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A Study on Relationship Between Economic Policy Uncertainty and Investment in India

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ABSTRACT:

Investment is one of the crucial elements of a firm's growth and sustainability as it gives long term cash flows to the business. At the same time economic policy uncertainty has a profound impact on firm's investment decisions, mainly in terms of increased risk and uncertainty for organizations when planning future investment. This study aims to explore the relationship of economic policy uncertainty on investment.

INTRODUCTION:

Economic policy uncertainty is the risk caused by incalculable government actions, such as unanticipated changes in taxes, interest rates or new regulations. When businesses and families are unconfident about future policies, they become scared. To protect themselves, they usually delay big purchases, pause hiring and save their cash. It is like a smog situation. When you cannot see what is ahead, you slow down or pull over to circumvent a crash. Similarly when policy uncertainty is high, businesses leaders stop investing in new projects and hiring taken till the fog clears and they know the rules of the game.

LITERATURE REVIEW:

YEAR	AUTHORS	TITLE	OBJECTIVES	METHODOLOGY	FINDINGS
2016	Baker and et.al.	Measuring economic policy uncertainty	This study focus the economic policy uncertainty based on some frequency	Using firm level data for find out the result	This article find that policy uncertainty is associated with greater stock price volatility and reduce investment and employment.
2021	Bergman and Worm	Economic policy uncertainty and consumer perceptions: The Danish Case	This study focus the interrelationship between uncertainty, consumer confidence and a composite leading indicator.	Using disaggregated data on consumer confidence we find that males are on average more optimistic about the future developments of the economy.	This article find that uncertainty significantly affects household expectations about their own financial situation and for the Danish economy 12 months ahead, household become more pessimistic when uncertainty increases .

YEAR	AUTHORS	TITLE	OBJECTIVES	METHODOLOGY	FINDINGS
2024	Adeloye and et.al.	Economic policy uncertainty and financial markets in the United State.	This study investigates the relationship by analyzing key variables such as stock market volatility, credit spreads, government bond yields and trade volume.	The study employs an autoregressive distributed log model, incorporating an error correction mechanism and co-integration test.	The findings indicate that stock market volatility has a significantly negative impact on market performance, demonstrating that increased volatility adversely affects market outcomes a ver extended periods.
2025	Nguyen and et.al.	Economic policy uncertainty and firm level stock returns: Further evidence from China	This study investigates the effects of global economic policy uncertainty (EPU) and Chinese EPU on yearly firm level stock returns.	The basic model includes the risk free rate, market returns and firm characteristics. Size, market to book ratio and profitability.	The effect of Global Chinese EPU on Chinese firm level stock returns is more significant and consistent in the Shanghai market than the Shenzhen market.

OBJECTIVES OF THE STUDY:

The objectives of the study are:

I) To study the current face of economic uncer5tainty.

II) To examine the power of economic policy uncertainty on investment in India.

METHODOLOGY:

This article is based on the theoretical framework model to explain about economic uncertainty and investment. The basic model focuses on the last one year uncertainty index in Indian market and also try to focus on relationship between economic uncertainty and investment perspective in Indian market.

DRIVERS OF ECONOMIC UNCERTAINTY:

IMPORT RELIANCE – High import dependence reveal economies to external shocks and supply chain upset during periods of economic uncertainty. To diminish these vulnerabilities, government and industries typically pivot on import dominance for localizations supply chain diversification and strategic domestic manufacturing to reach greater self-reliance.

GLOBAL GEOPOLITICS – Global geopolitics remarkably smash economic uncertainty in India primarily through energy stocks, supply chain fragmentation and volatile capital flows.

ENERGY AND COMMODITIES – Build up tensions in reproving oil-producing and shipping zones (like the Red Sea and Strait of Hormuz) disrupt maritime roots, forcing expensive rerouting and sharply enlarge freight and insurance costs. This operate up the cost of raw materials for Indian manufacturing, putting upward pressure on retail inflation.

WEATHER AND AGRICULTURE – Weather and agriculture create a crucial role for economic precariousness. When the weather changes rapidly crops fail, which uplift food costs for everyone. In the last two years in India, get up weather uncertainty has caused large scale damage to crops. According to an article publish in economic and political weekly weather uncertainties have severely affected the food grain production in India in the last two agriculture years that is from 2021-22 to 2022-23.

BUSINESS CONFIDENCE – Business confidence acts as the viaduct between economic uncertainty and actual economic growth when uncertainty jump up, it erodes business confidence. Economic uncertainty such as convey government policies, geopolitical tensions, or inflation generate a risky environment. Because firms cannot foretell future profits, their confidence drops. This makes them detain hiring and stop buying new equipment.

RELATIONSHIP BETWEEN ECONOMIC UNCERTAINTY AND INVESTMENT:

Economic uncertainty and investment share an contrary relations when uncertainty rises, both businesses and individuals tend to hold up investments. High quantify of uncertainty affect the expectations of businesses and consumers. Expectations affect purchasing decisions especially major ones. Consumers often borrow money to build a major purchase such as new vehicle and businesses often borrow money to invest in equipment. In general, economic uncertainty dispirit business investment. In periods of heightened uncertainty, firms are likely to delay capital expenses, reduce spending on research and development and freeze hiring because it becomes challenging to approximate return on the investment (ROI). For emerging economy, unreliability can discourage foreign direct investment (FDI) which is vital for economic growth. As capital flows become more vaporous, the growth hope for developing countries can severely suffer.

ECONOMIC UNCERTAINTY INDEX:

Economic uncertainty index for India (1-4-25 to 31-03-26)

April	157.31353	October	135.84845
May	98.96153	November	133.43193
June	145.55710	December	197.80248
July	81.77809	January	170.68399
August	122.74760	February	323.80758
September	165.33517	March	268.51711

Source: Baker, Scott R, Bloom, Nick, Davis, Steven J via FRED

The economic policy uncertainty index for India is a monthly estimate that pathway the frequency of new articles in major Indian newspapers discussing economic policy related uncertainty. The index is constructed by sum up how often publications reference phrase related to uncertainty, the economy and policy (such as regulations, central banks and legislations). These counts are then scaled, normalized and benchmarked so that the average value in the pre-2011 periods equals 100. Higher values specify greater volatility and unpredictability while lower values reflect stable policy environments.

CONCLUSION:

Economic uncertainty directly moisten and detain investment in India by increasing risk premiums and making irrevocable projects unviable. In the current situation Indian economy veneer a number of challenges. These includes inflation, an unstable rupee and a large current account deficit. In addition the country faces significant infrastructure needs and a growing population that is increasingly young and educated. Basically economic uncertainty has a very significant impact on investment in corporate sector. Our investigation show that uncertainty index affects the firm performance positively. These findings have major implications for policy makers in countries like India trying to achieve the binary objectives of job creation and sustained economic growth.

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