NPTEL

Course Name: Security Analysis and Portfolio Management

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Session # 13 Economic Analysis – I

Q.1.: What is fundamental analysis and what are the major components of the same?
Ans.: For estimating the price of a stock, the security analyst must forecast the earnings and cash flows that can be expected from the firm. This is primarily known as fundamental analysis. Fundamental analysis – also known as EIC analysis – comprises of:

- Economic Analysis
- Industry Analysis
- Company Analysis

Q.2.: What are the key domestic economic variables to be considered for economic analysis?
Ans.: The following domestic economic variables need to be considered for economic analysis.

- Gross Domestic Product
- Industrial Growth Rate
- Monsoon and Agriculture
- Employment and Capacity Utilization
- Price Level and Inflation
- Interest Rates
- Budget Deficit
- Sentiment: Consumers' and producers' optimism or pessimism

Q.3.: What is meant by demand shocks and what are different methods of demand shocks?
Ans.: Demand Shocks: an event that affects the demand for goods and services in the economy. Demand shocks are characterized by aggregate output moving in the same direction as interest rates and inflation. Different methods of demand shocks are:

- Reduction in Tax rates
- Increase in money supply
- Increases in government spending

Q.4.: What is meant by demand shocks and what are different methods of demand shocks?
Supply Shocks are events that influence production capacity and costs. Supply shocks are usually characterized by aggregate output moving in the opposite direction of inflation and interest rates. Some of the examples of supply shocks are:

- Natural calamity
- Changes in educational level of workforce

- Changes in the wage rates
- Changes in the price of imported oil

Q.5.
(a). State different methods of economic forecasting.
(b) What are different types of cyclical indicators?
Ans.:
(a) Different methods of economic forecasting are:

- Cyclical Indicator Approach
- Diffusion Indices
- Econometric Models

(b) Cyclical indicators are classified as below:

I. **Leading Indicators:** Economic series that usually reach peaks or troughs before corresponding peaks or troughs in aggregate economy activity. A list of leading indicators is given as below:
    - Average weekly hours, manufacturing
    - Average weekly initial claims for unemployment insurance
    - Manufacturers' new orders, consumer goods and materials
    - Vendor performance, slower deliveries diffusion index
    - Manufacturers' new orders, nondefense capital goods
    - Building permits, new private housing units
    - Stock prices, 500 common stocks
    - Money supply, M2
    - Interest rate spread, 10-year Treasury bonds less Federal funds (%)
    - Index of consumer expectations
II. **Coincidence Indicator:** Economic series that have peaks and troughs that roughly coincide with the peaks and troughs in the business cycle. A list of coincidence indicators is given below:
    - Employees on nonagricultural payrolls
    - Personal income less transfer payments
    - Index of industrial production
    - Manufacturing and trade sales
III. **Lagging Indicator:** Economic series that experience their peaks and troughs after those of the aggregate economy. A list of lagging indicators is given as below:
    - Average duration of unemployment
    - Inventories to sales ratio, manufacturing and trade
    - Change in labor cost per unit of output, manufacturing (%)
    - Average prime rate charged by banks (%)
    - Commercial and industrial loans outstanding
    - Consumer installment credit outstanding to personal income ratio
    - Change in consumer price index for services (%)