NPTEL

Course Name: Security Analysis and Portfolio Management

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Session # 14 Economic Analysis – II

Q.1: What is diffusion index?
Ans.: It is a measure of how widespread a phenomenon. It is based on the trends, direction of change, rate of change and comparison of previous business cycles. One can set of a diffusion index of leading indicators by counting the number of indicators that rise during a particular period and expressing it as a percentage of total.
Q.2: State the different types of interrelationship among inflation, interest rates and security prices.
Ans.:

- Inflation and interest rates generally move together.
- Interest rates and bond prices are inversely related.
- There is no direct and consistent relationship between interest rates and stock prices. It varies over period of time.

Q.3: What is a yield curve? What can one infer about the economy by looking at the yield curve?
Ans.: Yield curve shows relationship between market yields and time to maturity, holding all other characteristics, like credit risk, constant. Upward sloping and steepening curve implies accelerating economic activity whereas flat structure implies a slowing economy. Inverted curve may imply a recession.
Q.4: What is financial conditions index (FCI). Given an example of FCI and its components.
Ans.: A financial conditions index (FCI) summarizes the information about the future state of the
economy contained in these current financial variables. Ideally, an FCI should measure financial
shocks – exogenous shifts in financial conditions that influence or otherwise predict future
economic activity. One of the example of FCI is: Financial Conditions Index for India (Goldman Sachs: (GS India FCI). The components and the respective weights of the same are:

- interest rates (0.55)
- money supply (0.29)
- exchange rate (0.125)
- stock market (0.035).

Q.5: State the macroeconomic variables that can be considered as determinants of stock prices.

Ans.: Some of the macroeconomic variables as determinants of stock prices are:

- Potential output of economy
    - Productivity, resources, investment opportunities

- Corporate tax rate (tx)
- Government spending (G)
- Nominal money supply (M)