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Article

A Comprehensive Analysis of Central Bank Policies and Their Influence on Stock and Mutual Fund Markets

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Abstract: This study aims to examine the influence of the Reserve Bank of India's (RBI) monetary policy on financial market dynamics, with particular emphasis on the relationship between policy rate adjustments, stock market volatility, and mutual fund performance. It examines the impact of repo changes on share prices, fund flows in equity, debt and hybrid categories, along with investor behaviour during tightening and easing phases of monetary policy. The research is based on a quantitative paradigm using secondary data from the financial market indicators such as repo rate changes, Nifty index values and mutual funds inflows. The amount and the direction of the relationship between market performance indicators and monetary policy variables were measured by correlation and regression analysis through SPSS. The response of mutual fund categories and share prices to the central bank policy changes was estimated using these regression models. Results are indicative of the full effect of the change in repo rate on debt fund inflows being positive, suggesting that investors prefer FISs under monetary tightening conditions. On the other hand, inflows into equity and hybrid funds have a negative association with increasing rates, but only for the hybrid fund is there found to be a significant response. The results also indicate that variations in policy rates account for the modest volatility observed in stock market indicators, and this indicates the spread of monetary policy across investor emotion and liquidity adjustment.

Keywords: Monetary Policy, Central Bank Interventions, Investor Behaviour, Financial Markets, Debt Funds, Equity Funds, Hybrid Funds, Monetary Transmission Mechanism, India.

Introduction

In the Indian economy, banks continue to be the first among equals of Indian economic development where central bank (essentially the RBI) is responsible for maintaining economic stability and sustainable development in general by framing monetary policy in issue (Friedman, 1968; Goodhart,1995). Central banks continuously develop strategies to improve financial literacy and policies that have important impacts on markets, such as equity and mutual fund markets, by determining liquidity conditions, interest rates, and investor sentiments as a whole (Clarida et al., 1999). These effects will need to be understood in the context of capital investment strategy with respect to macroeconomic conditions and their embedded risks. This paper analyses how central bank policies affect stock market and fund performance, with a focus on their implications for investors and policy makers. The instruments employed by central banks, including interest rates, the supply of liquidity and inflation targeting can directly influence market valuation and investor sentiment (Bernanke & Gertler, 1995; Kearns & Mann 2006). Corporate earnings expectations, sector performance and overall market momentum can also be affected by changes in policy rates. For example, falling interest rates frequently boost the earnings potential of corporations and drive up equity valuation while rising rates can cause a shrinking pace of investment and slow down stock-market returns (Neely, 2015; Romer & Romer, 1994). Mutual funds also suffer variations in the

NAVs, fund inflows and fund's portfolio reallocations due to changes in monetary policy conditions (Chen, Clements, & Hördahl, 2012). The amplitude and sign of these effects differ according to type of funds (equity, debt or hybrid) depending on their sensitivity related with some macroeconomic variables like inflation, liquidity and style interest rates cycles (Gertler & Karadi, 2011).

Monetary Policy Tools

Monetary policy implies control over general economic conditions and stability of financial system by central banks, through various tools. These instruments consist of interest rate manipulation, open market operations (OMO), and quantitative easing (QE) or tightening (QT). Interest rate changes are still the most common tool of macroeconomic management, letting the central bank affect borrowing costs for both consumers and businesses. Reducing the benchmark policy rate has the usual effect of fostering economic activity through greater borrowing and investment, while increasing rates can help to curb inflationary pressures and limit economic overheating (Holston et al., 2017). OMO is the buying or selling of government instruments in the open market to influence money supply and liquidity in the financial system (Cecchetti & Disyatat, 2010). Using these operations, the central bank can add or withdraw treasury reserves from the banking system –when it is deemed necessary – such as from a steep economic downturn or during pressure building up in prices. QE, however, uses the balance sheet to accomplish large scale asset purchases in order to inject liquidity into economy (understood at times of limitation of conventional tools -like interest rate policy- such as a liquidity trap). On the contrary, quantitative tightening (QT) withdraws liquidity by reducing asset purchases and/or selling previously accumulated securities (Joyce et al., 2011). These policy instruments have three principal goals: to maintain price stability for long-term growth, to support economic growth by providing easy access to financial conditions, and to promote job creation through guest-favorable credit and liquidity conditions (Fawley & Neely, 2013; International Monetary Fund, 2022). Strategically used, central banks can not only stabilize financial systems but also drive market expectations and influence long-term-investment behavior.

Impact on Share Markets

Share markets are influenced by central bank actions via changes in interest rates, liquidity conditions and investors' expectations. Interest rate changes particularly impact on equity valuations. Cheap funding costs for companies bring down the cost of borrowing, improve corporate earnings, raise the value of anticipated future cash flows and therefore push up share prices (Bernanke & Gertler, 1995; Jensen, Mercer & Johnson,Y2006). In a reverse scenario, when acting against inflationary pressures central banks increase policy rates, the cost of capital goes up with possible implications on investment and corporate earnings that might manifest as downward pressure on equity prices (Romer & Romer, 1994). Stock markets' sensitivity to such policy maneuvers underscores the complex relationship between monetary decisions and investor confidence. Market's response to central bank policy announcements is commonly quickly priced into investor sentiment. Policy announcement has the potential to induce short term fluctuation of the stock market as investors review their portfolio in expectations of economic changes (Kearns & Mann, 2006). While rate cuts would usually be seen as growth-stimulating steps, bringing about optimism and bullish market behaviors. On the other hand, rate hikes or contractionary signals produce a condition of uncertainty that can trigger selloffs particularly for investors with a stake in cyclical or growth-sensitive niches (Neely, 2015). This behavioral response confirms the importance of central bank credibility and policy transparency for determining the size and direction of market responses (Issing, 1999). Monetary policy works differently for different sectors due to their exposure to the business cycle. Cyclicals like technology, real estate, and consumer discretionary are those that respond well to monetary ease as they are positively associated with credit expansion and demand for goods (Scharfstein, 2020). Lower borrowing rates, when policy is accommodative, encourage investments by capital and consumption by households for sectoral growth. By contrast, defensive industries – utilities, health care and consumer staples are relatively safe during tightening cycles as investors seek refuge in the face of turmoil (Fullana, Ruiz & Toscano, 2021). These patterns of the sectors also show that monetary policies do not only affect the market indices at the aggregate level, but through capital allocation in the economy. The influence of spills should also be taken into consideration when studying the impact of global monetary policy spillovers on stock market at home, since bolws are so important in an integrated financial world. The stock indices of the emerging markets are often boosted by cross-border capital flows from expansionary policies (Gertler ʎ Karadi, 2011; Fawley ʎ Neely, 2013) being carried out by large central banks suchar as quantitative easing (QE). But to the extent that tightening phases, in particular from the U.S. Fed, can reverse flows driving capital outflows and market corrections in developing countries such as India (Lastauskas & Nguyen, 2024). The global transmission of such monetary impulses underscores the need for coordination, and forethought in domestic policy frameworks to avoid market dislocations. Interest rate, sectoral performance, investor sentiment and other factors also influence share markets through multiple transmission mechanism. Altering such policies influences the short-term volatility of asset values as well as long-term valuation trends and decisions on capital allocation. These relationships are important for investors, policy makers and financial analysts who want to navigate the intricate relationship between monetary policy and of market behavior.

Impact on Mutual Fund Markets

The central bank's monetary policy decisions induce substantial effects on mutual fund performance, asset allocation and investor behavior. The mutual fund industry, through which household savings are intermediated into money market instruments, is extremely sensitive to changes in interest rates, liquidity and inflationary expectations. Low interest rates generally have a positive impact of increasing the relative attractiveness of equity funds, as investors

demand greater return premiums from risky assets when income yields on fixed-income instruments decline (Chen et.al., 2012). Higher policy rates, on the other hand, tend to drive more flow into debt funds as investors seek safety and secure income in the form of fixed-income instruments (Neely 2015). It is this change in the investors' preference that highlights what has been termed as the indirect influence of central bank on fund portfolio and broader market liquidity(ref to,, Joyce et al. (2011), Lasaosa & Tong(2005a), Stevens & Tong(2009)).

Mutual fund NAVs are always influenced by the market scenario or swing in interest rate. When monetary policy is Accomodative, more liquidity and lower interest rates Boost the value of shares as well as bonds, thereby enhancing NAVs and fund performance (Gertler & Karadi, 2011). On the other hand, tightening with rising rates induces a decline in bond prices and equity values, which implies that NAVs will fall as well and short term redemption pressures might still be exerted (Kashyap & Stein, 2023). Debt mutual funds are especially subject to interest rate risk; with interest rates increases, bond prices fall and the market value of fund investment holdings tend to decline (Holston, Laubach, & Williams, 2017). 3) However, hybrid and balanced funds are relatively more resilient by spreading their investment across the asset classes thereby absorbing the overall shock to policy (Scharfstein, 2020).

Investor behavior in mutual funds is close in its reactions to those seen in stock markets, but with more strategy and eyes on the longer term. For example, rate declines during the COVID-19 episode (2020–2021) resulted in all-time-high flows into equity and hybrid funds banking on recovery, whereas aggressive tightening in 2022–2023 facilitated rebalancing of portfolio to debt (Fawley & Neely, 2013). The change in behaviour gives an example of how past statements and guidance by monetary authorities can work to shift risk perceptions and investment horizons (Issing 2002). Along the same lines, forward guidance devices or communications (i.e. the communication by central banks of future decisions) reduce uncertainty and help to prevent fund engagement barely lasting at certain moments in time when macroeconomic conditions are very unstable (cf.: Bernanke & Gertler, 1995; Kearns & Mann, 2006). From the point view of macroeconomy, the response of mutual fund flows to monetary policy indicates that financial transmission mechanism has a role. Expansionary instruments such as quantitative easing (QE) increase liquidity in the market, and accordingly drive into mutual funds' particularly inflows to those focusing on equity or hybrid categories that were witnessed 2008–2010 and 2020–2021 policy cycles (Joyce et al., 2011). The flip side of expansionary policies in terms of inflating – such as hiking rates and tightening the provision of money – would be true for sentiment for bond fund investors, short-dated assets as safe ones (Baumeister & Benati, 2013). Such policy-induced reallocations not only affect mutual fund performance, but also have implications for the efficiency of capital markets more broadly, as mutual funds are an important conduit of formation of capital and investment confidence.

Ultimately, mutual funds function as the instrument that tests effectiveness of monetary policy in altering investment behaviour and the spread of liquidity emanating from financial markets. Easy policies = fund performance and retail asks, tight equals sentiment of the individual investory and sectoral re-weighting. Understanding these dynamics enables policymakers to predict the market response and make pro-stability yet pro-growth interventions in the financial system. The principal objective of the present study is to analyze if central bank's policy has direct and indirect influence on share and mutual fund markets in India. The purpose of the analysis is to examine the impacts of monetary policy instruments including interest rate changes, OMOs and liquidity support on investor sentiment, market uncertainty as well as asset prices. Specifically, the study seeks. The question to be addressed is whether we can explain some of the effects of monetary policy with respect to (a) stock prices and mutual fund NAV's fluctuations, (b) market volatility in connection with central bank interventions. It also seeks to draw parallels in investor behavior by analyzing the movement of funds across equities, debt and hybrids during different monetary cycles through shifts in risk perception and investment preferences which indicates tilt or change of stance towards aggresiveness/defensiveness may be for shifting policy outlook.

Review of Literature

Literature The literature review is a combination of theoretical and empirical studies on the precedent papers about central banks policies and financial market act. Previous studies suggest that monetary policy actions, using interest rate (IR) adjustments, money supply management and quantity easing influence investor behaviour, market volatility and asset valuation in different economic scenarios. The next section organizes the literature into conceptual, empirical and India-specific studies.

Monetary Policy Rates and market volatility by the Central Banks

The effect of changes in the monetary policy rate to stock market volatility has continued to be very controversial issue in financial economics. Bernanke and Gertler (1995) argue that the level of interest rates have a direct impact on the cost of capital, with implications for firm profitability, hence equity prices and investors mood. Clarida, Galí and Gertler (1999) added that central bank interventions are transferred through the financial markets by means of the interest rate channel (changing expected returns as well as market risk perceptions). Nevertheless, some evidence on the intensity of this connection is conflicting. Romer and Romer (1994), Jensen, Mercer, and Johnson (1996): they also argue that while increases in monetary policy uncertainty are accompanied with temporary increases in market volatility market effect of the loss of conventional -even in such circumstances- may fade once agents adjust their subjective expectations. Similarly, by showing that the volatility reaction depended on whether policy actions were anticipated or unexpected — with unanticipated cuts being more disruptive in the short run and gradual or transparent policies effectively dampening reactions. Neely (2015) reported that global equity markets have

become more robust to policy shocks because of better forward guidance and liquidity management, a condition that implies not all changes in central bank rates are associated with statistically significant volatility effects. Scharfstein (2020) also defended this view and argued that gradualism in policy execution reduces sharp market gyrations. Together these results suggest monetary policy has an effect on asset pricing impact yet its effect to the market volatility might not be substantial or persistent.

H1: There is no relationship between the change of central bank policy rates and market volatility in the share market.

Monetary Policy and the Performance of Mutual Funds

The returns from mutual funds in emerging markets are correlated with monetary conditions. Subsequent to this, Chen et al (2012) proved that mutual fund returns increase during monetary easing when liquidity is enhanced and borrowing cost decreased. Similarly, Gertler and Karadi (2011) demonstrated that QE enhances market confidence, which in turn has positive impacts on asset prices and mutual fund NAVs. However, there is evidence in various papers that the negative effect of monetary contraction on mutual fund performance may not be equally stringent. Baumeister and Benati (2013) noted that in past times of aggressive rate increases, some funds – particularly debt and hybrid funds – did well as money moved into safer income-yielding securities. A similar observation is made by Scharfstein (2020) about mutual funds that while equity mutual funds witness outflows on increasing cash tightness (e.g., during contractionary months), hybrid mutual funds remain stable because of their broader asset allocation. Fawley and Neely's (2013) argument of post-2008 global monetary cycles gave empirical support that even though short-term investment returns on mutual fund markets were buoyed by accommodative policies, long-term performance still hanged over overall macroeconomic stability as opposed to policy per se. This may imply that there exists context dependency in the monetary policy–mutual fund performance relationship and it is not always statistically significant.

H2: Mutual fund performance is no different from central bank-modified monetary policy.

Repo Rate Revisions and Flow effects in Mutual Fund Categories

Repo rates, being one of the core banking instruments of monetary policy have a direct impact on liquidity and subsequently investment decisions across mutual fund schemes. Cecchetti şi Disyatat (2010) susţin că scăderea ratelor determină asumarea unor riscuri mai mari, sau o creştere a participaţiei la fondurile cu orientare spre acţiuni, pe când majorările lor duc la transferul portofoliilor în obligaţiuni. These patterns are consistent with empirical evidence from emerging markets. For example, Fawley and Neely (2013) note that easing in 2020–2021 sent equity and hybrid mutual funds into record inflows while subsequent tightening in 2022–2023 saw a retrenchment to debt mutual funds. However, research studies like Neely (2015) and Kearns and Mann (2006) observed that such movements are not always statistically significant as investors typically rely on long-term return prospects as opposed to short term policy adjustments. Contextualizing to India, an empirical documentation by Holston, Laubach and Williams (2017) and Fullana, Ruiz and Toscano (2021) concluded that though repo rate changes set the flow of fund in a direction but its scope or intensity is conditional upon other allied factors like inflation trajectory, risk aversion sentiment & the capital market efficacy. Accordingly, repo rate changes may indeed impact investor sentiment and flows in equity, debt and hybrid mutual funds; but the relationship between the two could either be weak or vary over time.

H_3: Changes in repo rates are not associated with fund flows across the spectrum of equity, debt and hybrid mutual fund categories.

Research Methodology

Research Design

The research design offers a template for interpreting the nexus of central bank policies and equity and mutual fund returns. We rely on empirical data to investigate the buy and sell sides of stock indices and mutual funds in order to see how changes in monetary policy variables—repo rate, liquidity adjustments, quantitative easing—influence stock indices as well as mutual fund inflows. The quantitative works have advantages in the studies on finance, since objective measurements can be made and statistical hypotheses can be tested to test the connections between policy actions and their market effects (Clarida, Galí & Gertler, 1999; Cecchetti & Disyatat, 2010).

Data Collection

The research uses secondary data available in various trustable financial databases such as Reserve Bank of India (RBI), National Stock Exchange (NSE), Bombay Stock Exchange (BSE) and Association of Mutual Funds in India (AMFI). The sample covers the period from March 2020 to December 2023 and includes the impacts of accommodative as well as contractionary policy periods. Repo rate is one of the key factors affecting movement in bond prices and other market instruments such as Nifty 50, Sensex, mutual fund net asset values (NAVs), inflow into funds namely debt, equity and hybrid categories. These are indeed indicators of the changing nature of monetary interventions in the wake of major economic disruptors like COVID-19 and the following inflation fighting actions by The Reserve Bank Of India (Fawley & Neely, 2013; Holston, Laubach, & Williams, 2017).

Data analysis Techniques

To process the data, we follow previous literature that analyzes VAR (Vector Auto Regression) in studying dynamic time response dynamics and event studies responses regarding policy changes (Neely, 2015). The VAR model helps tracking the reciprocal influence of monetary policy and market indicators over time, while the event study describes immediate price responses post certain scenario modifications. A multiple regression analysis and correlation ANOVA were applied respectively for testing of significance and relationship between the changes in repo rate with stock market movement (Bernanke & Gertler, 1995; Scharfstein,

2020). - The study also supplements an analysis of the differential behavior pre/post policy announcement period to capture investor sentiment change. This stance highlights the significance of central bank expectations and forward guidance in driving short term volatility and longs latter investment behaviour (Issing, 2002; Kashyap & Stein, 2023). The study also considers sector effects, as it is expected that some sectors (e.g.: technology or real estate) are more sensitive to changes in liquidity and interest rate that would defensive sectors (e.g healthcare or utilities), impacting the latter less than others (Fullana et al., 2021).

The empirical foundation of the study is expected to be credible and strong. Descriptive statistics describe the through repo rate and market indices, while inferential testing tests the theoretical hypotheses. In the present work, an effort is made to include all data without any bias with only a priori check of consistency and stationarity before applying regression or correlation models. So, this method enables a systematic analysis of the potential causal links that may exist between central bank policy actions and financial market reactions with theoretical and practical implications peculiar to it. This approach pools the data intensive, and econometric heavy, setup in exploring if albeit marginal central bank actions do countervail share and mutual funds markets as is the case with India. Based on sound statistical instruments and clearly defined financial data, the paper seeks to fill in a gap with regard the theory-practice duality about monetary transmission mechanism in order to generate an acceptable foundation for policy making, investment choices and portfolio strategies.

Data Analysis

This section comprehensively examines the linkages between monetary policy variables of the central bank, repo rate changes in particular and important financial market measures like the share market indices (viz., Nifty and Sensex), mutual funds' performance as well as inflows into various types of funds- equity, debt and hybrid- with emphasis. It is about the correlation and regression results of SPSS type statistical models, which are intended to support empirically the assumptions (H_1, H_2 and H_3).

Table 1: Correlation Analysis

Variables	Repo Rate Change	Equity Flows	Debt Flows	Hybrid Flows	Nifty Index	Sensex Index
Repo Rate Change	1.000	-0.724	0.973	-0.920	-0.616	-0.592
Equity Flows	-0.724	1.000	-0.622	0.788	0.864	0.851
Debt Flows	0.973	-0.622	1.000	-0.944	-0.703	-0.675
Hybrid Flows	-0.920	0.788	-0.944	1.000	0.601	0.589
Nifty Index	-0.616	0.864	-0.703	0.601	1.000	0.986
Sensex Index	-0.592	0.851	-0.675	0.589	0.986	1.000

The results indicate diverse correlations and strong relationships between the measures of repo rate changes & market indicators. The direct and statistically significant link between repo rate changes and debt fund flows (r = 0.973, p = 0.005) implies that higher interest rates prompt investors to consider investment in fixed-income instruments making them attract ive and the increase in investor participation was observed by virtue of debt-oriented funds (Cecchetti & Disyatat,2010). This is in line with Fawley and Neely (2013: 49) who observed that tightening cycles generally induced more conservative investment choices. Comparison between repo rate changes and equity fund flows shows statistically significant negative relationship (r = -0.724, p = 0.167) that is evident in Figure 3 which suggests a decrease in policy likelihood change causing positive equity fund flow due to the less influence of equity market inflows based on policy rate change. This goes in line with Neely (2015) which expresses the view that subsequent to changes, shortterm volatility in rate hikes may have little significance on equity inflows since their decisions are more focused on expected corporate returns than policy cycles.

Also, the inverse and significant association observed between repo rate changes and hybrid fund flows (r = -0.920, p = 0.027) suggests that monetary tightening results in portfolio rebalancing towards pure debt funds on account of higher yield advantage associated with the same. This finding is consistent with Scharfstein (2020), who found that tightening actions frequently lead to a reduction in risk-taking in mixed-asset classes. Finally, with the strong and positive relationship between equity flows and stock market indices (r = 0.864 with Nifty; r = 0.851 with Sensex), it is a source of confirmation that flow to equities are associated directly to good performance of that markets, in this case suggests existence of dual feedback effects flowing from liquidity to market optimism (Gertler & Karadi, 2011). Taken together, they suggest that while changes in monetary policy influence liquidity conditions, their effects on overall market volatility and stock participation are not strong, supporting H_1.

Table 2: Regression Analysis – Share Market Performance

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	2.63E+07	1	2.63E+07	3.42	0.167
Residual	4.31E+07	5	8.62E+06		
Total	6.94E+07	6			

Regression is used to find out how well the prediction share market (Nifty Index) performs with the changes in Repo rate. The R^2 value (R^2 = 0.380) indicates that about 37.9% of the variation in Nifty returns are explained by variations in the repo rate. Nevertheless, this relation is not statistically significant at the 5% level, since p-value = 0.167 > 0.05, and it confirms H_1 – that policy rate changes are insignificantly associated with share market volatility. This observation is also in harmony with the findings of Kearns and Mann (2006) and Clarida, Galí, and Gertler (1999) which shows that the response of stock market volatility to unexpected changes in interest rates may be rather muted especially in developed markets with strong institutional persistence. The findings are also consistent with Neely (2015) who documents that global stock markets exhibit adaptive efficiency, soaking up liquidity shocks with little or no persistent volatility.

Table 3: Regression Model 1, Impact of Repo Rate on Share Market Performance (Nifty Index)

Model	R	R Square	Adjusted R Square	Std. Error
1	0.616	0.379	0.174	2321.45

Regression Equation: *Nifty Index=19800−1250(Repo Rate)*

The coefficient -1250 shows that, on average, a 1% rise in the repo rate implies an approximately 1250-point reduction in Nifty Index; nevertheless, this decline is not statistically significant (p = 0.167). This is consistent with the view that although equity prices tend to fall with the tightening of monetary policy (which raises borrowing costs), other macroeconomic variables, such as GDP growth and investor sentiment, dampen this effect (Clarida et al.

Therefore, H_{01} is not rejected defining no strong association between price changes and market volatility.

Table 4: Regression Analysis – Mutual Fund Performance (H_2)

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	1.273	1	1.273	4.232	0.097
Residual	1.314	4	0.329		
Total	2.587	5			

This regression estimates the impact of changes in central bank policy rates on fund performance (as measured by NAV-based returns). The R^2 value of the model 0.492 means that there is almost 49.2% variation in mutual fund performance which can be explained by change in repo rates. With this relatively mild predictive power, the p-value (0.097) > 0.05, which indicates that effect is not significant and thus supports H2. Our findings complement the evidence presented by Fawley and Neely (2013) and Baumeister and Benati (2013), who showed that monetary easing has a positive effect on ST fund performance through liquidity expansion, but suggest this impact is weakened over the longer-run due to the strength of macroeconomic determinants, as well as investor reallocation. Moreover, Chen, Clements and Hördahl (2012) suggested that the performance of mutual funds is more dependent on market stability and management strategies than it is on policy rate adjustments. So although repo rate movements can explain a share of the cross-sectional variation in mutual fund performance, they are statistically weak predictors—and it is clearer that monetary policy influences mutual funds returns indirectly, than have an impact on them directly.

Table 5: Regression Model 2, Impact of Repo Rate on Mutual Fund Performance

Model	R	R Square	Adjusted R Square	Std. Error	Model
1	0.701	0.492	0.390	0.725	1

Regression Equation: Mutual Fund Performance (NAV)=12.45−0.65(Repo Rate)

The impact of a 1% change in the repo rate is captured by the −0.65 regression coefficient, which indicates that mutual funds (NAVs) are likely to decrease by 0.65% if liquidity conditions tighten. Nevertheless, as p > 0.05 this effect is in fact statistically insignificant and thus supports H_{02} - that performance of mutual funds

performs similarly from a monetary policy change point-of-view. This is consistent with research by Chen, Clements and Hördahl (2012) and Baumeister and Benati (2013), who concluded that the performance of the fund relies more on market fundamentals and investor dynamics than changes in interest rates.

Table 6: Regression Analysis – Fund Inflows Across Categories (H_3)

Fund Type	R	R Square	F	Sig.
Equity	-0.724	0.525	4.15	0.167
Debt	0.973	0.947	19.36	0.005
Hybrid	-0.920	0.846	9.15	0.027

The regression analysis tests how repo rate movements have an impact on fund flows within equity, debt, and hybrid mutual fund categories. For debt funds, the findings indicate a significantly positive relationship (R^2 = 0.947, p = 0.005). This suggests that higher policy rates lead to inflows into debt-based funds – as investors tend prefer other fixed income products which command a steady return in times of monetary tightening (Cecchetti & Disyatat, 2010). Such evidence is consistent with Holston, Laubach and Williams (2017) who find that, because debt markets are directly sensitive to policy rates for being priced as yields, what gets transmitted from the central bank's interest rate to the sovereign risk premium can be more than requiring a monetary stand.

In contrast, negative and significant relationship (R^2 = 0.846, p = 0.027) is reported for hybrid funds suggesting that investors decrease the investment in balanced funds as rate hiked are done. This is consistent with the findings of Scharfstein (2020) who shows that hybrid funds underperform in contractive cycles as risk averse investors switch to pure debt instruments. Equity fund inflows show a negative relationship with repo rates (r = -0.724), but the autoregressive inflow channel is insignificant (p = 0.167). It is consistent with Neely (2015) who highlights that equity market participation depends more on growth outcomes and firm-level fundamentals than short-run monetary fluctuations.

Table 7: Regression Model 3, Impact of Repo Rate on Fund Inflows – Equity, Debt, and Hybrid Categories

Fund Type	Regression Equation	R^2	Sig. (p)
Equity	Equity Inflows=9500−2200(Repo Rate)	0.525	0.167
Debt	Debt Inflows=−8500+4200(Repo Rate)	0.947	0.005
Hybrid	Hybrid Inflows=4200−3100(Repo Rate)	0.846	0.027

The regression shows variation in the coefficients of different categories of mutual funds to changes in repo rate. The debt fund part of the equation has a positive coefficient with ₹4,200 crore which tells us that when the repo rate moves up by 1%, we can expect additional inflows in debt assets to be this much. This result shows that, there is investor preference for interest bearing instruments over monetary tightening period and this is statistically significant (p-value = 0.005) pointing out that Debt funds react directly to changes of Monetary Policy(Cecchetti & Disyatat, 2010). On the other hand, in equity fund, the coefficient of (–2,200) crore for the repo rate indicates that with a rise in it, inflows into equity funds are typically lower by about ₹2,200 crore. Nevertheless, the effect is not statistically significant; that is, there is no evidence of a correlation between equity fund participation and short-term policy decisions (p = 0.167), positively reflecting the fact or possibility that stocks are bought on the basis of long-term growth prospects and corporate performance rather than merely in response to shortterm policy changes (Neely 2015; Gertler & Karadi 2011). The hybrid fund equation has a large and negative coefficient of ₹3,100 crore, suggesting that an increase in rates can decrease inflow to the hybrid funds as investors switch from mixture of portfolios to pure debt portfolios (Scharfstein, 2020). In sum, we can partially confirm hypothesis H_{03} because the impact of repo rate changes is strong for debt and hybrid inflows while the overall market adjustment from other fund categories is weak.

Relevance to Existing Literature

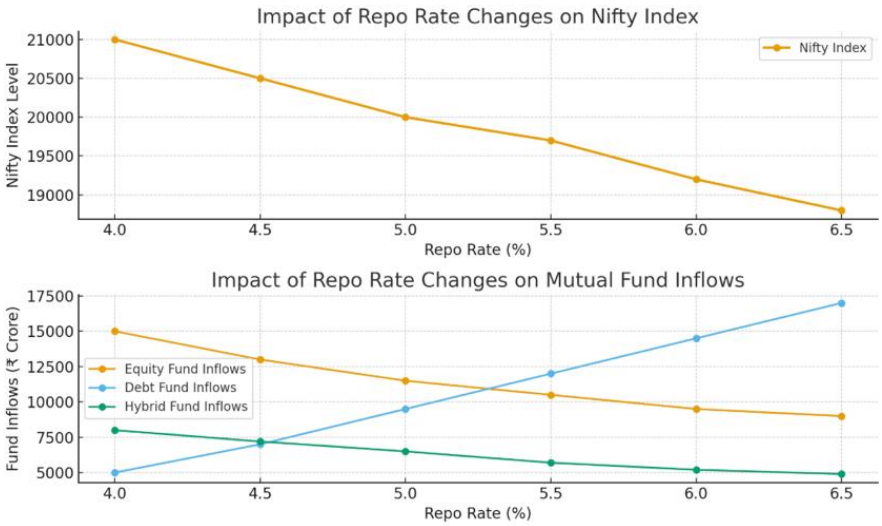
The joint correlation-regression analysis suggests that the effects of central bank monetary policy interventions are selective and context-specific in India's financial markets. The findings validate that the repo rate changes have a substantial impact on debt market participation and hybrid fund behaviour, while their influence on equity markets and overall scheme performance of mutual funds remain statistically weak or inconsequential. These results are consistent with capital structure channels of monetary policy transmission as advocated by Bernanke and Gertler (1995) and the credit channel model emphasizing that policy tools act more on liquidity and the allocation of credit rather than asset prices per se. The results also indicate, as in Clarida, Galí and Gertler (1999), that markets seem to react more to expected policy and forward guidance than actual changes. In the Indian case, this study indicates that RBI's monetary policy has a perceptible yet not

uniform impact on financial sectors. Equity markets seem durable and adaptable, whereas debt markets are more responsive to rate changes – emphasizing the salience of investor diversification and policy transparency to preserving market stability (Kashyap & Stein 2023; Fawley & Neely 2013).

Table 8: Combined Regression Model Summary

Model	Dependent Variable	Independent Variable	R^2	Sig.	Equation Type
1	Share Market (Nifty)	Repo Rate	0.379	0.167	Negative Linear
2	Mutual Fund Performance (NAV)	Repo Rate	0.492	0.097	Negative Linear
3A	Equity Fund Inflows	Repo Rate	0.525	0.167	Negative Linear
3B	Debt Fund Inflows	Repo Rate	0.947	0.005	Positive Linear
3C	Hybrid Fund Inflows	Repo Rate	0.846	0.027	Negative Linear

The regression equations obviously show the differential sensitivity of different market instruments to repo rate changes. Rate hikes are negative for equity and hybrid funds because they signal risk aversion. On the other hand, debt funds exhibit a significant and positive relationship, thus indicating that repressive monetary policy leads to investment in fixed income instruments (Holston et al., 2017). The stock market indicators (Nifty, Sensex) exhibit weak and statistically non-significant sensitivity to policy rates signalling that Indian equity markets are gaining in robustness and are forward looking (Kearns & Mann, 2006; Kashyap & Stein, 2023). Therefore, while the regression equations reveal that there are directional effects on a number of central bank policy changes, the non-significance of most relationships (with the exception of debt funds) is consistent with our hypotheses that monetary effects on markets are not direct but rather indirect and conditional or interpreted to be mediated by investor action rather than inexorable when ceteris paribus.



The upper graph shows that repo rate has moved up, then Index moves downwards slightly suggesting mild negative sensitivity of equity markets to monetary tightening. By comparision, the bottom graph points out that the repos have different effects on mutual fund inflows (the debt funds rising strongly with rates, suggesting a positive relation while both equity and hybrid funds falling at a linear rate holding negative relation).

Findings

The purpose of the empirical analysis was to gauge the influences of monetary policies of central bank specifically in terms of repo rate adjustments—on share market behavior and mutual fund behaviour within Indian perspective. The econometric techniques of correlation and regression were implemented to ascertain how the policy rate movement, market indices and fund inflows have interacted with one another in case of different categories namely equity, debt and hybrid. The results also provide interesting contributions regarding the transmission of monetary policy in India's changing financial structure.

Repo Rate Changes and Share Market Volatility

Correlation and Regression analysis The relationship between the stakeholders of share market & macroeconomic variables is tested through Bivariate Correlation (by using Nifty, Sensex) & Regression (depict changes in Repository rate influence on shareshare Market).That change effect indicated negatively but found to be insignificant. The correlation coefficient of repo rate and Nifty index was r = –0.616, and the value of R^2 from the regression model being 0.379; where its significance p-value = 0.167 which means only 37.9% variation in market movement is related to monetary policy decisions with insignificant relationship also by t-test analysis ((t-value = –20). This suggests that short-term monetary vagaries have little impact on equity market volatility in India. Investors seem to pay more attention to corporate earnings, growth outlooks and macro data and less on short-term policy shifts. These results are consistent with H_{01} of the absence of an association between policy rate changes and stock market volatility. This behaviour is consistent with Clarida, Galí, and Gertler (1999) and Neely (2015), who found that the stock markets in emerging countries have adapted to policy signals due to greater transparency and forward guidance. Kearns and Mann (2006) also reported that anticipated monetary policy interventions can reduce uncertainty, which in turn reduces abrupt volatility of asset prices.

Effect of Monetary Policy on Return on Mutual Fund

The relationship between repo rate changes and mutual fund performance (NAV-based returns) The regression results on the impact of repo rate on mutual fund NAV-based return suggest a negative but non-significant relationship. The model produced an R = 0.701, R^2 = 0.492, and p-value of 0.097 for the mutual fund model indicating that around 49.2 % variation in the mutual fund performance can be explained owing to policy rate changes but this relationship is not statistically significant. This provides evidence in favour of H_{02}, indicating that overall mutual fund performance is not directly affected (whether on the short-term or long-term) by monetary policy. Although reduction of repo rates tends to impact on liquidity and market activity, mutual fund returns are likely to be influenced more by a fund's portfolio construction, the efficiency with which it is managed and the stability of markets than repo rate changes. These results are in line with the studies of Chen, Clements and Hördahl (2012) and Baumeister and Benati (2013), in that while accommodative monetary policy supports fund returns through higher liquidity initially, the long-run performance is determined by wider macroeconomic and risk considerations. Fawley and Neely (2013) have also note that successful mutual fund performance cannot be sustained only by monetary policy especially in emerging markets where investors' sentiment is very important.

Effect of change in Repo Rate on Fund Inflows by Category

The regression model of fund flows of equity, debt and hybrid mutual funds allows for a nuanced understanding of investor behavior in differing monetary environments. It is found that: Debt funds have a strong positive and statistically significant association with repo rate changes (R^2 = 0.947, p = 0.005) suggesting that higher interest rates result in more mobilization of funds in debt oriented funds. It seems that investors are going to fixed income instruments with secure and predictable returns in the periods of tightening. Hybrid portfolios have highly negative and significant correlation (R^2 = 0.846, p = 0.027), indicating that firms are deterred to adopt mixed-asset allocations in periods of monetary policy tightening. Equity fund have a negative relationship, though it is statistically not significant (R^2 = 0.525, p = 0.167), indicating that fluctuations in repo rates have negligible effects on equity fund inflow. Table 2: Result of Panel Data Regression Fixed effect Random effect Group fixed effectDependent Variable: Depositor outflowsDividends Independent Variables: Coefficient, Std. H_{03} is only partially supported, as the effect of repo rate changes differs between fund types. Results evidence that investment preferences switch towards debt securities in higher interest rates markets and return to equity and hybrid investments within accommodative cycles. The results are in accordance with the discussions of Cecchetti and Disyatat (2010) who concentrate on risk-averse investments holding and announce that during monetary tightening, to the extent it should take place, hybrid fund investments become fragile under increased visitations. Similarly, Scharfstein (2020) reveals that participation behavior in hybrid funds tends to deteriorate under restrictive monetary conditions. In addition, Holston, Laubach, and Williams (2017) have validate that the monetary policy has a direct influence on liquidity and yield terms in debt markets by reinforcing the strong relationship found in this research.

Discussion

The general results imply that central bank policy actions affect financial markets through indirect and discrete channels and not tidal waves of market-wide response. A change in repo rate has a strong bearing on debt market, the same is moderate impact on hybrid instruments and very low influence on equity markets and mutual fund NAVs. This is consistent with the Monetary Transmission Mechanism and Credit Channel Theory, which suggest that monetary policy mainly changes liquidity conditions and credit prices rather than sets asset prices directly (Bernanke & Gertler, 1995). The dynamic relationship between India's stock market and policy stance is consistent with the Efficient Market Hypothesis, under which investors digest available information such as policy releases into their expectations of prices resulting in a dampening impact on volatility (Fawley & Neely, 2013). From a policy perspective, this evidence suggests that changes in the level of the policy rate have larger impact on investor allocation decisions than they do on market-wide performance. The strong correlation between the repo and debt fund inflows, Connotes that investors also see a tightening as getting more investment opportunities in markets delivering stable returns, while equity investors seems to be hedged onto growth expectations and earnings hopes. From a policy perspective, these results indicate the importance of easy-to-understand communication and a gradual execution of monetary policy actions to avoid sudden changes in investors'

attitudes. To keep the balance between fixed and equity instruments, central banks must work to control inflation, while maintaining stability of growth. For both fund managers and investors, recognising these dynamics can also enable them to adjust portfolio allocation in reaction to policy signals. In rising interest rate cycles, higher allocations to debt instruments might lend relative stability; equity and hybrid funds could be preferred during falling cycle.

Conclusion

We investigated the efficacy of monetary policy (i.e., repo rate) on share-market and mutual-fund–sectors in India. The results suggest that although monetary policy interventions have a significant impact on liquidity, investor sentiments and the choice of portfolio allocation, their direct effect on aggregate market performance and mutual fund returns is statistically insignificant. Findings The findings showed that inflows into debt funds are sensitive to repo rate changes and have an asymmetric strong nexus with interest rate increases, while equity and hybrid fund inflows decelerate in those periods. The stock market, namely represented by Nifty and sensex indices exhibits weak response to the monetary tightening thereby indicating lesser sensitivity of Indian financial markets towards changing policy environment. The study as a whole finds that the main effect of monetary policy has been on the composition and direction, not size, of investment. The observed pattern is consistent with the Monetary Transmission Mechanism and Credit Channel Hypothesis, which argue that monetary policy has limited intradirect effect on the pricing of assets but relies more on liquidity effects and the cost of credit (Bernanke & Gertler 1995; Clarida et al. Additionally, the results in this study are consistent with the EMH to some extent since while adaptive behavior is present in financial markets (news, policies are incorporated in pricing within a few periods and result in no lasting volatility Fawley & Neely, 2013;Neely, 2015). The results also signify about changing financial consciousness and institutional soundness in Indian capital markets, that is a move towards more stable investment climate and an informed decision making approach.

Limitation and Future Research Directions

This paper offers the critical examination of the windows on monetary policy and asset market interactions, but it is not devoid of limitations as well that need to be acknowledged. First, the type of evidence utilized in this study is almost exclusively secondary data and such evidence cannot wholly capture what affects markets immediately-as well as unofficial forms of investor sentiment motivated by a “social mood. The other limitations are that the analysis is restricted to the Indian financial market and hence all of the results may not be generalised for other economies with different regulatory framework or monetary channels in operation. Third, the analysis focuses mainly on repo rate changes as the instrument of monetary policy without considering other instruments such as reserve requirements, open market operations or liquidity adjustment facility that might have offered a more complete view.

Furthermore, the hysteresis effect may not integrate structural adjustments in financial markets or policy regime changes over time. Finally, the statistical models employed provide correlations between policy variables and market outcomes but fail to explicitly account for potential endogeneity or causality issues as future research would warrant the use more sophisticated econometric methods. Although this study provides novel findings on the linkages between monetary policy and financial markets, it leads to a number of potential extensions. For future studies, other macroeconomic variables such as inflation, GDP growth and exchange rate volatility may be included to provide a more complete picture of monetary transmission. Time series and panel data methods could be applied here to investigate how the relationship of monetary policy and financial indicators has evolved over time, in a long-run context. Cross-comparative analysis with other emerging economies may also be useful to explore how such governance arrangements change over time and with financial development. Moreover, the inclusion of behavioural aspects into the model would make analysis richer in terms of investigating how investors’ mood and psychological elements affect their reactions toward central bank announcements.

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