflation

Globally, core inflation—inflation rates when fuel and food prices are excluded—generally remained soft in the first half of 2017. In most advanced economies, core inflation failed to decisively increase toward central bank targets (about 2-3 percent), even as domestic demand gathered pace. In many emerging market and developing economies, core inflation has moderated, partly due a slow-down of the impact of earlier exchange rate depreciations on inflation and in some case, recent appreciation of their currencies against the US dollar. However, much of the softening of core inflation in emerging market economies can be attributed to India and Brazil, where a sharp decline in food price inflation in the middle of the year and high excess capacity in the economy, have also contributed to weaker inflation.

During the second half of 2017, fuel prices rose substantially. An improving global growth outlook, the extension of the OPEC+ agreement to limit oil production, and geopolitical tensions in the Middle East have led to a rise of about 20 percent in oil prices between August 2017 and mid-December 2017, to over $60 per barrel. Partly due to surge in crude oil prices in the second half of 2017 (Chart 1.3), the inflation rates for the year 2017 as a whole are projected to increase in advanced economies from 0.8 percent in 2016 to 1.7 percent in 2017. In contrast, the inflation is projected to decline marginally in the emerging and developing markets from 4.3 percent in 2016 to 4.2 percent in 2017.

Chart 1.3: Consumer Price Inflation across major regions



Source: World Economic Outlook Database, October 2017 (data for Advanced economies and Emerging markets as of January 2018 WEO update)

1.1.3. Trade

Global trade is estimated to have grown by 2.5 percent in 2016 in volume terms, the slowest pace since 2009, with weak growth seen in both advanced economies and emerging market and developing economies. Export in emerging countries and advanced economies as a whole increased by 2.3 and 2.6 percent respectively (Chart 1.4). Global trade growth picked up meaningfully in late 2016 and early 2017, reflecting a recovery in global demand and especially capital spending. Consequently, according to the IMF estimates, the global trade growth is projected to rebound to about 4.7 percent in 2017. The pick-up in external demand was seen both in advanced countries (such as Euro area and Japan) and in emerging market economies (such as Brazil, Russia, Turkey and emerging market economies in East Asia).

Chart 1.4a: Global Export (Goods & Services) Growth Projections for 2017 and 2018

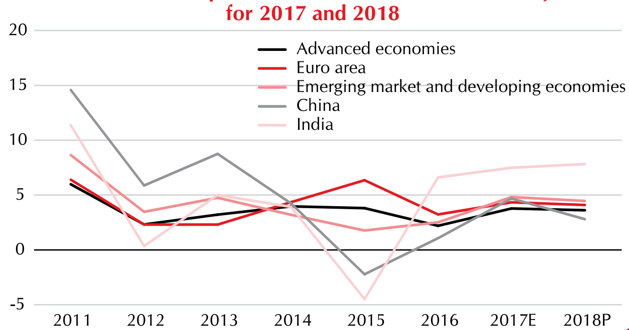
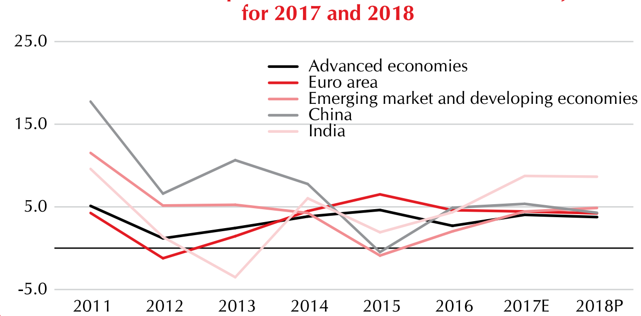


Chart 1.4b: Global Import (Goods & Services) Growth Projections for 2017 and 2018



Source: World Economic Outlook Database, October 2017

Box 1.1: Major global developments

1. *Upturn in global economy*: The upswing in global growth that began in mid-2016 has continued to gather momentum. Global growth is estimated at 3.7 percent in 2017 (compared to 3.2 percent in 2016) while it is expected to rise further to 3.9 percent in 2018, according to the IMF. At the same time, the growth in global trade volumes picked up in 2017, supported by an upswing in investment, especially in advanced economies.
2. *Fed rate hike*: Post financial crisis, the Federal Reserve had cut the effective federal funds rate close to zero in 2009. This helped the US economy to fight the recession by pumping out vast amounts of money to businesses and consumers through an expanding array of new lending programs. After 6 years (in December, 2015), the Federal Reserve decided to raise the target federal funds rate from 0-0.25 percent to 0.25-0.50 percent as the US economy began to get healthier. During the subsequent period, the economic activity has been rising at a solid rate with lower unemployment rate, increase in household spending and higher investments by businesses, leading the Federal Reserve to repeatedly increase the target federal funds rate. In December 2017, the target federal funds rate was raised to 1.25-1.5 percent.
3. *Brexit*: On June 23, 2016, in a historic move, the British citizens voted to exit the European Union. Those who voted for the exit believed that: (a) Britain is being held back by the EU as the EU imposes too many rules on business; (b) EU charges billions of pounds a year in membership fees for little in return; and (c) Britain should take back full control of its borders and reduce the number of people immigrating to live and/or work in the UK. The event sent major shockwaves across the globe, although in the subsequent period, its impact was found to be less severe than what was expected.
4. *Inclusion of yuan in SDR*: On October 1, 2016, the Chinese currency yuan (or remnibi) was added to the Special Drawing Rights (SDR), IMF's basket of reserve currencies created in the year 1969. The executive board of the IMF that represents the Fund's 189 member nations, arrived at the decision that the yuan is able to meet the standard of being freely usable and hence, is eligible to join the dollar, euro, yen and pound in the SDR basket. This is the first change in the composition of SDR since the year 1999 when euro replaced the Deutsche marc and the French franc. The weightings of the reserve currencies in the new basket are as follows: US dollar (41.73 per cent), euro (30.93 per cent), yuan (10.92 per cent), yen (8.33 per cent) and pound sterling (8.09 per cent). (Source: IMF press release September 30, 2016)
5. *Recovery in oil Prices:* Crude oil price has increased significantly from 29.78 USD/bbl in January 2016 to 59.93 in the month of November 2017. This is a remarkable development for the world economy, particularly for the emerging markets and developing countries.
6. *US's exit from the Paris climate agreement:* In June 2017, President Donald Trump's decision to withdraw US from the Paris climate agreement is expected to have harmful effect on the global warming and as well as the economic growth in the medium term. There will be no penalty for leaving, as the Paris deal is based upon the premise of voluntary emissions reductions by participating countries.
7. *Tax Cuts and Jobs Act introduced in the US:* On December 22, 2017, President Donald Trump signed the Tax Cuts and Jobs Act that aims at reducing tax rates for businesses and individuals. The Act seeks to cut the corporate tax rate from 35 percent to 21 percent for tax years beginning after 2017, cut income tax rates, double the standard deduction, and eliminate personal exemptions. The corporate cuts are permanent, while other changes expire at the end of 2025.

1.2. Indian Scenario

1.2.1. Economic Growth

Until early 2016, India's growth had been accelerating, while growth in other major countries (such as US, China, OECD) was decelerating. Beginning FY 17, the converse happened. The world economy began to recover in a synchronous way, while India's GDP growth began to decelerate. In other words, India's growth was "decoupled" from global growth, as has been described by the Economic Survey 2017-18. A number of factors accounted for this, including demonetization, introduction of GST and the twin balance sheet problem. Further, while real interest rates began to rise in India since middle of 2016, they continued to decline globally. Anyway, the slowdown in FY 17 and FY 18 notwithstanding, India registered an average real GDP growth rate of over 7.3 percent for the period FY15- FY 18, which is the highest among the major economies of the world. This was possible because of distinctly improved macro fundamentals (such as inflation, current account balance, fiscal deficit and so on) over the last 4 years. Not surprisingly, Moody's Investors Service ("Moody's") upgraded the Government of India's local and foreign currency issuer ratings to Baa2 from Baa3 in November 2017 – after a stagnated period of 13 years. India's sovereign credit rating was last upgraded in January 2004 to Baa3 (from Ba1). Moody's cited low inflation, prudent external balance and the Government's resolve to stick to its fiscal consolidation path as key reasons for the upgrade in credit rating.

As regards FY 18, it was marked by two swings. In the first half, the economy continued to "decouple"', that is, to slow down as the rest of the world accelerated, because of reasons stated earlier. In the second half, however, the economy witnessed robust recovery, as the shocks began to fade, corrective actions were taken and the synchronous global recovery boosted exports. For the year as a whole, real GDP growth is estimated to slow down to 6.5 percent, while GVA growth is expected to come even lower at 5.6 percent (Chart 1.5).

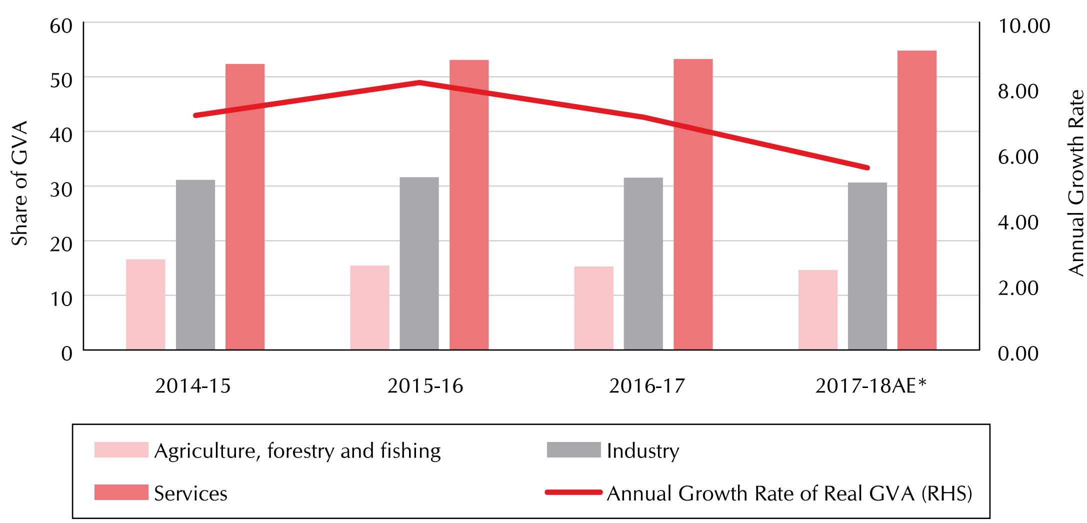
On a sectoral level, agriculture is estimated to witness the sharpest slowdown among all sectors in FY 18 on account of lower food grain production (1st advance estimate at 134.7 mn tonnes, lower by 3.9 percent YoY) and sowing, below-normal monsoon season and decline in reservoir levels. Similarly, industrial growth has dropped on poor manufacturing and mining performance, however, a pick-up in construction activity has provided some relief to the sector. Services, on the other hand, is expected to improve on a broad basis, with financial services continuing to contribute the highest to the overall growth.

Table 1.1: Annual wise real GVA and GDP growth (%YoY)

Indicator	FY15	FY16	FY17	FY18AE*
Real GVA at basic prices	7.2	8.1	7.1	5.5
Agriculture, forestry and fishing	(0.2)	0.6	6.3	0.9
Industry	7.0	9.8	6.8	2.7
Services	9.8	9.6	7.5	8.6
Real GDP	7.5	8.0	7.1	6.5

*Source: CSO. *AE – Advance estimate*

Chart 1.5: Annual Growth Rate & Composition of Real GVA (At 2011-12 Prices)



*Source: CSO. *AE – Advance estimate*

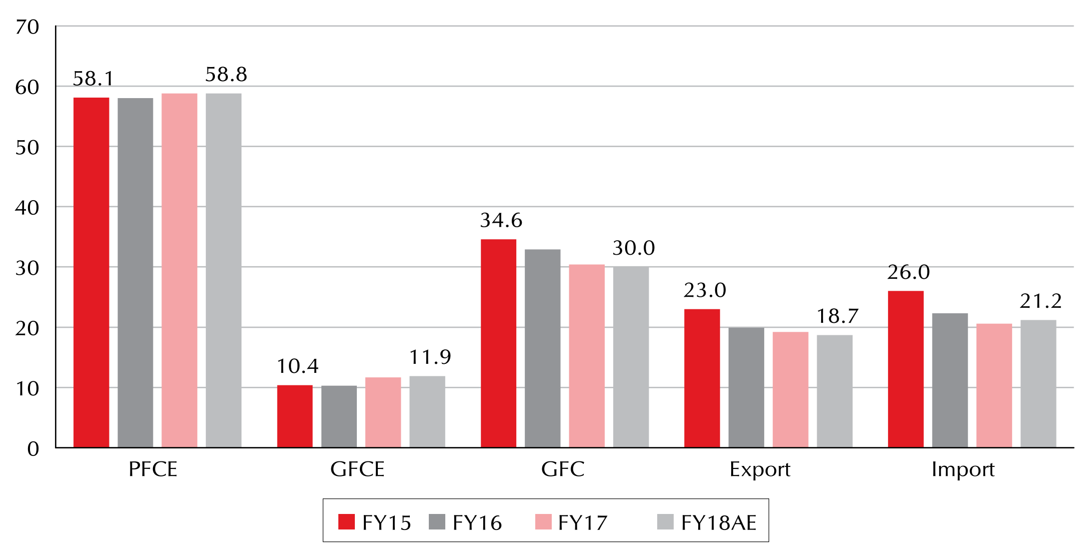
From an expenditure perspective, the economy continues to be consumption driven. In FY17, the real growth in the Government Final Consumption Expenditure (GFCE) was as high as nearly 21 percent (See Table 1.2), mainly due to the payment of higher wages and salaries to the government staff that followed the implementation of the recommendations of the Seventh Central Pay Commission (7CPC). Real Private Final Consumption Expenditure (PFCE) also grew above its four year average (+6.3 percent) at 8.7 percent during FY17. However, with lingering effects of demonetization and uncertainty around GST implementation, both PFCE and GFCE are estimated to be lower in FY18. The share of investment (Gross Fixed Capital Formation or GFCF) in the GDP persistently declined from 34 percent in FY12 to 27 percent in FY17. Although GFCF is estimated to grow faster in FY18 as compared to FY 17, it is still not high enough to prevent a further reduction in the share of GFCF to GDP. After nearly stagnating in FY15 and declining in FY16, exports of goods and services picked up in FY17 and is estimated to maintain similar growth rate in FY 18. In FY 17, the growth in imports also increased, albeit slower than exports, helping to reduce the current account deficit in FY17. In FY 18, imports are estimated to grow faster at 10 percent, led by higher crude oil prices.

Table 1.2: Components of GDP by expenditure

Indicator	%YoY (constant prices)			
	FY15	FY16	FY17	FY18AE
Private Consumption (PFCE)	6.2	6.1	8.7	6.3
Government Consumption (GFCE)	9.6	3.3	20.8	8.5
Gross Fixed Capital (GFC)	8.3	5.6	1.7	6.9
Gross Fixed Capital Formation (GFCF)	3.4	6.5	2.4	4.5
Exports of goods and services	1.8	(5.3)	4.5	4.5
Imports of goods and services	0.9	(5.9)	2.3	10.0

*Source: CSO. *AE – Advance estimate*

Chart 1.6: Different components of GDP by expenditure (percent of GDP at Current Prices)

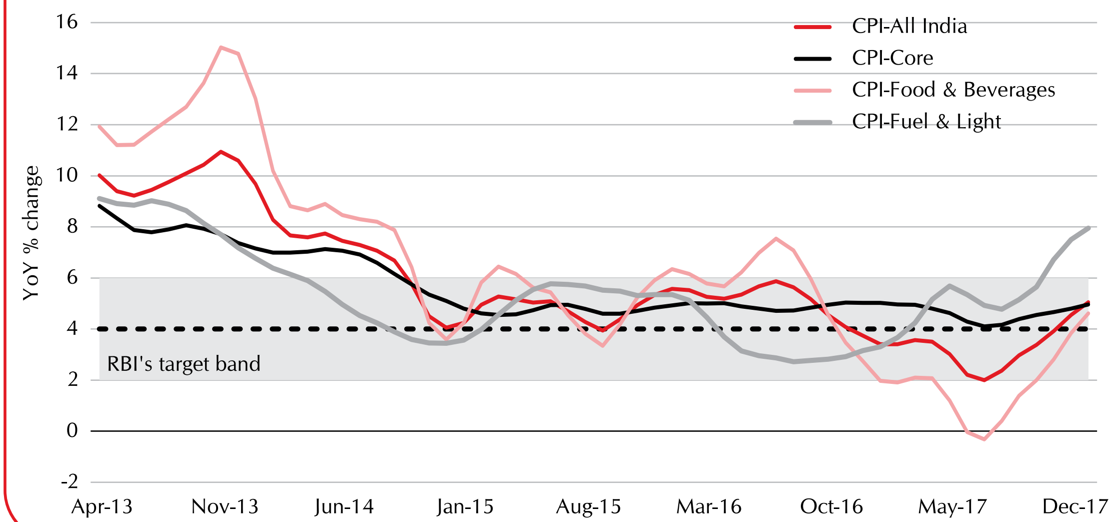


*Source: CSO. * AE – Advance estimate*

1.2.2. Inflation

Retail inflation, measured by the year-on-year change in the consumer price index (CPI), has been on a rise since the second quarter of FY18. Even then, inflation has remained in RBI's comfort zone of 4+/-2 percent, and is less than half the peak of 11.5 percent seen in November 2013. Several factors such as lower global oil and food prices, muted support prices for farmers, higher buffer stocks and crackdown on hoarding have aided in bringing inflation under control. However, the recent rise in inflation was led by a pick-up in food prices (specially vegetable prices) amidst a weak monsoon, higher international crude oil prices, and impact of higher housing rent allowance (HRA) given to government employees under 7CPC. Anticipating that some of the proposals contained in the 2018-19 budget such as the new method of fixing minimum support price, higher custom duty for a number of commodities and above all, fiscal slippage in both FY18 and FY19 to be inflationary in nature, the RBI continues to follow a 'neutral' stance on its monetary policy.

Chart 1.7: CPI Inflation-Base Year 2012 (3 month moving average)



Source: CSO

1.2.3. Fiscal discipline

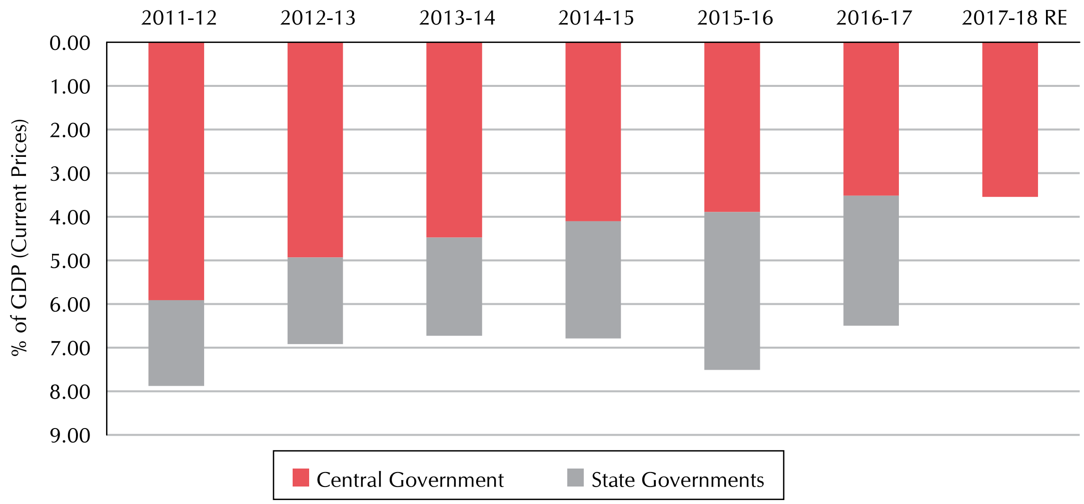
In the Union Budget 2018-19, the Government has slipped from the fiscal consolidation path that it sought to follow. In FY 18, against a target of 3.2 percent of GDP, there was a fiscal deficit slippage of 0.3 percent of GDP (see Table 1.3). Even though in a fast growing economy like India, fiscal consolidation (rather than fiscal slippage) is expected to be the norm, there was a slippage in FY 18—albeit small—on account of disruptions due to GST and demonetization,. The revenue deficit slippage in FY 18 is much higher (0.7 percent of GDP) than fiscal deficit slippage and is a matter of concern. This implies that the capital spending by the Government was significantly compressed in FY 18. Indeed, about 73 percent of Government's market borrowing in FY 18 was for consumption. The Government's capital expenditure at 1.6 percent of GDP in FY18 is the lowest since FY15. Furthermore, the budget's proposal to amend the FRBM Act to do away with the revenue deficit target is worrying.

Table 1.3: Key fiscal indicators of the Centre and States (percent to GDP)

Fiscal Year	Central Government		State	
	Fiscal Deficit	Revenue Deficit	Fiscal Deficit	Revenue Deficit
2011-12	5.9	4.5	1.97	0.37
2012-13	4.9	3.7	1.99	0.46
2013-14	4.5	3.2	2.25	0.72
2014-15	4.1	2.9	2.69	1.12
2015-16	3.9	2.5	3.62	2.03
2016-17	3.5	2.1	2.98	1.29
2017-18 RE	3.5	2.6		

Source: Union Government: Budget Documents, RBI
Note 1: Surplus (-) / Deficit (+); GDP is at current prices (2011-12 series)
Note 2: The revised estimates for state government deficits in FY 18 are not available yet.

Chart 1.8: General Government Gross Fiscal Deficit (percent of GDP)



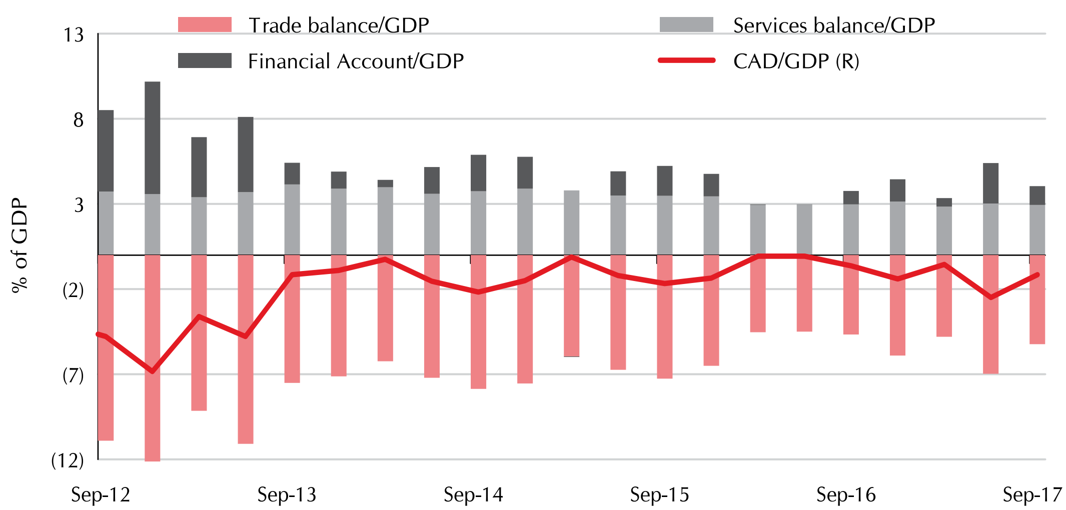
Source: Union Budget documents; State Government: Finance Accounts (various years)

What matters from the macroeconomic stability viewpoint is the general government fiscal deficit (center plus states) and not just the central government's deficit alone. With several states having promised farm-loans-waivers to alleviate the rural distress, state finances have deteriorated over the last few years. As can be seen from Chart 1.8, state finances have widened by 1percent of GDP over the last 5 years and have largely undone the Center's fiscal consolidation efforts.

1.2.4. External sector

In the year 2017, the external sector of the Indian economy benefitted from the swift global recovery. With the global economy gathering pace to grow 3.7 percent, and the world trade volume rising to 4.7 percent in 2017 (IMF estimates), India's external sector has continued to be resilient. Indeed, this trend has been continuing for the last 4-5 years. Just 4 years ago, poor macroeconomic performance caused India a significant balance of payments distress in 2013. Four years later, the external scenario has changed dramatically. The CAD has collapsed from nearly 5 percent of GDP in 2012-13 to less than 1 percent in 2016-17, benefitting significantly from the sharp drop in crude oil prices. Further, strong capital flows supported the overall balance of payments account that has remained benign since FY14 and also in the first half of FY18. In the first half of FY 18, however, CAD was higher at 1.8 percent of GDP, primarily on account of a higher trade deficit. While the current account came under pressure, the net capital flows dominated by foreign investment and banking capital was more than sufficient to finance the current account deficit leading to accretion in foreign exchange reserves. Foreign reserves approximated US$ 409 bn at the end of Dec'17, as compared to US$ 360 bn a year ago.

Chart 1.9: Break up of balance of payments as a percent of GDP



Source: CMIE, Reserve Bank of India

India's external debt remains within manageable limits as indicated by the external debt indicators (See Table 1.4). Total external debt increased by 5.1 percent to US$ 495.7 billion at end-Sep'17 from end-Mar'17. Both the long term and short term debt increased during the period in absolute terms. The increase in short term debt (by 5.4 percent) was mainly due to an increase in trade related credits. By end-Sep '17, the foreign exchange reserves cover to total external debt improved to 80.7 percent from 68.2 % at the end of FY 14, indicating a marked improvement. (See Table 1.4).

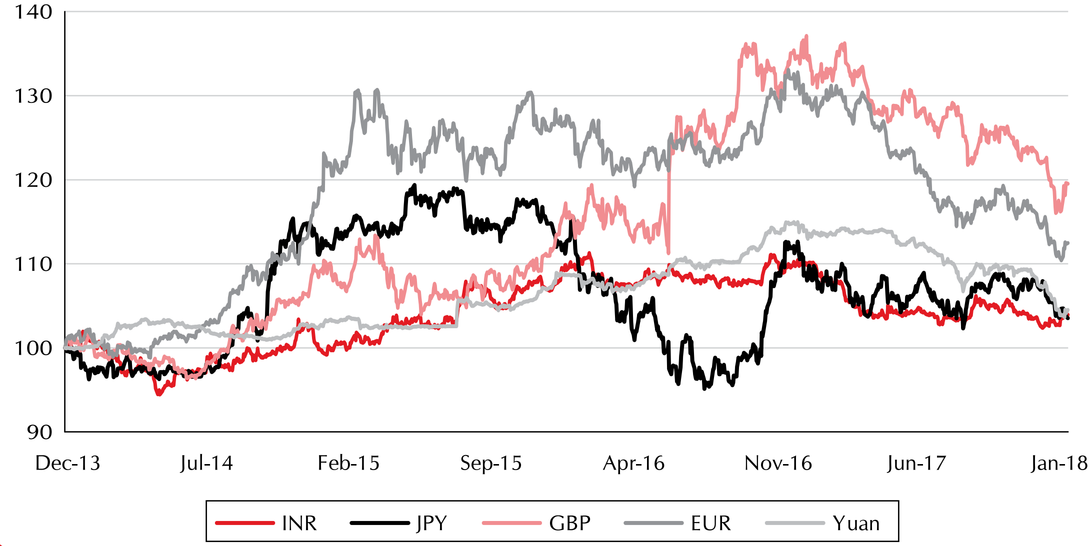
Table 1.4: India's Key External Debt Indicators

Year	External Debt (US$ billion)	Ratio of External Debt to GDP (percent)	Ratio of Short-term Debt to Foreign Exchange Reserves (percent)	Ratio of Short-term Debt to Total Debt (percent)	Ratio of Foreign Exchange Reserves to Total Debt (percent)
FY11	317.9	18.2	21.3	20.4	95.9
FY12	360.8	21.1	26.6	21.7	81.6
FY13	409.4	22.4	33.1	23.6	71.3
FY14	446.2	23.9	30.1	20.5	68.2
FY15	474.7	23.9	25	18	72
FY16	485.0	23.5	23.1	17.2	74.3
FY17 PR	471.8	20.2	23.8	18.6	78.4
End-Sep 2017 P	495.7	*	23.2	18.7	80.7

Source: Reserve Bank of India. P: Provisional. PR: Partially Revised.

A relatively stable rupee has also helped keep the external account situation under check. After a sharp depreciation of 21 percent between FY12 to FY14, and 9 percent between FY15 to FY17, the rupee has appreciated by 2.5 percent to a level of Rs 64.24 per US dollar during Dec'17 from the level of Rs 65.88 per US dollar during Mar'17 on the back of significant capital flows. Furthermore, within year fluctuations have also become much less. Consequently, with the positive developments in balance of payments, external debt and rupee, India's external worries have reduced significantly over the past few years.

Chart 1.10: The rupee remains stable relative to other major currencies (Rebased to 31-Dec-13 = 100)

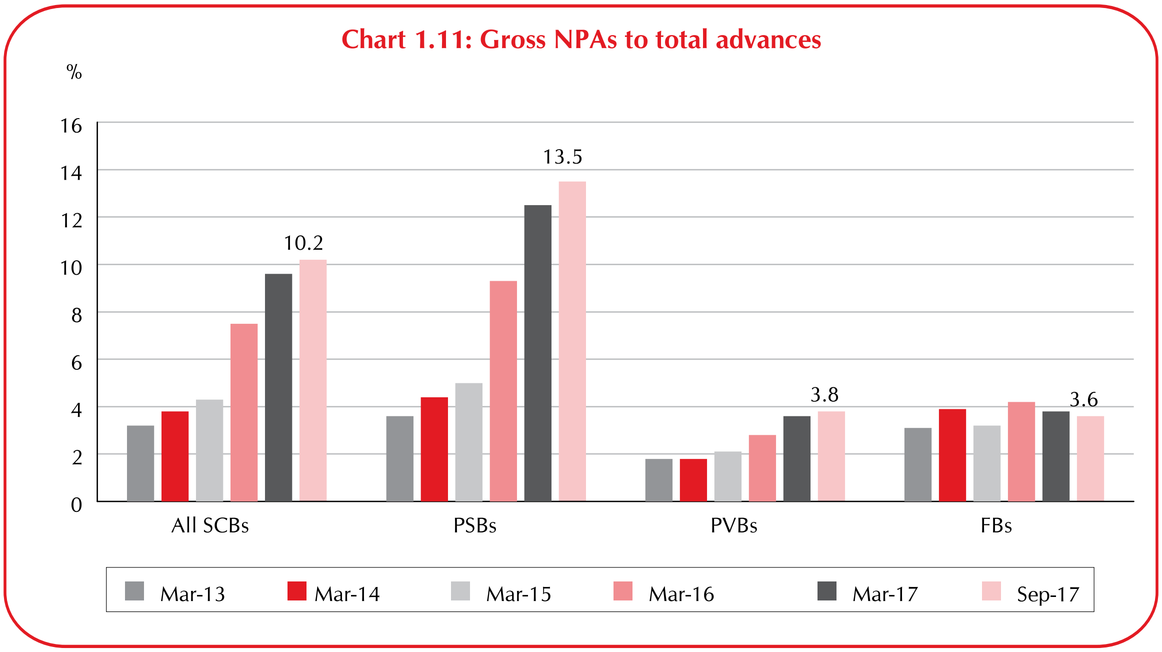


Source: Bank of International Settlement, Daily data.

1.2.5. Banking Sector

In India, the health of the banking sector has been deteriorating over the past few years and particularly sharply since FY 16, as reflected in surging nonperforming assets (NPAs)(see Chart 1.11a). As can be seen from the Chart 1.11, gross NPAs as a percentage of total advances has been rising from FY13, initially modestly, but sharply since FY 16, with gross non-performing advances (GNPA) ratio of Scheduled Commercial Banks (SCBs) rising to 10.2 percent by Sep'17. At one level, the sharp rise in the GNPA ratio since FY 16 was due to the Asset Quality Review conducted by the RBI in August-November 2015, forcing banks to clean up their books. But the deeper issue was that the bad loans had been accumulating over the years through inadequate loan monitoring by banks, aggressive lending practices by banks, loan frauds and corruption; but these loans were swept under the carpet, which got exposed by the RBI's intervention in the second half of 2015. Another interesting aspect of the problem was that the bad loans were much more concentrated in the public sector banks as compared to the private banks or the foreign banks, as can be seen from the Chart. More than four-fifths of the non-performing assets were in the public sector banks, where the NPA ratio had reached 13.5 percent by September 2017.

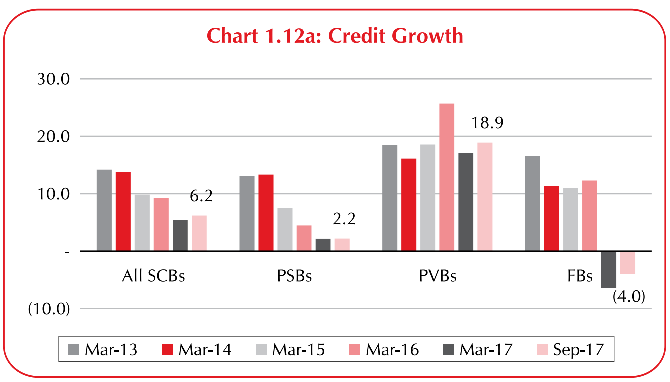
The problem was reflected on the balance sheets of the corporate sector; many large corporates were overleveraged and many firms did not earn enough to pay the interest obligations on their loans. India was clearly suffering from the twin balance sheet problem—a problem that continues even today, although it has been somewhat mitigated.

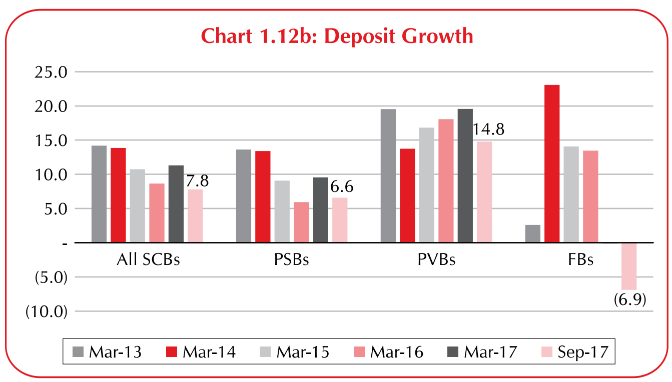


Source: RBI

Note: PSBs = Public sector banks, PVBs = Private sector banks and FBs = Foreign banks.

This situation led to severe consequences. Credit and investments, which had already been falling since the global financial crisis in 2008, were further intensified with the twin-balance sheet problem. Muted credit growth leads to lower investments and poses a significant risk to growth. However, after two years of declining credit growth, all scheduled commercial banks witnessed an uptick in credit growth from 4.4 percent in Mar'17 to 6.2 percent in Sep'17. The PSBs credit growth also increased from 0.7 percent to 2.2 percent over the same period. Personal loans, however, continue to be the major contributor to credit growth. On the other hand, deposit growth of SCBs decelerated from 11.1 percent in Mar'17 to 7.8 percent in Sep'17, and this decline was observed across all bank groups.





Source: RBI Financial Stability Report, CMIE

Note: SCBs = Scheduled Commercial Banks, PSBs = Public sector banks, PVBs = Private sector banks and FBs = Foreign banks.

Amidst these ongoing concerns, the Indian government has taken various measures to resolve the banking problem. The government provided a boost to banks by announcing a recapitalisation plan of Rs 2.11 trn for the sector in Oct'17. The aim is to help banks clean up their balance sheets and start fresh. Further, to improve the resolution of bank loans in the long run, the Insolvency and Bankruptcy Code had been enacted in May'16, which is proving to be very promising (details in Box 1.2). In Aug'16, the government amended the existing Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Sarfaesi) Act, and the Debt Recovery Tribunal (DRT) Act that would help faster recovery and resolution of bad debts by banks and financial institutions.

Box 1.2: Reform initiatives and policy measures in India

Some of the important initiatives taken in the recent past are summarised below:

1. *Implementation of GST*: In a path-breaking development, the GST—which subsumes all indirect taxes levied on goods and services by the Central and State governments--was launched on 1 July 2017. With a policy change of such scale and complexity, the transition unsurprisingly encountered several challenges in implementation, which especially affected the informal sector. The Government was quick to respond to rationalize and reduce the rates, and simplify the compliance burdens. The GST Council, which is a joint forum of centre and states, has been formed, which acts as the key decision-making body for all important decisions regarding the GST. It is being envisaged as one of the most effective institutional mechanisms for cooperative federalism, which could potentially tackle a wide array of difficult structural reforms (that involve the states), such as creating a common agricultural market, integrate fragmented and inefficient electricity markets and so on.
2. *Recapitalisation of Banks*: Stringent capital adequacy requirements imposed by RBI in the wake of the Basel III norms and high and rising levels of NPAs of PSBs have led to significant capital erosion of PSBs, making it imperative for banks to significantly raise their capital base. To ensure that PSBs are adequately capitalized to meaningfully expand credit and drive economic growth, the Union Government took a decision on 24th October 2017 to inject Rs 2.11 lakh crore worth of capital into the sector. The programme has been integrated with an ambitious reform agenda, under the rubric of an Enhanced Access and Service Excellence (EASE) programme. This recapitalization will pave the way for the public sector banks to lend additional credit of about Rs 5 lakh crore.
3. *Seventh Pay Commission*: The Seventh Pay Commission inter alia recommended a staggering 23.5 per cent hike in the salaries of the Central Government staff. The Union Cabinet approved the implementation of the Commission in June 2016. The recommendations cover about 4.7 million central government employees and around 5.3 million pensioners. The new pay scales are expected to put an extra burden of a whopping Rs 1 trillion (0.7 percent of GDP) on the exchequer in 2016/17. Subsequently, several state governments have also implemented revision in salaries of employees based on the recommendations of the Seventh Pay Commission.
4. Monetary Policy Committee: For the first time in its history–in October 2016– the Reserve Bank of India (RBI) appointed a Monetary Policy Committee (MPC), comprising three members from the RBI and three prominent academics. The MPC has been assigned the responsibility of framing monetary policy so as to contain the inflation at the target rate of four per cent. The upper tolerance level of inflation has been fixed at six per cent while the lower target rate is two per cent. The MPC, which holds bi-monthly meetings to inter alia review monetary policy, changed policy repo rate only once during the year 2017. In August 2017, the MPC cut the repo rate by 25 basis points to 6 percent, which is the lowest in almost 7 years. The cut in the policy rate was carried out in view of expected normal monsoon and significant decline in core inflation.
5. *Insolvency and Bankruptcy code (IBC) 2016*: The Insolvency and Bankruptcy Code, a landmark legislation replacing the existing patchwork of regulations with a consolidated regulatory framework governing the re-organization and insolvency resolution of incorporated entities was enacted by the Parliament in May 2016. By facilitating the resolution of 'insolvency situation' of a corporate debtor or, in extreme cases its liquidation through a time-bound and credible mechanism--the absence of which has hurt the Indian economy for decades—the Code not only addresses the need of the hour, but also provides a more efficient solution to the corporate insolvency issue for years to come. Since the enactment of the Code, substantial progress has been made in the implementation of the Code. The twin balance sheet problem was partially addressed by sending major stressed companies for resolution under the Code. During 2017, 540 corporates were admitted for resolution, of which 461 were undergoing resolution at the end of December 2017, while the rest faced closure through appeal/ review (39), approval of resolution plan (10) and commencement of liquidation (30).
6. *Financial Resolution and Deposit Insurance (FRDI) Bill, 2017*: What the IBC is expected to achieve for the financial firms, the FRDI bill seeks to do for the financial firms. The Bill establishes a Resolution Corporation to monitor financial firms, anticipate risk of failure, take corrective action, and resolve them in case of such failure.

The Corporation will also provide deposit insurance up to a certain limit, in case of bank failure. If resolution is not completed within a maximum period of two years, the firm will be liquidated. The Bill also specifies the order of distributing liquidation proceeds.

Demonetisation: On November 8, 2016, the Prime Minister announced the demonetisation of the then existing Rupees 500 and Rupees 1,000 notes, in order to (a) curb hoarding of black money, put a check on counterfeiting of Indian currencies and encourage more digitized transactions. As a result of this move, about 86 per cent of the cash in circulation was wiped off overnight. The step has been criticised in most quarters on account of deficiencies in its implementation. Also, the temporary slowdown in the Indian economy has been partially attributed to demonetisation.

1.2.6. Ease of doing business

According to the World Bank's report on *'Doing Business 2018: Reforming to Create Jobs'*, India for the first time moved into the top 100 (vs. 130th rank last year) in the global ranking of 'ease of doing business'. An improvement in investor protection rights, the establishment of debt recovery tribunals to reduce bank NPAs, easier tax compliance by implementing an online platform for electronic payment of some taxes are among the positive developments that led to the uptick in ranking. Notably, India was the only economy in South Asia to join the list of the top 10 improvers.

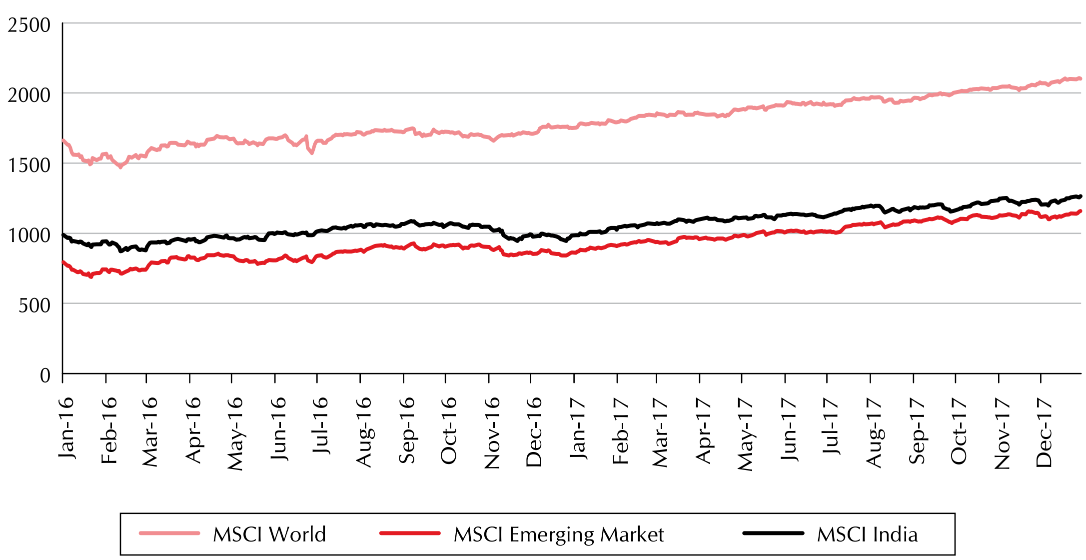
Section II: Trends in the Securities Markets – The International Scenario

Equity prices in advanced economies continued to rally in 2017, partly due to favourable sentiment resulting from global recovery, and improved corporate earnings prospects, expectation of a very gradual normalization path for monetary policy in advanced economies in a weak inflation environment, and low expected volatility in underlying fundamentals. Emerging market equity indices have also risen in 2017, lifted by the improved near-term outlook for economic growth and commodity exports (World Economic Outlook Update, January 2018).

1.1 Market Trends

Global integration of financial markets—the widening and intensifying of links—between high-income and developing countries has accelerated over the past few years. Financial markets in most countries have become increasingly global and synchronized. In 2017, the securities markets worldwide exhibited an upward trend due to favorable global economic scenario. The resurgence in global economic growth, favourable investor response to tax reforms in the US and rise in energy prices all contributed to strengthen the global markets to a new high at the end of 2017 (SEBI Bulletin, January 2018). Emerging markets stocks too recorded gains as investor sentiments were uplifted by forecast of a sustained global economic growth and improved corporate earnings (See Chart 1.13). Significantly, these gains in emerging markets came despite the US Federal Reserve raising its short term interest rates for third time in 2017.

Chart 1.13: Movement in MSCI World and Emerging Market Index



Source: Bloomberg

Equity markets exhibited an upward trend in both advanced and emerging markets in 2017. Among the advanced economies, US equities advanced and continued their steady rise throughout the year. UK stocks rose by the close of December quarter as IMF upgraded its global growth forecast, reflecting hopes for synchronised economic recovery and gradual progress on Brexit negotiations. Japanese equities strengthened slightly in US dollar terms. (SEBI Bulletin, January 2018).

Among the emerging markets, Chinese stocks recorded strong gains as the fourth quarter GDP growth remained stable. Indian equities generated strong gains as the government announced plans for a major recapitalisation initiative for Public sector banks. Brazilian stocks posted negative returns owing to weakening of its currency. Russian stocks underperformed slightly as compared to emerging European markets amidst higher prices and a strong currency.

According to the International Investment Funds Association, worldwide, net assets in regulated open-end funds increased by about 15 percent (yoy) to $47.37 trillion at the end of the third quarter (Q3) of 2017, excluding funds of funds (Table 1.5). During this period, while the net assets in equity funds increased by 19 percent (yoy), the bond fund net assets increased by 12 percent. Among all regulated open-end fund categories, equity and bond contributed around 74 percent of all long-term funds at the end of Q3 2017 which is marginally higher than Q1 2016 (73 percent). Notably, at the end of Q3 2017, the net assets under ETFs increased significantly by 34 per cent (yoy) to $ 4.28 trillion, although its contribution to total long term funds remained low at 10.3 percent.

Table 1.5: Net assets of worldwide regulated open end funds (US$ billion; end of period)

	2016				2017		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3**
All funds* (USD billion)	38,875	39,329	41,048	40,554	42,973	44,979	47,371
Long-term	33,722	34,240	35,899	35,420	37,817	39,649	41,652
Equity	16,294	16,433	17,303	17,326	18,768	19,587	20,614
Bond	8,368	8,680	9,071	8,796	9,312	9,740	10,176
Balanced/Mixed	5,227	5,294	5,458	5,323	5,659	5,926	6,218
Guaranteed	73	69	68	66	69	71	71
Real Estate	572	593	610	607	637	679	712
Other	3,188	3,171	3,388	3,302	3,372	3,646	3,860
Money market	5,152	5,088	5,149	5,135	5,156	5,330	5,719
Memo items included above:							
ETFs	2,815	2,877	3,183	3,315	3,751	4,001	4,281
Institutional	3,404	3,554	3,720	3,560	3,799	4,002	4,238

Source: International Investment Funds Association[1]

** Excludes funds of funds where possible*

Note: Regulated open-end funds include mutual funds, exchange-traded funds, and institutional funds.

Further, global volatility has been at historically low levels of late for a wide range of risky assets across most international markets, particularly the US markets. At the end of 2015, global volatility was close to its mean value over the period from 2000 to 2017, but by mid-2017 it had almost halved. The US Federal Reserve has found that global factors and U.S. conventional and unconventional monetary policies are key to understand the dynamics of global volatility and these factors largely account for the recent low levels of global volatility.

There is finally some optimism in the area of international capital flows, which collapsed during the global financial crisis, and has proven to be very persistent since then. Most of the decline in capital inflows has been experienced in Advanced Economies (AEs) rather than in Emerging Markets (EMs). In terms of the type of capital flows, most of the decline has taken place in portfolio inflows (equity and debt securities) and 'other investments' (which are often related to the lending activity of international banks), while FDI inflows have proved to be more resilient. After falling sharply during the crisis, international capital flows have only partially recovered in recent years. The capital flows to global GDP ratio in recent years is about one third of the pre-crisis (2003-07) average.

1 https://www.iifa.ca/files/1515520678_IIFA%20-%20Worldwide%20Open-End%20Fund%20Report%20-%20Q3%202017.pdf

1.1.1 Cash Market

Total domestic market capitalisation of member countries of World Federation of Exchanges (WFE) at the end of 2017 was 22.6 percent higher than at the end of 2016, reaching a new record high of $ 87.1 trillion, an all-time high during the period 2012-2017, globally (Chart 1.14). This increase was driven by an uptick in the domestic market cap across all regions – the Americas up 17.8 percent, Asia-Pacific region up 27.6 percent and the Europe, the Middle East, and Africa (EMEA) region up 24.3 percent at the end of 2017 as compared to 2016 (WFE Market Highlights, FY 2017). This increase in domestic market cap, was against a backdrop of a synchronized global recovery in GDP growth rates, the continuation of accommodative monetary policy in many regions, low levels of inflation, low market volatility, recovering commodity prices and strong corporate profits.

According to the WFE, the number of new listings through IPOs was up by 47.8 percent in 2017 as compared to 2016. [2] Non-IPO listings which accounted for about 36 percent of the total new listings increased by 49.1 percent in the same time period. The secondary market activities, on the other hand, contracted. The total value and volume of trades in equity shares declined by 2.6 percent and 5.1 percent respectively in 2017 compared to 2016.

Chart 1.14a: Domestic Market Capitalisation (USD trillion)

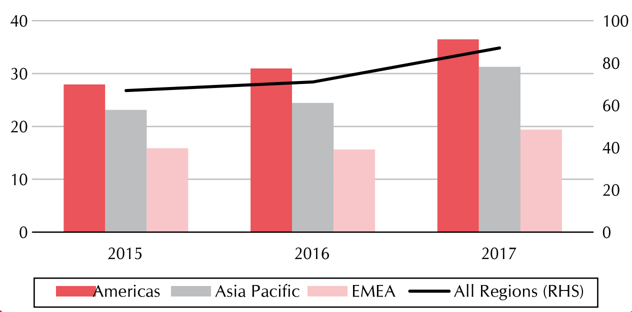


Chart 1.14b: Value of Share Trading (USD trillion)

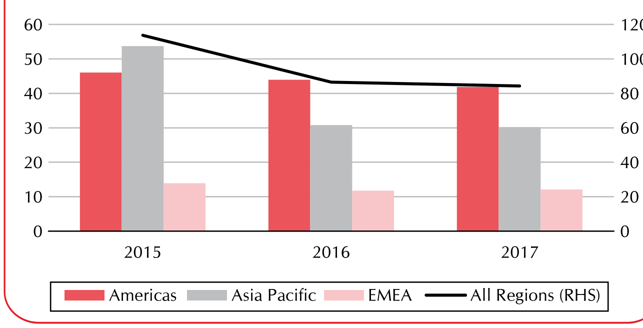


Chart 1.14c: Number of trades (billion of trades)

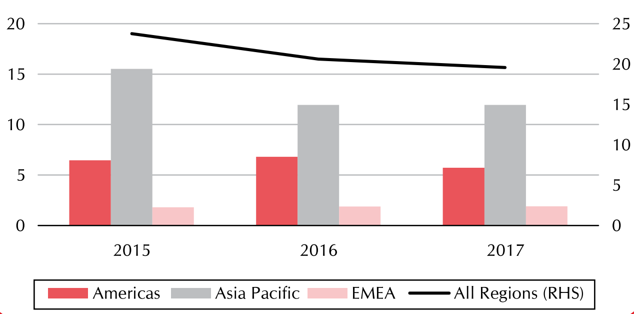
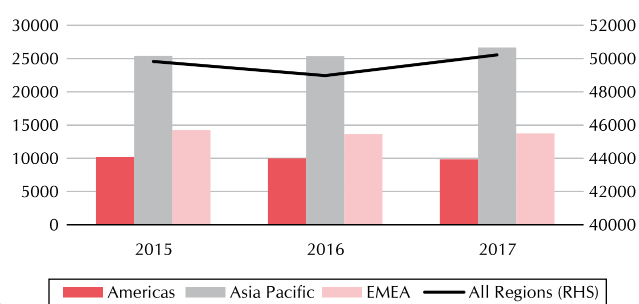


Chart 1.14d: Number of listed companies



Source: World Federation of Exchanges, 2017- Full year market highlights based on data from World Federation of Exchanges members, affiliates, correspondents and non-members.

Note: Bats Chi-X Europe is included in the data for Value of share trading and Number of trades, but not in the data for Domestic Market capitalisation.

Data is based on those exchanges which are reported by members of WFE.

Excluding investment funds, Including Alternative and SME Markets.

1.1.2 Derivatives Market

Based on WFE data as reported by the members of WFE, the total volume of Exchange Traded Derivatives (ETD) increased by 0.6 percent in 2017 compared to the previous year. While single stock options, stock index options and interest rate futures registered increase in volumes, stock index futures, currency derivatives and commodities

[2] Findings are solely based on data reported by the members of the WFE. For further details please refer to the monthly reports of the WFE at 'https://www.world-exchanges.org/home/index.php/statistics/monthly-reports

derivatives witnessed decline (See Chart 1.15).

Volumes traded of single stock options, which account for 77 percent of single stock derivatives, increased by 4.8 percent, mainly driven by a 3.6 percent increase in the Americas where more than 80 percent of total trading takes place. The Asia-Pacific saw a significant increase in volumes traded (up by 26.6 percent) while the EMEA region experienced a decline in volume traded (down by 2.4 percent). Total traded volume of stock Index options increased 22.6 percent in 2017, mainly due to 34.3 percent increase in the Asia-Pacific region where more than 65 percent of total trading takes place.

In a year when several key central bank interest rate decisions were scheduled to take place across various markets, it was unsurprising to notice an uptick in volumes of interest rate futures traded by 11.3 percent with increases in all the regions. Volumes traded of interest rate options which accounted for about 18 percent of interest rate derivatives were also up by 17.6 percent in 2017 compared to the previous year.

In case of commodity derivatives, there was a year-on-year decline in volumes traded in 2017 (down by 15.6 percent), entirely driven by 26 percent decline in the Asia-Pacific region where over 60 percent of total trading takes place.

Chart 1.15a: Stock Options

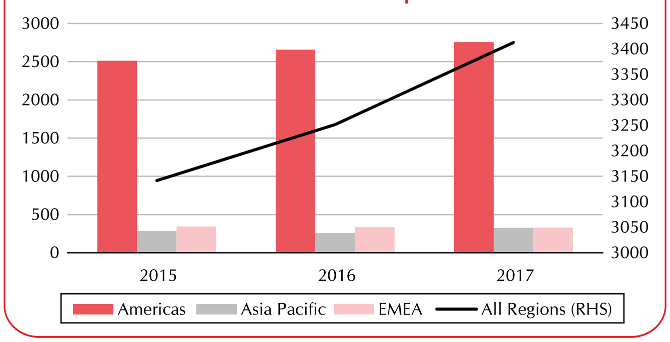
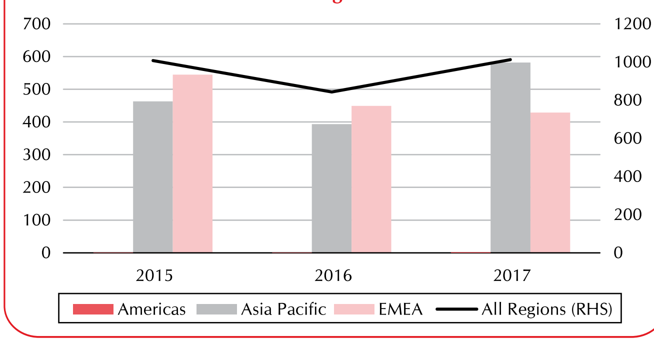


Chart 1.15b: Single Stock Futures



Char 1.15c: Stock Index Options

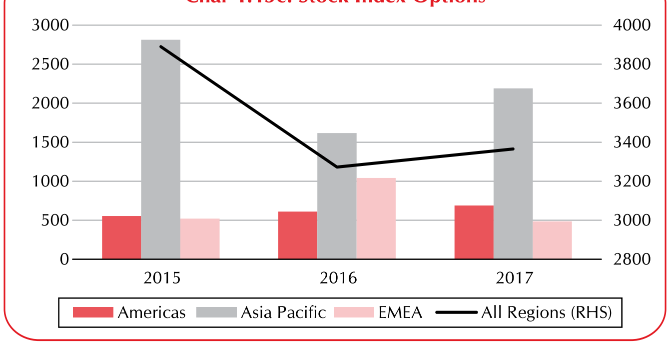


Chart 1.15d: Stock Index Futures

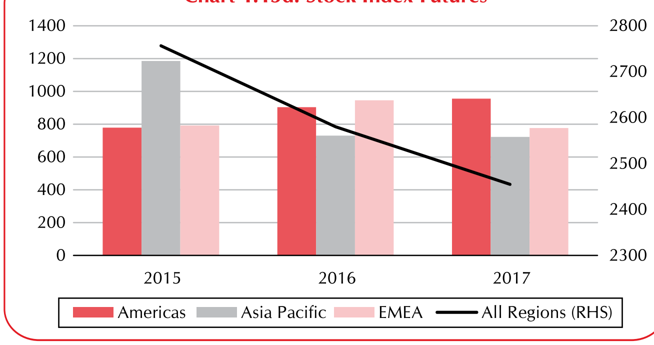


Chart 1.15e: Interest Rate Derivatives

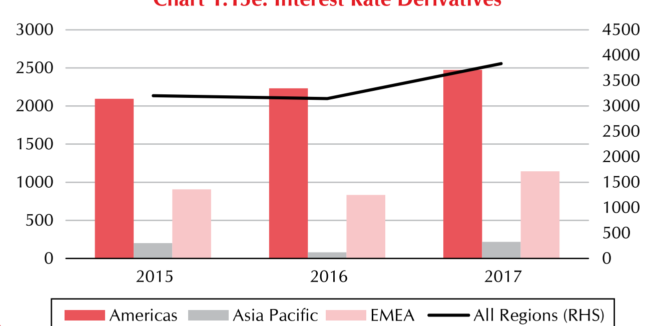


Chart 1.15f: Commodity Derivatives

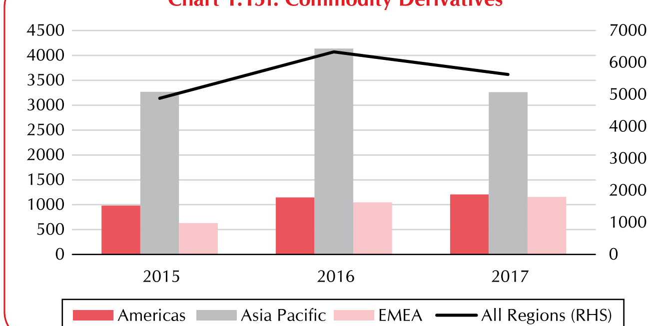


Chart 1.15g: Currency Derivatives

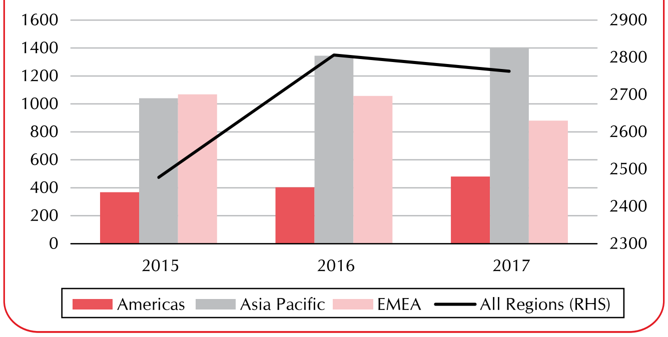
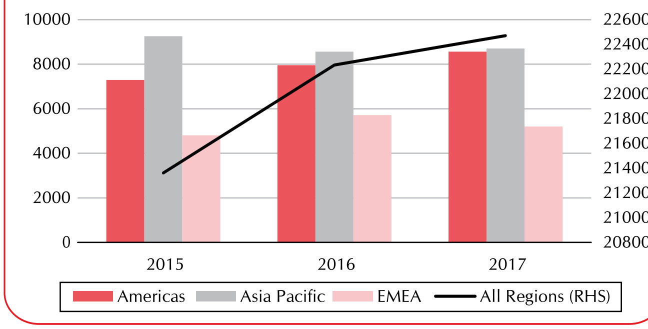


Chart 1.15h: All Derivatives



Source: World Federation of Exchanges, 2017- Full year market highlights.

1.1.3 Other Markets

According to the WFE data, while total listing of Exchange Traded Funds (ETF) increased by 5.7 percent in 2017 compared to 2016 driven by increases across all regions, the value traded was down by 12.6 percent mainly due to 13.9 percent decline in turnover in the Americas which accounts for over 85 percent of total value traded of ETFs. Both listings and value traded of Investment Funds were down by 9.5 percent and 15 percent, respectively in 2017 compared to the previous year.

Section III: Structure and Trends of the Indian Securities Market

This section outlines the basic structure of the Indian securities market as it exists now, along with the broad trends in different segments of the market 2016-17 and 2017-18 up to December 2017.

1.1 Basic Market Structure

The securities market has essentially three categories of participants: (a) issuers of securities, (b) investors in securities (in both primary and secondary markets), and (c) intermediaries. The issuers are the borrowers or deficit savers, who issue securities to raise funds. The investors in primary markets, who are surplus savers, deploy their savings by subscribing to these securities. The investors in secondary markets buy and sell securities from each other to adjust their holdings of securities depending on their changing needs. The intermediaries are the agents who match the needs of the users and the suppliers of funds in the primary market for a commission to help both the issuers and the investors to achieve their respective goals; besides, they play a variety of roles in the secondary market as well. There are a large variety of intermediaries providing various services in the Indian securities market (Table 1.6).

Table 1.6: Market Participants in Securities Market

Market Participants	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018$
Securities Appellate Tribunal (SAT)	1	1	1	1	1
Regulators*	4	4	4	4	4
Depositories	2	2	2	2	2
Stock Exchanges					
Cash Market	20	18	18	5	5
Equity Derivatives Market	3	3	3	3	3
Currency Derivatives Market	4	3	3	3	3
Brokers (Cash Segment)**	9,411	3,744	3,219	3,192	3,202
Corporate Brokers (Cash Segment)	4,917	3,290	2,820	2,775	2,778
Brokers (Equity Derivatives)	3,051	2,990	2,760	2,651	2,668
Brokers (Currency Derivatives)	2,395	2,406	2,205	1,985	2,310
Sub-brokers (Cash Segment)	51,885	42,351	35,246	30,610	25,642
Foreign Portfolio Investors	-	8,214	8,717	7,807	9,042
Portfolio Managers	212	188	202	218	261
Custodians	19	19	19	19	19
Registrars to an issue & Share Transfer Agents	71	72	71	73	73
Merchant Bankers	197	197	189	189	188
Bankers to an Issue	59	60	62	64	65
Debenture Trustees	31	32	31	32	32
Underwriters	3	2	2	2	1
Venture Capital Funds	207	201	200	198	196
Foreign Venture Capital Investors	192	204	215	218	220
Mutual Funds	50	47	48	45	45
Collective Investment Management Company	1	1	1	1	1
KYC Registration Agency (KRA)	5	5	5	5	5

** DCA,DEA,RBI&SEBI,**Including brokers on Mangalore SE (58), HSE (303), Magadh SE (197), SKSE (399), $ indicates as on December 31, 2017*

Source: SEBI Bulletin – April 2017 and January 2018.

Notes:

1. *With the commencement of FPI Regime from June 1, 2014, the erstwhile FIIs, Sub Accounts and QFIs are merged into a new investor classtermed as "Foreign Portfolio Investors (FPIs)".*
2. *With the commencement of FPI regime, all existing FIIs and SAs are deemed to be FPIs till the expiry of their registration. Figures for FPIs andDeemed FPIs are provided by NSDL.*
3. *The Hyderabad Securities and Enterprises Ltd (erstwhile Hyderabad Stock Exchange), Coimbatore Stock Exchange Ltd, Saurashtra Kutch StockExchange Ltd ,Mangalore Stock Exchange, Inter-Connected Stock Exchange of India Ltd, Cochin Stock Exchange Ltd, Bangalore Stock ExchangeLtd , Ludhiana Stock exchange Ltd, Gauhati Stock Exchange Ltd, Bhubaneswar Stock Exchange Ltd, Jaipur Stock Exchange Ltd, OTC Exchangeof India, Pune Stock Exchange Ltd and Madras Stock Exchange Ltd. have been granted exit by SEBI vide orders dated January 25, 2013, April 3,2013, April 5, 2013, March 3, 2014, December 08, 2014, December 23, 2014, December 26, 2014, December 30, 2014, January 27, 2015,February 09, 2015, March 23, 2015, March 31, 2015 and April 13, 2015 respectively.*
4. *SEBI vide order dated September 3, 2007 refused to renew the recognition granted to Magadh Stock Exchange Ltd.*
5. *Stock brokers and Sub-brokers of Inter connected Stock exchange, Cochin Stock Exchange, Bangalore Stock Exchange, and Ludhiana StockExchange, which were granted exit, are excluded.*
6. *United Stock Exchange of India Ltd. has stopped providing trading facilities to its members from 30th of December 2014 vide circular number:USE/CMPL/628/2014.*
7. *SEBI withdraw the recognition granted to Delhi Stock Exchange Limited dated November 19 2014.*

The securities market has two interdependent and inseparable segments, namely, the primary market and the secondary market. The primary market provides the channel for the creation and sale of new securities, while the secondary market deals with the securities that were issued previously. The securities issued in the primary market are issued by public limited companies or by government agencies. The resources in this kind of market are mobilised either through a public issue or through a private placement route. If any member of the public can subscribe to the issue, it is called a public issue; if the issue is made available only to a select group of people, it is known as private placement. There are two major types of issuers of securities—corporate entities, who issue mainly debt and equity instruments, and the government (Central as well as State), which issues only debt securities (dated securities and treasury bills).

The secondary market enables the participants who hold securities to adjust their holdings in response to changes in their assessment of risks and returns. Once new securities are issued in the primary market, they can be traded in the secondary market. The secondary market operates through two mediums, namely, the over-the-counter (OTC) market and the exchange-traded market. The OTC markets are markets where trades are negotiated. Most of the trades in government securities take place in the OTC market. All the spot trades where securities are traded for immediate delivery and payment occur in the OTC market. The other option is to trade using the infrastructure provided by the stock exchanges. The exchanges in India follow a systematic settlement period. All the trades taking place over a trading cycle (trading day = T) are settled together after a certain time (T + 2 days). The trades executed on the exchanges are cleared and settled by a clearing corporation. The clearing corporation acts as a counterparty and guarantees settlement. One component of the secondary market is the forward market, where securities are traded for future delivery and payment. A variant of the forward market is the futures and options (F&O) market. Currently, trading in futures and options in equity occurs mainly on the National Stock Exchange of India Ltd. (NSE).

1.2 Regulators

The process of mobilising resources is carried out under the supervision and overview of the regulators. The regulators regulate the conduct of the issuers of securities and the intermediaries and attempt to ensure fair market practices, so as to protect the interests of the investors. The regulators are also responsible for ensuring supply of quality securities as well as high service standards of the intermediaries. The regulator's aim is to ensure that the market participants behave in such a manner so that the securities markets continue to be a secure and important source of finance for the corporate sector and the government, while protecting the interests of investors.

In India, the responsibility for regulating the securities market is shared by the Department of Economic Affairs (DEA), the Ministry of Corporate Affairs (MCA), the Reserve Bank of India (RBI), and Securities and Exchange Board of India (SEBI). The orders of SEBI under the securities laws are appealable before a Securities Appellate Tribunal (SAT).

The Ministry of Finance regulates through the Capital Markets Division of the Department of Economic Affairs. - The Division is responsible for institutional reforms in the securities markets, building regulatory and market institutions, strengthening investor protection mechanism, and providing efficient legislative framework for securities markets. The Division administers legislations and rules made under the Depositories Act, 1996, Securities Contracts (Regulation) Act, 1956 and Securities and Exchange Board of India Act, 1992.

The Investor Education and Protection Fund (IEPF) has been set-up under Section 205C of the Companies Act, 1956 by way of the Companies (Amendment) Act, 1999 under the chairmanship of the Secretary of the Ministry of Corporate Affairs (MCA).

The Reserve Bank derives statutory powers to regulate market segments from specific provisions of the Reserve Bank of India Act, 1934. The prudential guidelines issued to eligible market participants form the broad regulatory framework for government securities, money market and interest rate derivatives. All the secondary market transactions in Government Securities are settled through a central counterparty mechanism under Delivery Versus Payment mode. Multilateral netting is achieved with a single funds settlement obligation for each member for a particular settlement date. The settlement is achieved in the RTGS (Real Time Gross Settlement) Settlement/Current Account maintained by the member in the Reserve Bank. The RBI formulates detailed guidelines on each segment of the money market (collaterised borrowing, uncollaterised call money market, Commercial Paper issuances by corporates, Primary Dealers and financial institutions and Certificates of Deposit) under the section Master Circulars for financial markets. In the foreign exchange market, the Foreign Exchange Management Act, 1999 (Act 42 of 1999), better known as FEMA, 1999, provides the statutory framework for the regulation of Foreign Exchange derivatives contracts. The powers in respect of the contracts for the sale and purchase of securities, gold-related securities, money market securities and securities derived from these securities, and ready forward contracts in debt securities are exercised concurrently by the RBI.

The SEBI is the regulatory authority established under the SEBI Act 1992 and is the principal regulator for stock exchanges in India. SEBI's primary functions include protecting investor interests and promoting and regulating the Indian securities markets. Foreign Portfolio Investors are required to register with Designated Depository Participants (DDPs) in order to participate in the Indian securities markets. Most of the powers under the Securities Contracts (Regulation) Act, 1956 (SCRA) can be exercised by the DEA while a few others can be exercised by SEBI. The powers of the DEA under the SCRA are also concurrently exercised by SEBI. Besides, the Depositories Act is administered by SEBI. The rules under the securities laws are framed by the government and the regulations are framed by SEBI.

Box 1.3: Some reform initiatives introduced in the securities market during March 2016 - December 2017

SEBI initiated a host of policies and programmes during the period with the objectives of (i) protecting investors' interests in securities; (ii) promoting the development of the securities market; and (iii) regulating the securities market., such as;

a) *Integrated reporting by listed entities*: SEBI has mandated submission of Business Responsibility Reports (BRRs) for top 500 listed entities to further improve disclosure standards of non-financial information. The key areas which are required to be reported by the entities pertain to environment, governance stakeholder relationships and so on.
b) *Implementation of New Accounting Standards Ind-AS by Listed Entities*: In accordance with the rules prescribed by the Ministry of Corporate Affairs, the listed entities are required to comply with the new accounting standards Ind-AS, which are on the lines of international accounting standards, in a phased manner beginning 2016-17. In order to facilitate a smooth transition during the first year of Ind-AS implementation, SEBI issued detailed guidelines. The formats for financial results were also aligned with those prescribed under the Companies Act/the Banking Regulation Act/IRDAI Act.
c) *Transparency in Listed Companies' Dividend Distribution Policies:* In order to bring in more transparency with respect to listed companies' dividend policies, a new Regulation 43A has been introduced in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. This requires the top 500 listed companies (by way of market capitalization) to formulate and disclose their dividend distribution policies in their annual reports and on their websites.

d) *Enhancing Corporate Governance Standards:* The SEBI Committee on corporate governance was formed on June 2, 2017 under the Chairmanship of Mr. Uday Kotak with the aim of improving standards of corporate governance of listed companies in India. The Committee submitted its report to SEBI on October 4, 2017; the report contained several proposals to enhance the current corporate governance norms to global standards. Subsequently, SEBI invited comments from the public till early November. The SEBI is currently reviewing the committee's proposals and comments from the public.

e) *Guidance on Board Evaluation:* The evaluation of the performance of the board of directors and its committees is an important component of corporate governance. The provisions on board evaluation are contained in the Companies Act, 2013 and the SEBI Listing Regulations, 2015. After studying the various practices on board evaluation by listed companies in India and abroad, the SEBI issued a guidance note on the matter of board evaluation in January 2017 that covers all major aspects of a board evaluation including subject of evaluation, process of evaluation including laying down objectives and criteria to be adopted for evaluating different persons, feedback to the persons being evaluated and action plan based on the results of the evaluation process.

f) *Guidelines for Functioning of Stock Exchanges and Clearing Corporations in the International Financial Services Centre (IFSC):* SEBI prescribed a broad framework for the functioning of stock exchanges and clearing corporations in IFSC by way of SEBI (IFSC) Guidelines, 2015, with regard to market structure, trading hours and settlement, product category, position limits, trading in rupee denominated bonds issued overseas (Masala bonds), the risk management framework, the dispute resolution mechanism and business continuity plan & disaster recovery. The Guidelines were amended on July 27, 2017; according to the Amendment, any Indian recognised stock exchange or any recognised stock exchange of a foreign jurisdiction can form a subsidiary to provide the services of stock exchange in IFSC wherein at least 51 per cent of paid up equity share capital should be held by such stock exchange and the remaining share capital should be held by the following: i) any other stock exchange, ii) a depository, iii) a banking company, iv) an insurance company, v) commodity derivatives exchange, whether Indian or of foreign jurisdiction and vi) a public financial institution of Indian jurisdiction, provided that any one of the aforesaid entities may acquire or hold, either directly or indirectly, either individually or together with persons acting in concert, upto15 per cent of the paid up equity share capital of such stock exchange.

g) *Actions taken against shell companies:* SEBI directed stock exchanges to take action against 331 suspected shell companies that are listed on the bourses.in August 2017. The exchanges were advised to subject these companies to stricter surveillance action and subsequently, were directed to appoint independent auditors to verify their financial credentials. Based on the audit findings, the exchanges were advised to dispose of the cases or take further action such as appointing forensic auditors. The exchanges are currently in the process of carrying out this mandate.

h) *Integration of Broking Activities in Equity Markets and Commodity Derivatives Market under Single Entity:* The SEBI is in the process of integrating equity and commodity markets which would ultimately result in the creation of a universal exchange that offers trading in equity and equity derivatives, commodity derivatives, debt, interest rate derivatives, currency derivatives, etc. under a single entity. The integration of these two markets is envisaged to happen in four phases. First, FMC was merged with SEBI on September 28, 2015. Consequent to this merger the commodity derivative market is also regulated by SEBI. Second, the Forward Contracts Regulation Act (FCRA) was repealed and the commodity derivatives market regulations shifted to SEBI under the Securities Contracts Regulation Act (SCRA), 1957. In the third phase, the broking activities of equity and commodity markets are integrated. Under the last phase, SEBI in its Board meeting on December 28, 2017 has approved the proposal of trading of commodity derivatives and other segments of securities market on a single exchange with effect from October 1, 2018.

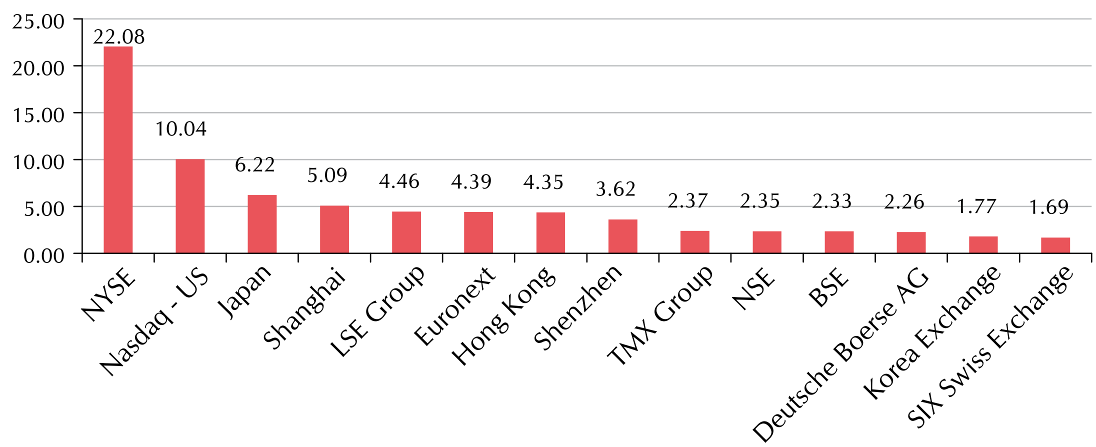
i) *Strengthening Risk Management in the Commodity Derivatives Market*: Immediately after the merger of FMC with SEBI, a comprehensive risk management framework was prescribed to streamline and strengthen risk management at the national commodity derivatives exchanges and align these to the extent appropriate with the securities market's norms.

j) *Review of the Position Limits Available to Stock Brokers / Foreign Portfolio Investors (FPIs) - Category I & II / Mutual Funds (MFs) for Stock Derivatives Contracts*: In order to ease trading requirements of stock brokers/foreign portfolio investors (FPIs) - Category I & II/mutual funds (MFs) in the equity derivatives segment, the extant sub-position limits applicable on stock futures including quantitative/value based restrictions on position limits for stock derivatives were removed. Accordingly, it was decided that the combined futures and options position limit for stock brokers/FPIs (Category I & II)/mutual funds shall be 20 per cent of the applicable market wide position limit (MWPL).

1.3 Market Trends in India

Out of the exchanges across the globe that are members of the WFE, two Indian stock exchanges – NSE (Rank: 10) and BSE (Rank: 11) – were in the top 11 in terms of domestic market capitalisation at the end of December 2017 (Chart 1.16). As of end December 2017, the domestic market capitalisation of the NSE stood at US$ 2.35 trillion, a notch higher than that of the BSE (US$ 2.33 trillion).

Chart 1.16: Domestic Market Capitalisation (USD trillion)

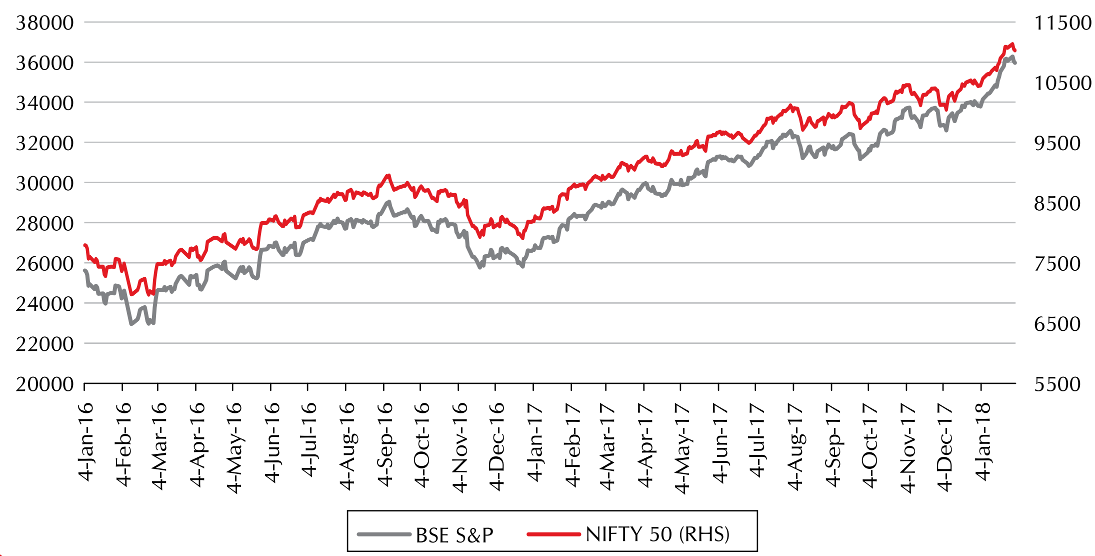


Source: WFE, Monthly Statistics, January 2018

Note: The ranking is based on the data from 80 stock exchanges across the world and is in terms of domestic market capitalisation at the end of December 2017.

As pointed out earlier, the surge in equity market in 2017 was almost a worldwide phenomenon and India was no exception. S&P BSE Sensex, the benchmark index of BSE, closed at 34,056 points as on end-2017, witnessing a gain of 28 per cent from its closing of 26,626 points from a year ago. During the same period, Nifty 50, the benchmark index of NSE, closed at 10,531 points, witnessing a gain of 29 per cent from its closing of 8,186 points at the end of 2016. The upward trend continued in January 2018 as well. On January 23, 2018, India's stock market reached at a new all-time high with benchmark indices Sensex and Nifty crossing the psychological levels of 36,000 and 11,000 respectively for the first time in the history of Indian capital markets. The P/E ratios of S&P BSE Sensex and Nifty 50 were 25.2 and 26.9 respectively at the end of Dec-17 compared to 20.6 and 21.9 respectively a year ago.

Chart 1.17: Movement of Sensex and Nifty



Source: NSE and BSE

Over the past two years, the Indian stock market has soared, outperforming many other major markets. For example, between end-December 2015 and January 2018, while S&P index rose by 45 percent, the Sensex surged 52 percent in dollar terms. What is worth noting is that while markets in US and India rose by nearly the same extent, their respective economies followed paths that are different in three major ways (Economic Survey - 2017-18):

i. Stock market surge in India has coincided with a deceleration in economic growth, whereas in US growth has accelerated.

ii. India's current corporate earnings-GDP ratio has been sliding since the global financial crisis, falling to just 3.5 percent, while profits in the US have remained a healthy 9 percent of GDP.

iii. Over the period of the boom, real interest rates have averaged -1.0 percent as compared with India's 2.2 percent, a difference of 3.2 percentage points.

Why did the Indian stock market surge despite the fact that India's growth has decelerated in 2016-17 and 2017-18. According to the Economic Survey 2017-18, two factors seemed to be at work. In early 2016, signs emerged that after a long decline, corporate profit to GDP ratio was set to rise. In anticipation of recovery in corporate earnings, investors bid up the prices. But, by 2017-18, the profit recovery was not as much as was expected. At this point, the second factor came into play and that was demonetization. Demonetisation, which was part of the government campaign against illicit wealth, had in effect put a tax on certain activities, particularly holding of cash, property or gold. This made stocks more attractive and pushed investors to reallocate their portfolios towards shares. There were other factors at work too.

1.3.1 Primary Market in Equity

When there is a boom in the stock markets, as has been the case in in India recently, firms typically issue more equity publicly, taking advantage of the reduced cost of capital to start new investment projects. During the first 9 months of 2017-18, there has been a steady increase in resource mobilisation in the primary market segment as compared to the corresponding period in the last financial year. During this period, 153 companies accessed the primary market through public and rights issues to raise Rs 727.87 billion compared to Rs 497.05 billion raised through 85 issues during the same period last year, showing 46 per cent increase in resource mobilisation over the year. (SEBI Bulletin, January 2018).

1.3.2 Primary Market in Debt

During the first nine months of 2017-18, the resources mobilised through primary market in debt witnessed a decline compared to the corresponding period in the previous financial year. Private placements continued to dominate the corporate bond market with Rs 4.60 trillion raised through 1,943 issues, showing a 4 percent year-on-year decline in mobilisation. On the contrary, there were only 5 public debt issues that raised Rs 41 billion over this period (as compared to Rs 239 billion raised through 10 public debt issues during the same period in the previous financial year; SEBI Bulletin, January 2018).[3]

1.3.3 Mutual Fund

The Indian mutual fund industry also registered a robust growth during April–December 2017 with a net inflow of Rs 2.15 trillion, mainly due to change in household investment pattern in the post demonetisation period. In this period, there was net outflow of Rs 70.56 billion from income / debt oriented schemes and a net inflow of Rs 1.33 trillion into growth / equity oriented schemes. Balanced schemes recorded inflow of Rs 703.11 billion. Exchange traded funds witnessed net inflow of Rs 195.89 billion whereas there was an outflow of Rs 5.69 billion from gold ETFs and an inflow of Rs 201.57 billion from other ETFs. The Fund of funds schemes investing overseas recorded net outflow of Rs 3.74 billion. The cumulative net assets under management by all mutual funds increased by 22 per cent to Rs 21.38 trillion at the end of December 2017 from Rs 17.55 trillion at the end of march 2017 (SEBI Bulletin, January 2018).

1.3.4 Equity Derivative Markets

The total turnover in equity derivatives at NSE increased to Rs 1,155 trillion in April-December 2017 from Rs 667.53 trillion in the same period last year, with 1,359 million contracts traded during this period vs. 1,023 million contracts traded in the corresponding period last year.

[3] Amount raised through debt issues for the last two months are provisional.

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