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## RBI Working Paper No. 03/2024 Equity Markets and Monetary Policy Surprises

Today the Reserve Bank of India placed on its website a Working Paper titled, "[Equity Markets and Monetary Policy Surprises](#)" under the Reserve Bank of India Working Paper Series<sup>1</sup>. The paper is co-authored by Mayank Gupta, Amit Pawar, Satyam Kumar, Abhinandan Borad and Subrat Kumar Seet.

This paper studies the impact of monetary policy announcements on the returns and volatility in the BSE Sensex by decomposing changes in Overnight Indexed Swap (OIS) rates on policy announcement days into target and path factors. The target factor captures the surprise component in central bank policy rate action, while the path factor captures the impact of central bank communication on market expectations regarding the future path of monetary policy.

The major findings of the paper are:

- (i) The empirical analysis using daily data suggests that equity returns are impacted only by the path factor (*i.e.*, market's expectations of future monetary policy trajectory), while both target and path factors (both of which capture the unanticipated component of monetary policy) impact the volatility in equity prices.
- (ii) An event study analysis undertaken by constructing short duration windows around the monetary policy announcements using intraday data also indicates that the path factor helps explain changes in equity returns.

While the short duration windows are aimed at controlling for other potential drivers of equity prices, it may be noted that the monetary policy announcements are accompanied by regulatory and developmental measures which can also impact markets. The sparse trading on occasions in the OIS markets as well as other domestic and global developments during the narrow window can also impact the analysis.

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(Yogesh Dayal)  
Chief General Manager

<sup>1</sup> The Reserve Bank of India (RBI) introduced the RBI Working Papers series in March 2011. These papers present research in progress of the staff members of the RBI and at times also those of external co-authors, when the research is jointly undertaken. They are disseminated to elicit comments and further debate. The views expressed in these papers are those of the authors and not necessarily those of the institution(s) to which they belong. Comments and observations may please be forwarded to the authors. Citation and use of such papers should take into account its provisional character.