



भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

वेबसाइट : www.rbi.org.in/hindi

Website : www.rbi.org.in

ई-मेल/email: helpdoc@rbi.org.in

संचार विभाग, केंद्रीय कार्यालय, एस.बी.एस.मार्ग, मुंबई-400001

Department of Communication, Central Office, S.B.S.Marg, Mumbai-400001

फोन/Phone: 022- 22660502

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RBI Bulletin - October 2020

The Reserve Bank of India today released the [October 2020](#) issue of its monthly Bulletin. The Bulletin includes Monetary Policy Statement, 2020-21, Resolution of the Monetary Policy Committee (MPC) October 7-9, 2020, Monetary Policy Report – October 2020, one Speech, two Articles and Current Statistics.

The two articles are: [I. GDP Growth Forecasts of the Reserve Bank of India – A Performance Assessment](#); and [II. Demystifying Equity Prices using Dividend Discount Model: An Indian Context](#).

I. GDP Growth Forecasts of the Reserve Bank of India - A Performance Assessment

An assessment of forecast performance of key macro-economic variables is important for the formulation of forward-looking monetary policy by the central banks.

This article evaluates the growth projections of the Reserve Bank of India (RBI) against the final official estimates, which are available with a considerable lag.

Highlights:

- An assessment of annual growth forecasts suggests that the growth projections, on an average, underestimated realised growth.
- Forecast errors, committed in both directions, were free of any systematic bias.
- The magnitude of forecast error reduced and directional accuracy improved with the narrowing down of forecast horizon and availability of more information for assessing the economic condition.

II. Demystifying Equity Prices using Dividend Discount Model: An Indian Context

Financial variables provide useful information in assessing economic conditions and consequently serve as an important input for policy making. The movement of equity prices represents the interplay of different forces and hence there is a need to dissect these factors for effective policy making. This article uses dividend discount model (DDM) to estimate the implied equity risk premium (ERP) for Indian equities and attributes the changes in equity prices to factors including growth expectations, risk-free rate and ERP.

Highlights:

The application of DDM framework for Indian equity market yields average ERP estimates at 4.7 per cent for the study period (2005-2020).

- DDM model ascribes the changes in equity prices to earnings expectations, followed by ERP with negative contribution coming from interest rates in the upswing periods during 2005-08 and 2009-10.
- The decline in the Indian equity market during 2010-13 is explained by ERP and interest rates, even though earnings expectations contributed positively. The equity market resumed its upward momentum post taper tantrum episode from 2013-15 enabled both by ERP and interest rates as the DDM decomposition highlights.
- The rise in equity prices in India during 2016 to early 2020 was mainly supported by decrease in interest rates and ERP, with increase in forward earnings expectations contributing to a lesser extent.
- Thereafter, spike in ERP on COVID-19 related concerns initially contributed equity prices declining sharply to compensate for increased risks. Subsequent recovery in equity prices witnessed since March 2020 is largely driven by easing of ERP.

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(Yogesh Dayal)
Chief General Manager