THE SIGNIFICANCE OF THE EQUITY MARKETS

Equities markets have been under extreme pressure in the last three years. Since March 2000, when the first signs of the market reversal began, the descent was dramatic and rapid. It was only in the second quarter of 2003, the turnaround began, which everyone hopes will be stronger and sustainable. The meltdown has been so sharp and severe that it caused enormous erosion in the personal wealth, which is estimated to be anywhere up to US$7 trillion, steep fall in trading volumes, which in case of a few leading international exchanges was up to 70 percent, closure of a few new and growth markets such as Neuer Markt, and Jasdaq etc., hefty fines and penalties for investment banks and analysts for policies and practices that are considered imprudent and in deviance with better practices. Simultaneously stricter norms evolved for corporate listing and as also their governance and in India in particular, a wide range of reforms came into being to make the securities markets more streamlined and systematic.

Beginning May 2003, equity markets worldwide began to show a turnaround that is sizeable and significant. By end August Nasdaq recovered 59 percent and Dow Jones 28 percent from their lows in the recent period. India's own SENSEX too made a remarkable recovery gaining anywhere up to 40 percent since April 2003. Derivatives markets everywhere are growing at a rapid pace and the debt segments have been. Favorable trends are also evident in portfolio flows with foreign institutional investors taking renewed interest in the emerging markets. Despite sluggish international economy and rising concerns in domestic and international security, stock markets have been showing optimism and hope.

While it might be the return of good times once again for the equity markets, the issues of their significance and importance in the national economies and as a major source of mobilization of financial resources remain relevant. Equitisation emerged as an important imperative in the International and domestic financial policy, in the last two decades. The developments in the last three years have however dented the prospects.

According to the World Federation of Exchanges, stock exchanges worldwide began to show a turnaround that is sizeable and significant. By end August, Nasdaq recovered 59 percent and Dow Jones 28 percent from their lows in the recent period. India's own SENSEX too made a remarkable recovery gaining anywhere up to 40 percent since April 2003. Derivatives markets everywhere are growing at a rapid pace and the debt segments have been. Favorable trends are also evident in portfolio flows with foreign institutional investors taking renewed interest in the emerging markets. Despite sluggish international economy and rising concerns in domestic and international security, stock markets have been showing optimism and hope.

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Notwithstanding the growth, certain concerns may merit the attention of the policy makers and stock exchanges in order to ensure strong and sustainable stock markets. A few of these are flagged here for further consideration.

According to a recent data provided by the International Monetary Fund, Bonds, Equity and Bank Assets in the world amounted in 2001 to US$150 trillion. Of this, bank assets accounted for a major chunk (US$ 79 trillion) followed by Debt Securities ($41 trillion) and value of stocks ($29 trillion). Stock market capitalization which just formed 19 percent of the total value of bonds, equities and loans in 2001 might have further eroded in the next two years following the depressed conditions in the equity markets. The share of stock market capitalization in the capital markets is relatively low in both mature and emerging economies. For instance, in the US, the capital of international finance, the share of stock market capitalization is about 25 percent from bank loans and the only 13 percent from equities.

For the world as a whole, where bank deposits formed more than twice that of the gross domestic product (256 percent) and debt securities nearly one and half times (1134 percent), it is just about 93 percent in respect of stock market capitalization, which must have further declined in the last two years.

As a source of mobilization too the share of equity markets, is relatively lower. Between 1997-2001, in the major emerging markets of the US $3430 billion domestic finance mobilized, most of it came from bonds (69 percent) and bank loans (26 percent) with only a little coming from the equity markets (5 percent). Similarly in the financial resources raised in the international markets of $598 billion, once again it is the most that came through bonds (51 percent) as compared to 36 percent from bank loans and the only 13 percent from equities.

The primary role of the stock exchange is to enable corporates to raise resources. The sharp slow down in this regard could be matter of great concern for the stock exchanges. For instance, the new and secondary capital raised by the member exchanges of the World Federation of Exchanges, which was about $896 billion in 2000, fell to US$262 billion in 2003 with further decline in 2003. Emerging market equity financing which reached a peak of US$41 billion in the year 2000 fell to US$11 billion in 2001 only to rise a little later in the next year US$16 billion. The share of equities in emerging market financing which showed gradual rise from 6 percent in 1998 to 14 percent in 1999 to 19 percent in 2000 made a steep fall to 7 percent in 2001 to show an improvement to 12 percent in 2002 but in the first two months of the year 2003 it again showed sluggishness.

In India too this trend is evident. The share of household savings in shares and debentures has fallen from about 13 percent in the early 1990s to about 2 percent now. Equity which accounted for 73 percent of the new capital issuance in 1994-95 declined to 16 percent in 2001-02 and further to 8 percent in 2002-03. Debt, Private Placements, Private Equity are emerging as significant sources of finance that could pose issues of importance of stock markets in economy. Indian private sector which raised Rs. 18463 crores in the form of equity in 1995-96 could mobilize only half of that in the year 2002-03 (Rs. 8388 crores). Between