



# Economy & Markets

## A Glossary of Terms

No.	Terms	Description
1	<b>Appreciation</b>	A rise in the value of an asset over time and the opposite of depreciation. e.g. When the value of a currency rises relative to another, it appreciates.
2	<b>Alpha Coefficient</b>	It is the excess return of the fund above risk adjusted market return, given its level of risk as measured by beta. An investment with a positive alpha indicates that the fund has performed better than expected, given its beta. And a negative alpha indicates that the fund has under performed.
3	<b>Arbitrage</b>	The practice of buying and selling an interlisted stock on different exchanges in order to profit from minute differences in price between the two markets.
4	<b>Balance of Payment</b>	The balance of payments (or BOP) measures the payments that flow between any individual country and all other countries. It is used to summarize all international economic transactions for that country during a specific time period, usually a year. The Balance of Payments is the sum of the Current Account and the Capital Account. The Balance of Payments Identity states that, $\text{Current Account} + \text{Capital Account} = \text{Change in Official Reserve Account}$
5	<b>Base Effect</b>	It is a purely arithmetic phenomenon. That is, when calculating growth, growth seems higher from a smaller base and vice versa. For example, WPI inflation in Jan-March, 2007 was high as the base (i.e. WPI figures of corresponding period last year) was much lower.
6	<b>Basis Point</b>	A basis point (often denoted as bp or bps) is a unit that is equal to 1/100th of 1%. It is commonly used to denote the change in a financial instrument, or the difference (spread) between two interest rates. For example, a loan that bears interest of 0.50% above LIBOR is said to be 50 basis points over LIBOR.
7	<b>Benchmark Rate</b>	A rate used as a yardstick for measuring or setting other interest rates; for example, a bank's prime lending rate, which it uses to price loans, is widely used as a base from which other securities such as corporate debentures are priced.
8	<b>Beta</b>	It is the measure of the relative sensitivity of a stock or mutual fund to the market. The market is assigned a beta of 1. The higher the beta, the more sensitive the stock or fund is considered to be relative to the market as a whole. In other words, funds with beta more than 1 will react more to any fluctuations (whether upward or downward) in market than funds with beta less than 1. If Beta of a stock is 2, then it will return 50% when the benchmark index returns 25%. Similarly, when the market is down 25%, the stock goes down by 50%.

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9	<b>Black-Scholes</b>	A formula for pricing financial options. Its invention allowed a previously undreamed of precision in the pricing of options, and probably made possible the explosive growth in the markets for options and other derivatives that took place after the formula became widely used in the early 1970s. Myron Scholes and Robert Merton were awarded the nobel prize for economics for their part in devising the formula.
10	<b>Big Mac Index</b>	The Big Mac Index is an informal way of measuring the purchasing power parity (PPP) between two currencies and provides a test of the extent to which market exchange rates result in goods costing the same in different countries.
11	<b>Business Cycle</b>	It consists of the cycle of boom and bust. In other words, the long-run pattern of economic growth and recession.
12	<b>Call Rate</b>	It is the overnight inter-bank lending rate. It denotes the liquidity in the money market.
13	<b>Capital Account</b>	The capital account records all transactions between a domestic and foreign resident that involves a change of ownership of an asset. It is the net result of public and private international investment flowing in and out of a country. This includes foreign direct investment, plus changes in holdings of stocks, bonds, loans, bank accounts, and currencies.
14	<b>Capital Adequacy Ratio</b>	The ratio of a bank's capital to its total assets, required by regulators to be above a minimum ("adequate") level so that there is little risk of the bank going bust. How high this minimum level is may vary according to how risky a bank's activities are.
15	<b>Capital Flight</b>	When Capital flows rapidly out of a country, usually because something happens that causes investors suddenly to lose confidence in its economy. This is particularly worrying when the flight capital belongs to the country's own citizens. This is often associated with a sharp fall in the Exchange Rate of the abandoned country's currency..
16	<b>Cash Reserve Ratio (CRR)</b>	CRR is a bank regulation that sets the minimum reserves each bank must hold to customer deposits and notes. The reserve ratio is sometimes used as a tool in monetary policy, influencing the country's economy, borrowing, and interest rates. Central banks may raise CRR to suck out excess liquidity.
17	<b>Closed Economy</b>	An economy that does not take part in inter-national trade; the opposite of an Open Economy. At the turn of the century about the only notable example left of a closed economy is North Korea.
18	<b>Currency Peg</b>	When a Government announces that the Exchange Rate of its currency is fixed against another currency or currencies.
19	<b>Cost of Capital</b>	The cost of capital for a firm is a weighted sum of the cost of equity and the cost of debt. Firms finance their operations by three mechanisms: issuing stock (equity), issuing debt (borrowing from a bank is equivalent for this purpose) (those two are external financing), and reinvesting prior earnings (internal financing).

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20	<b>Current Account</b>	The current account balance is defined by the sum of the net exports of goods and services (i.e. exports minus imports) plus net returns on investments abroad.
21	<b>CPI</b>	Consumer price index is a statistical estimate of the movement of the retail prices of goods and services bought for consumption purposes by households. The two main uses are: a measure of inflation, and the indexation (or evaluation) of wages, salaries, pensions or regulated or contracted prices.
22	<b>Depression</b>	A bad, depressingly prolonged Recession in economic activity. The textbook definition of a recession is two consecutive quarters of declining Output. A slump is where output falls by at least 10%; a depression is an even deeper and more prolonged slump. The most famous example is the Great Depression of the 1930s. After growing strongly during the "roaring 20s", the American economy (among others) went into prolonged recession. Output fell by 30%. Unemployment soared and stayed high: in 1939 the jobless rate was still 17% of the workforce. Roughly half of the 25,000 Banks in the United States failed.
24	<b>Derivatives</b>	Financial Assets that "derive" their value from other assets. For example, an option to buy a Share is derived from the share. Economists mostly regard derivatives as a good thing, allowing more precise pricing of financial Risk and better Risk Management. However, they concede that when derivatives are misused the Leverage that is often an integral part of them can have devastating consequences. So they come with an economists' health warning: if you don't understand it, don't use it. The world of derivatives is riddled with jargon. Here are translations of some of them: <ul style="list-style-type: none"> <li>● A forward contract commits the user to buying or selling an asset at a specific price on a specific date in the future.</li> <li>● A future is a forward contract that is traded on an exchange.</li> <li>● A swap is a contract by which two parties exchange the cashflow linked to a liability or an asset. For example, two companies, one with a loan on a fixed Interest Rate over ten years and the other with a similar loan on a floating interest rate over the same period, may agree to take over each other's obligations, so that the first pays the floating rate and the second the fixed rate.</li> <li>● An option is a contract that gives the buyer the right, but not the obligation, to sell or buy a particular asset at a particular price, on or before a specified date.</li> </ul>
25	<b>External Commercial Borrowings</b>	These are medium and short term foreign currency loans raised by corporates from outside the country.
26	<b>Foreign Direct Investment (FDI)</b>	Foreign direct investment (FDI) is defined as "investment made to acquire lasting interest in enterprises operating outside of the economy of the investor." The FDI relationship consists of a parent enterprise and a foreign affiliate which together form a transnational corporation (TNC). In order to qualify as FDI the investment must afford the parent enterprise control over its foreign affiliate. FDI creates new production capacity and jobs, transfer technology and know-how, and can lead to linkages to the global marketplace.

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27	<b>Foreign Institutional Investor (FII)</b>	<p>Foreign Institutional Investor (FII) is used to denote an investor – mostly of the form of an institution or entity, which invests money in the financial markets of a country different from the one where in the institution or entity was originally incorporated.</p> <p>FII investment is frequently referred to as hot money for the reason that it can leave the country at the same speed at which it comes in.</p> <p>In countries like India, statutory agencies like SEBI have prescribed norms to register FIIs and also to regulate such investments flowing in through FIIs.</p>
28	<b>Fiscal Policy</b>	<p>Fiscal policy is the economic term that defines the set of principles and decisions of a government in setting the level of public expenditure and how that expenditure is funded. Fiscal policy and monetary policy are the macro economic tools that governments have at their disposal to manage the economy.</p>
29	<b>Fiscal Deficit</b>	<p>The excess of total expenditure over total receipt in Government budget is fiscal deficit.</p>
30	<b>GDP</b>	<p>A region's gross domestic product, or GDP, is one of the ways for measuring the size of its economy. The GDP of a country is defined as the market value of all final goods and services produced within a country in a given period of time.</p> <p><math>GDP = \text{consumption} + \text{investment} + (\text{government spending}) + (\text{exports} - \text{imports})</math></p>
31	<b>GNP</b>	<p>Gross National Product (GNP) is the total value of all final goods and services produced by a country's factors of production and sold on the market in a given time period. For example, because Mercedes-Benz is owned by Germans, its profits from its Belgian activities would count towards German GNP, but because the activities take place in the Belgium it would count toward Belgian GDP. A Brit working in Paris would have his income count toward UK GNP but his output would be part of French GDP.</p>
32	<b>Hedge Fund</b>	<p>A hedge fund is an investment fund charging a performance fee and typically open to only a limited range of investors with a reputation for secrecy. In the United States, hedge funds are open to accredited investors only. Because of this restriction, they are usually exempt from any direct regulation by the SEC, NASD and other regulatory bodies.</p> <p>A Hedge fund's activities are limited only by the contracts governing the particular fund, so they can follow complex investment strategies, being long or short assets and entering into futures, swaps and other derivative contracts. Their common objective is to generate returns that are not closely correlated to those of the broader financial markets.</p>
33	<b>IIP</b>	<p>Index of Industrial Production (IIP) is an abstract number, the magnitude of which represents the status of production in the industrial sector for a given period of time as compared to a reference period of time.</p> <p>It consists of the following major segments: Manufacturing (wt. 79.36%), Mining (10.47%) and Electricity (10.17%).</p> <p>IIP is also segmented into various use-based categories i.e., Basic goods, Capital goods, Intermediate goods, Consumer durables and Consumer non-durables.</p>
34	<b>Long Position</b>	<p>The buying of a security such as a stock, commodity or currency, with the expectation that the asset will rise in value.</p> <p>If you buy a stock you are "Long the Stock". Traders create a long position when they think the price will go up.</p>

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35	<b>Market Stabilization Scheme (MSS)</b>	<p>The Government issues Treasury Bills and/or dated securities under the MSS in addition to the normal borrowing requirements, for absorbing liquidity from the system. The bills/bonds issued under MSS would have all the attributes of the existing Treasury Bills and dated securities. The bills and securities will be issued by way of auctions to be conducted by the Reserve Bank. The amounts raised under the MSS would be held in a separate identifiable cash account titled the Market Stabilisation Scheme Account (MSS Account) to be maintained and operated by the Reserve Bank. The impact on revenue and fiscal deficits of the Government will be to the extent of interest payment on bills/securities outstanding under the MSS. Further, the cost would be shown separately in the Budget. This would add transparency to the cost of sterilisation. It is a cost to the Government.</p> <p>The Government of India, in consultation with the Reserve Bank, has recently revised the ceiling for the outstandings under the Market Stabilisation Scheme (MSS) for the year 2007-08 to Rs.2,00,000 crore.</p>
36	<b>Monetary Policy</b>	<p>Policies adopted by Central Bank to control the Money Supply, and thereby manage demand. Monetary policy involves Open-Market Operations, Reserve Requirements and changing the Short-Term Rate of Interest (the Discount Rate). It is one of the two main tools of Macroeconomic Policy, the side-kick of Fiscal Policy.</p>
37	<b>Money Supply (M3)</b>	<p>In India components of M3 are Currency with the Public, Demand Deposits and Time Deposits with banks, "Other" deposits with Reserve Bank. Sources of M3 are Net Bank credit to Government, Bank credit to Commercial Sector, Net foreign exchange Assets of Banking Sector, Government's currency liabilities to the public, Banking sector's net non-monetary liabilities other than time deposits.</p>
38	<b>NAIRU</b>	<p>NAIRU (Non-Accelerating Inflation Rate of Unemployment) is a concept in economic theory significant in the interplay of macroeconomics and microeconomics. It states that if actual unemployment falls below the NAIRU, the inflation rate is likely to rise quickly (accelerate). In terms of output, the NAIRU corresponds to potential output, the highest level of real gross domestic product that can be sustained at any one time.</p>
39	<b>Nifty</b>	<p>S&amp;P CNX Nifty is a well diversified 50 stock index of NSE (National Stock Exchange) accounting for 21 sectors of the economy. It is widely used for portfolio benchmarking.</p>
40	<b>Open Interest</b>	<p>Open Interest is the number of open contracts of a given future or option contract. An open contract can be a long or short contract that has not been exercised, closed out, or allowed to expire.</p>
41	<b>P/E Ratio</b>	<p>The P/E ratio (price-to-earnings ratio) of a stock is a measure of the price paid for a share relative to the income or profit earned by the firm per share. A higher P/E ratio means that investors are paying more for each unit of income.</p> $\text{P/E ratio} = \frac{\text{Price per Share}}{\text{Earnings Per Share}}$

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42	<b>Per Capita Income</b>	Per capita income means how much each individual receives, in monetary terms, of the yearly income that is generated in their country through productive activities. Per capita income is usually reported in units of currency per year. Data on per capita income based on a country's total personal income are rarely available. Thus, the Gross domestic product (GDP) is more commonly used.
43	<b>Primary Deficit</b>	Primary deficit is the fiscal deficit after deducting the interest payment. It gives the idea of actual deficit without taking into account the interest payment.
44	<b>Purchasing Power Parity</b>	A purchasing power parity exchange rate equalizes the purchasing power of different currencies in their home countries for a given basket of goods. These special exchange rates are often used to compare the standards of living of two or more countries.
45	<b>Revenue Deficit</b>	The excess of revenue expenditure over revenue receipt in budget is called revenue deficit. It does not take into account the capital receipts and capital expenditure.
46	<b>Reserve</b>	Foreign exchange reserves (also called Forex reserves) in a strict sense are only the foreign currency deposits held by central banks and monetary authorities. However, the term foreign exchange reserves in popular usage commonly include foreign exchange and gold, SDRs and IMF reserve position.
47	<b>SENSEX</b>	<p>Sensex is the common name for the "Bombay Stock Exchange Sensitive Index". It consists of the 30 largest and most actively traded stocks, representative of various sectors, on the Bombay Stock Exchange.</p> <p>SENSEX, first compiled in 1986 was calculated on a "Market Capitalization-Weighted" methodology of 30 component stocks representing a sample of large, well-established and financially sound companies. The base year of SENSEX is 1978-79.</p> <p>From September 2003, the SENSEX is calculated on a free-float market capitalization methodology. The "free-float Market Capitalization-Weighted" methodology is a widely followed index construction methodology on which majority of global equity benchmarks are based.</p> <p>The Sensex is generally regarded as the most popular and precise barometer of the Indian stock markets. It is the oldest stock market index currently in use.</p>
48	<b>SDR</b>	The SDR is an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries. SDRs are allocated to member countries in proportion to their IMF quotas.
49	<b>Shorting</b>	Selling a Security, such as a Share, that you do not currently own, in the expectation that its Price will fall by the time the security has to be delivered to its new owner. If the price does fall, you can buy the security at the lower price, deliver it to whoever you sold it to and make a Profit. The Risk is that the price rises, leaving you with a loss.
50	<b>SLR</b>	Statutory Liquidity Ratio is the amount which a bank has to maintain in the form of cash, gold or approved Govt. securities. The quantum is specified as some percentage of the total demand and time liabilities of a bank. This percentage is fixed by the Reserve Bank of India.

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51	SPV	<p>The acronym stands for special purpose vehicle. In the US, the term used is special purpose entity (SPE). The name SPV is given to an entity which is formed for a single, well-defined and narrow purpose.</p>
		<p>Is there a difference between a special purpose vehicle and a company?</p>
		<p>SPVs are mostly formed to raise funds from the market. Technically, an SPV is a company. It has to follow the rules of formation of a company laid down in the Companies Act, 1956. Like a company, the SPV is an artificial person. It has all the attributes of a legal person. It is independent of members subscribing to the shares of the SPV. The SPV has an existence of its own in the eyes of law. It can sue and be sued in its name. The SPV has to adhere to all the regulations laid down in the Companies Act. Members of an SPV are mostly the companies and individuals sponsoring the entity. An SPV can also be a partnership firm. A company may do many things which are mentioned in the memorandum of association (MoA) or permitted by the Companies Act. An SPV may also do the same, but its scope of operation is limited and focused.</p>
52	WPI	<p>This is the index that is used to measure the change in the average price level of goods traded in wholesale market. It is widely used in India. The revised series of the Index of Wholesale Prices in India has a base year of 1993-94 with 435 items. The major categories are Primary Articles, Fuel, Power, Light &amp; Lubricant and Manufactured Products.</p>
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