

CWMP — Paper 1 – Financial Planning and Tax Planning

Complete Book | Table of Contents | 23 chapters + 7 sections

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CH-1

Indian Economic Environment

Topic 1 — Introduction to Economics:

Meaning, Micro and Macroeconomics

Economics studies how people, firms and governments use **scarce resources** to satisfy unlimited wants.

- **Scarcity** — Land, labour, capital and enterprise are limited, while human wants keep growing.
- **Choice** — Scarcity forces every household, firm and government to choose between alternatives.
- **Opportunity cost** — The value of the next best alternative given up is the real cost of a choice.
- **Central questions** — Every economy decides **what** to produce, **how** to produce and **for whom**.

Basis	Microeconomics	Macroeconomics
Focus	Individual units — a consumer, a firm, one market	The economy as a whole — aggregates
Key variables	Price of a product, demand, supply, cost, wages in one industry	GDP, inflation, unemployment, interest rates, fiscal deficit, exchange rate
Typical question	How will a rise in gold price change jewellery demand?	How will a repo-rate hike change growth and inflation?
Use for a wealth manager	Analysing a company or a sector	Setting asset allocation and timing across asset classes

Example: A client earning ₹1,20,000 a month keeps ₹10 lakh idle in a savings account at 2.5% instead of a 7% deposit. The yearly **opportunity cost** is about ₹45,000 of forgone interest.

Remember this

- Micro = individual units and prices; Macro = national aggregates such as GDP, inflation and interest rates.

Topic 2 — The Indian Economy: Structure and Key Features

- **Mixed economy** — Public and private sectors coexist; markets set most prices under government regulation.
- **Three sectors** — Primary (agriculture), secondary (industry) and tertiary (services) together produce national output.
- **Services lead** — Services contribute the largest share of gross value added (GVA).
- **Workforce gap** — Agriculture employs the largest share of workers but contributes a much smaller share of output.
- **Demand-led** — Private consumption is the largest component of GDP, which makes domestic demand the main growth engine.
- **Demographic dividend** — A large working-age population supports savings, consumption and long-term investment demand.



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Reforms that shaped today's economy

Reform	Year	Significance for markets
Liberalisation, Privatisation, Globalisation (LPG)	1991	Opened trade, foreign investment and capital markets
Insolvency and Bankruptcy Code	2016	Time-bound resolution of stressed companies
Flexible inflation targeting	2016	Statutory inflation target and the Monetary Policy Committee
Goods and Services Tax (GST)	2017	One national indirect tax; rates rationalised from 22 September 2025
Income-tax Act, 2025	In force from 1 April 2026	Replaced the 1961 Act; 'tax year' replaces previous year and assessment year

Size and growth (new GDP series, base year 2022-23)

Indicator	Value
Real GDP, 2025-26 (Provisional Estimates)	₹323.12 lakh crore; growth 7.7% (7.1% in 2024-25)
Nominal GDP, 2025-26	₹346.36 lakh crore; growth 8.9%
Real GVA growth, 2025-26	7.9%
Real GDP growth, Q1 2026-27 (after the exam cut-off)	7.8%

Remember this

- New national accounts series: base year **2022-23** (replaced 2011-12); real GDP growth 2025-26 = **7.7%**.

Topic 3 — Economic Policies: Objectives and Types

Economic policy is the set of actions of the government and the central bank that steer growth, prices, jobs and external balance.

Objectives

- **Growth** — Raise output and incomes on a sustainable path.
- **Price stability** — Keep inflation low and stable so that money keeps its value.
- **Employment** — Create enough jobs for a growing workforce.
- **Equity** — Reduce inequality of income, wealth and opportunity.
- **External stability** — Keep the current account deficit, rupee and forex reserves at sustainable levels.
- **Financial stability** — Keep banks, markets and payment systems resilient to shocks.

Policy	Made by	Main tools	Example
Monetary	RBI and its Monetary Policy Committee	Repo rate, SDF, MSF, CRR, SLR, open market operations	Repo-rate change to control inflation
Fiscal	Union and State Governments, approved by legislatures	Taxes, public spending, borrowing, subsidies	Higher capital expenditure on roads and railways
Trade	Ministry of Commerce and Industry	Customs duties, export incentives, trade agreements	Lower duty on inputs to promote exports
External sector	RBI and Government under FEMA, 1999	Forex intervention, capital-flow limits	Selling dollars to curb rupee volatility



Policy	Made by	Main tools	Example
Industrial and structural	Central Government	Production-linked incentives, labour codes, ease of doing business	Incentives for electronics manufacturing

- **Trade-offs** — Objectives can clash; a rate hike that cools inflation may also slow growth.
- **Policy mix** — Monetary and fiscal policy work best when they pull in the same direction.

Remember this

- Monetary policy = RBI (money and interest rates); fiscal policy = Government (taxes, spending, borrowing).

Topic 4 — Monetary Policy Framework and Tools

- **Primary objective** — Price stability while keeping in mind the objective of growth.
- **Inflation target** — The Government sets it under Section 45ZA of the RBI Act, 1934, in consultation with RBI.
- **Current target** — 4% CPI (Combined) inflation with a band of 2% to 6%, for 1 April 2026 to 31 March 2031.
- **MPC** — A six-member committee under Section 45ZB fixes the policy repo rate; it meets at least four times a year.
- **Failure** — Average inflation outside the 2–6% band for three consecutive quarters; RBI must then report reasons and remedies to the Government.

Tool	How it works	Position at exam cut-off (30 June 2026)
Policy repo rate	Rate at which RBI lends overnight to banks against government securities	5.25%
Standing Deposit Facility (SDF)	Floor of the corridor; absorbs surplus funds without collateral	5.00% (repo – 0.25%)
Marginal Standing Facility (MSF) and Bank Rate	Ceiling of the corridor; emergency overnight borrowing	5.50% (repo + 0.25%)
Cash Reserve Ratio (CRR)	Share of NDTL kept as cash with RBI; earns no interest	3% of NDTL
Statutory Liquidity Ratio (SLR)	Share of NDTL held in cash, gold or approved securities	18% of NDTL
Open market operations (OMO)	Purchase or sale of government securities	Purchase injects liquidity; sale absorbs it

Update after the cut-off — On 7 October 2026 the MPC raised the repo rate by 25 bps to **5.50%**; SDF became 5.25%, MSF and Bank Rate 5.75%.

Qualitative (selective) tools

- **Risk weights** — Higher risk weights on a loan category make such lending costlier.
- **Loan-to-value limits** — Margins on loans against gold, shares or property control the amount lent.
- **Moral suasion** — RBI persuades banks through meetings and letters, without a formal order.

Remember this

- Target 4% $\pm$ 2% (2026–31); corridor = SDF (repo – 25 bps) to MSF (repo + 25 bps); CRR 3%, SLR 18%.

Topic 5 — External Sector Policy: Exchange Rate and Capital Flows

- **Exchange-rate regime** — The rupee is market-determined; RBI intervenes only to curb excessive volatility.

- **Legal base** — The Foreign Exchange Management Act (FEMA), 1999 governs foreign-exchange transactions.
- **Current account** — The rupee is convertible on current account since August 1994.
- **Capital account** — Convertibility is partial; FPI, FDI, external borrowing and outward investment follow set limits.
- **Forex reserves** — RBI's reserves act as a buffer against sudden capital outflows.

Tool	Purpose	Relevance to wealth clients
Forex market intervention	Smooth sharp moves in the rupee	Reduces currency shock to overseas investments
Liberalised Remittance Scheme (LRS)	Lets resident individuals remit up to USD 2,50,000 per financial year	Route for overseas shares, funds, property and education
FPI and FDI limits	Control the size and type of foreign capital	Foreign flows move equity and bond prices
External commercial borrowing rules	Limit corporate foreign borrowing	Affect currency risk of borrowing companies

Example: Mrs Kapoor remitted USD 1,60,000 in May for a foreign equity fund. She can remit at most USD 90,000 more under LRS in the same financial year.

Remember this

- LRS limit: **USD 2,50,000** per resident individual per financial year; current-account convertibility since 1994.

Topic 6 — Key Economic Indicators in India

An **economic indicator** is a statistic that shows the direction and strength of economic activity.

Indicator	Compiled by	Frequency	What it tells an investor
GDP and GVA	National Statistics Office (NSO), MoSPI	Quarterly and annual; base 2022-23	Pace of growth and corporate earnings potential
Index of Industrial Production (IIP)	NSO, MoSPI	Monthly	Momentum in mining, manufacturing and electricity
Consumer Price Index (Combined)	NSO, MoSPI	Monthly; base 2024 = 100	Retail inflation; RBI's target variable
Wholesale Price Index (WPI)	Office of the Economic Adviser, DPIIT	Monthly; base 2022-23 = 100	Wholesale price pressure and input costs
Purchasing Managers' Index (PMI)	Private survey of purchasing managers	Monthly	Above 50 = expansion over the previous month
Unemployment rate	Periodic Labour Force Survey (NSO)	Monthly, quarterly and annual	Labour-market health and consumption demand
Fiscal deficit	Controller General of Accounts	Monthly; annual in the Budget	Government borrowing and pressure on bond yields
Current account balance and forex reserves	RBI	Quarterly; reserves weekly	External strength and rupee outlook
10-year G-sec yield and rupee rate	Market data	Daily	Cost of money and currency trend

**Remember this**

- CPI (Combined), base 2024, compiled by NSO = headline inflation; WPI, base 2022-23, compiled by DPIIT; PMI above 50 = expansion.

Topic 7 — Leading, Coincident and Lagging Indicators

Type	Behaviour	Examples
Leading	Turn before the economy turns; used for forecasting	Stock indices, PMI, new orders, yield-curve slope, business confidence
Coincident	Move with the economy	GDP, IIP, power demand, GST collections, retail sales
Lagging	Turn after the economy; confirm a trend	Unemployment rate, CPI inflation, bank lending rates, NPAs

- Technical recession** — Commonly defined as two consecutive quarters of negative real GDP growth.
- Inverted yield curve** — Short-term yields above long-term yields often signal an expected slowdown.

Example: Manufacturing PMI falls from 56 to 49 and new export orders decline. A wealth manager reads this **leading** signal as a possible slowdown and trims exposure to cyclical sectors before lagging NPAs rise.

Remember this

- Leading = forecast (PMI, stock prices); coincident = now (GDP, IIP); lagging = confirm (unemployment, NPAs).

Topic 8 — Economic Indicators and the Value of Investment

The value of every investment is the present value of its expected cash flows; indicators change both the cash flows and the discount rate.

Change in indicator	Equity	Bonds	Gold / real assets
Faster GDP growth	Positive — higher earnings	Mildly negative — yields may rise	Neutral to positive for real estate
Rising inflation	Negative — costs and discount rates rise	Negative — real return falls, yields rise	Gold usually gains as a hedge
Rising interest rates	Negative — higher discount rate, costlier debt	Negative — prices fall as yields rise	Negative for property demand
Rupee depreciation	Positive for exporters; negative for importers	Negative if foreign investors sell	Rupee gold price rises
Higher crude oil price	Negative for oil users; inflation risk	Negative — inflation and deficit fears	Gold often firm

Real rate of return (Fisher relation)

$$1 + r_{real} = \frac{1 + r_{nominal}}{1 + \pi}$$

$$r_{real} \approx r_{nominal} - \pi$$



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N1. [Numerical] A client holds a bank fixed deposit at 7.00% a year. Inflation is 5.00% and the client's tax rate is 30%. Find the real return before and after tax.

Item	Value
Nominal deposit rate	7.00%
Inflation	5.00%
Tax rate	30%

Solution:

Formula:

$$r_{real} = \frac{1 + r_{nominal}}{1 + \pi} - 1$$

Pre-tax real return = $1.07 \div 1.05 - 1 = 1.90\%$ (approximation $7 - 5 = 2\%$).

Post-tax nominal return = $7.00\% \times (1 - 0.30) = 4.90\%$.

$$r_{real} = \frac{1.049}{1.05} - 1 = -0.10\%$$

Answer: Real return is 1.90% before tax but about -0.10% after tax, so the deposit loses purchasing power.

Remember this

- Real return $\approx$ nominal return – inflation; always compare post-tax real returns.

Topic 9 — Impact of Monetary Policy on the Economy and Financial Markets

Transmission of a repo-rate change

- The MPC changes the policy repo rate.
- Overnight money-market rates move within the SDF–MSF corridor.
- Treasury bill, CD and bond yields adjust.
- Banks reset deposit and lending rates; external-benchmark loans reset at least once in three months.
- Borrowing, spending and investment change, and finally output and inflation.

Market	Repo-rate hike	Repo-rate cut
Bank deposits	Higher fixed-deposit rates attract savers	Deposit rates fall; savers look for alternatives
Loans and EMIs	EMIs on floating-rate loans rise	EMIs fall; credit demand improves
Bond prices	Yields rise, prices fall	Yields fall, prices rise; long bonds gain most
Equity	Valuations fall; rate-sensitive sectors suffer	Supports valuations of banks, autos and real estate

Example: A ₹40 lakh repo-linked home loan for 20 years at 8.00% has an EMI of ₹33,458. After a 25 bps rise to 8.25%, the EMI becomes ₹34,083 — about **₹625 a month** more.

$$\% \Delta P \approx -D_{mod} \times \Delta y$$

N2. [Numerical] A client holds G-secs worth ₹5 crore with a modified duration of 7.2. The 10-year yield rises by 25 bps after a policy hike. Estimate the change in value.

Item	Value
Market value	₹5,00,00,000
Modified duration	7.2
Change in yield	+0.25%

Solution:

Formula:

$$\% \Delta P \approx -D_{mod} \times \Delta y$$

$$\% \Delta P \approx -7.2 \times 0.25\% = -1.80\%$$

$$\Delta P \approx 5,00,00,000 \times (-1.80\%) = -9,00,000$$

Answer: The holding loses about ₹9 lakh (1.80%); a 25 bps fall in yield would add a similar amount.

Remember this

- Yield ↑ → bond price ↓; the longer the duration, the bigger the price change.

Topic 10 — Impact of the Union Budget on the Economy and Financial Markets

- Budget** — The Annual Financial Statement (Article 112) shows estimated receipts and expenditure for the year.
- Timing** — The Union Budget is presented on 1 February for the financial year from 1 April.

Channels of impact

Budget lever	Effect on economy	Effect on markets
Fiscal deficit and borrowing	Higher deficit adds demand but may crowd out private investment	Larger borrowing pushes bond yields up
Capital expenditure	Builds infrastructure; crowds in private investment	Supports infrastructure, cement and capital-goods stocks
Personal income tax	Changes disposable income and consumption	Lower tax supports consumer sectors
Capital-market taxes	Changes the post-tax return on investments	Moves trading volumes and investor behaviour

Union Budget 2026-27 (presented 1 February 2026)

Measure	Detail	Likely impact
Fiscal deficit	4.3% of GDP (BE), from 4.4% (RE 2025-26)	Consolidation supports bond prices
Capital expenditure	₹12.22 lakh crore	Infrastructure and allied sectors
Gross / net market borrowing	₹17.2 lakh crore / ₹11.7 lakh crore	Supply of G-secs for banks and funds
Securities transaction tax	Futures 0.02% → 0.05%; options premium 0.1% → 0.15%	Higher cost of derivatives trading
Share buy-backs	Taxed as capital gains for shareholders, with extra tax on promoters	Changes payout choices of companies
Income-tax slabs	No change; Tax Year 2026-27 under the Income-tax Act, 2025	Stable disposable income

Remember this

- Budget 2026-27: fiscal deficit **4.3%** of GDP; capex **₹12.22 lakh crore**; STT on futures 0.05%, options 0.15%.

Topic 11 — Government and Fiscal Policy: Role and Instruments

Fiscal policy is the use of government taxation, spending and borrowing to influence the economy.

Function of government	Meaning	Example
Allocation	Provide public goods that markets under-supply	Defence, roads, public health
Distribution	Reduce inequality of income and wealth	Progressive income tax, food subsidy
Stabilisation	Smooth booms and slumps; keep prices and jobs stable	Higher spending in a slowdown

Instrument	Key points
Taxation	Direct taxes (income tax, corporate tax) and indirect taxes (GST, customs); GST main slabs 5% and 18% from 22 September 2025, with 40% on select goods

Instrument	Key points
Public expenditure	Revenue expenditure (salaries, interest, subsidies) and capital expenditure (assets, loans)
Public borrowing	Dated securities and Treasury Bills fill the gap between spending and receipts
Transfers	Grants to States, subsidies and direct benefit transfers

Type	When used	Action
Expansionary	Slowdown, high unemployment	Spend more, tax less, or both
Contractionary	Overheating, high inflation	Spend less, tax more
Neutral	Economy near equilibrium	Spending broadly matches revenue

- Automatic stabilisers** — Progressive taxes and welfare spending cushion the cycle without a new decision.
- Fiscal federalism** — The Finance Commission (Article 280) recommends tax devolution; the GST Council (Article 279A) sets GST rates.

Remember this

- Musgrave's three functions: allocation, distribution and stabilisation.

Topic 12 — Fiscal Deficit, FRBM Framework and Public Debt

Fiscal deficit = Total expenditure – Revenue receipts – Non-debt capital receipts

Primary deficit = Fiscal deficit – Interest payments

Revenue deficit = Revenue expenditure – Revenue receipts

Deficit	What it shows
Fiscal deficit	Total borrowing requirement of the Government
Revenue deficit	Borrowing used for current consumption
Primary deficit	Borrowing need excluding interest on past debt
Effective revenue deficit	Revenue deficit minus grants for creating capital assets

FRBM Act, 2003 — current framework

- Debt anchor** — From 2026-27 the anchor is Central Government debt: 50 ± 1% of GDP by 31 March 2031.
- Current level** — Central Government debt is estimated at 55.6% of GDP in BE 2026-27.
- Escape clause** — Deviation of up to 0.5% of GDP for war, calamity, farm collapse, structural reform or a sharp growth fall.
- Crowding out** — Heavy government borrowing raises interest rates and can squeeze private investment.

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N3. [Numerical] Using Budget 2026-27 estimates (₹ lakh crore), find the fiscal, revenue and primary deficits as a percentage of GDP.

Item	₹ lakh crore
Total expenditure	53.47
Revenue expenditure	41.25
Revenue receipts	35.33
Non-debt capital receipts	1.18
Interest payments	14.04
Nominal GDP	393

Solution:

Formula:

$$\text{Deficit ratio} = \frac{\text{Deficit}}{\text{GDP}} \times 100$$

Fiscal deficit = 53.47 – 35.33 – 1.18 = 16.96; 16.96 ÷ 393 = 4.3% of GDP.

Revenue deficit = 41.25 – 35.33 = 5.92; 5.92 ÷ 393 = 1.5% of GDP.

Primary deficit = 16.96 – 14.04 = 2.92 ⇒ 0.7% of GDP

Answer: Fiscal deficit 4.3%, revenue deficit 1.5% and primary deficit 0.7% of GDP.

Remember this

- FRBM anchor: Central Government debt **50 ± 1%** of GDP by 31 March 2031; escape clause up to **0.5%** of GDP.

CWMP | Module A | CH-1 | MCQs

Q1. A wealth manager lists four issues: (i) a bank's locker rent, (ii) national CPI inflation, (iii) gold-jewellery demand in one city, (iv) the national unemployment rate. Which are macroeconomic issues? [Ref: Topic 1, p. 2]

- (a) (i) and (iii) only (b) (ii) and (iv) only
(c) (i), (ii) and (iv) only (d) (ii), (iii) and (iv) only

Q2. Which statement about the structure of the Indian economy is correct? [Ref: Topic 2, p. 2]

- (a) Agriculture contributes the largest share of GVA and also employs most workers
(b) Services contribute the largest share of GVA, while agriculture employs the largest share of workers
(c) Industry contributes the largest share of GVA and also employs the largest share of the country's workers
(d) India follows a socialist economic system in which the state fixes most prices

Q3. Which pairing of policy and tool is NOT correct? [Ref: Topic 3, p. 2]

- (a) Monetary policy — open market operations in government securities
(b) Fiscal policy — change in personal income-tax rates
(c) Monetary policy — production-linked incentive scheme for electronics
(d) External sector policy — intervention in the foreign-exchange market

Q4. Average CPI (Combined) inflation is 6.4%, 6.3% and 6.2% in three consecutive quarters. Under the inflation-targeting framework, what follows? [Ref: Topic 4, p. 3]

- (a) Nothing, because inflation in each quarter stayed below the 7% level at which action is triggered
(b) The Government must change the inflation target immediately
(c) RBI must report to the Government the reasons, remedial actions and expected time to return to target
(d) The MPC is dissolved and the Government appoints a fresh committee for the rest of the period

Q5. At the exam cut-off the policy repo rate was 5.25% with a symmetric corridor of 25 bps on each side. A bank short of funds late in the day borrows overnight under the MSF. The rate it pays is: [Ref: Topic 4, p. 3]

- (a) 5.00% (b) 5.25% (c) 5.50% (d) 5.75%

Q6. Mr Rao, a resident individual, has remitted USD 2,10,000 under the Liberalised Remittance Scheme this financial year. How much more can he remit under LRS in the same year? [Ref: Topic 5, p. 3]

- (a) USD 40,000 (b) USD 90,000 (c) USD 2,50,000 (d) USD 1,40,000

Q7. A fund manager wants the official measure of retail inflation that RBI targets. Which index and compiler should she track? [Ref: Topic 6, p. 3]

- (a) WPI compiled by the Office of the Economic Adviser, DPIIT
(b) CPI (Combined) compiled by the National Statistics Office, MoSPI
(c) The manufacturing PMI compiled from a private survey
(d) The GDP deflator compiled by RBI

Q8. Match each indicator to its type: P = manufacturing PMI, Q = quarterly GDP, R = unemployment rate. Which option is correct? [Ref: Topic 7, p. 4]

- (a) P — lagging, Q — leading, R — coincident
(b) P — coincident, Q — lagging, R — leading
(c) P — leading, Q — lagging, R — coincident
(d) P — leading, Q — coincident, R — lagging

Q9. A client earns 7.5% on a corporate deposit, pays tax at 20% and faces inflation of 5.5%. Using the exact Fisher relation, her post-tax real return is about: [Ref: Topic 8, p. 4]

- (a) 2.00% (b) 1.90% (c) 0.47% (d) -0.47%

Q10. The rupee depreciates sharply against the US dollar. Which outcome is most likely, other things remaining equal? [Ref: Topic 8, p. 4]

- (a) Software exporters gain, while oil marketing companies face higher costs
(b) Oil importers gain, while software exporters lose revenue in rupees
(c) Gold prices in rupees fall because gold is priced in dollars
(d) Imported inflation falls, giving room for an immediate repo cut

Q11. A debt fund has a modified duration of 4.5 years. After a policy rate cut, market yields fall by 50 bps. The approximate change in the fund's NAV is: [Ref: Topic 9, p. 4]

- (a) A fall of 2.25% (b) A rise of 4.50%
(c) A rise of 0.50% (d) A rise of 2.25%

Q12. After a repo-rate cut, which borrower is likely to see the earliest fall in the loan rate? [Ref: Topic 9, p. 4]

- (a) A borrower on an MCLR-linked loan whose reset date is eleven months away
(b) A home-loan borrower on a repo-linked external benchmark loan
(c) A borrower with a fixed-rate personal loan for three years
(d) A borrower whose loan is linked to the base rate set in 2012

Q13. Which statement about Budget 2026-27 measures affecting financial markets is correct? [Ref: Topic 10, p. 5]

- (a) STT on futures was raised from 0.02% to 0.05% and on options premium from 0.1% to 0.15%
(b) STT on delivery-based equity purchases was abolished to boost retail trading
(c) Income-tax slabs were raised sharply for Tax Year 2026-27 under the new regime
(d) The fiscal deficit target was raised to 4.8% of GDP to fund a much larger capital expenditure programme



Q14. Which of the following is an automatic stabiliser rather than a discretionary fiscal measure? [Ref: Topic 11, p. 5]

- (a) A special stimulus package of extra road spending announced during a slowdown
- (b) A one-time cut in customs duty on gold announced in the Union Budget
- (c) A new production-linked incentive scheme for the textile industry
- (d) Progressive income tax, whose collections fall faster when incomes fall

Q15. A government has total expenditure of ₹60 lakh crore, revenue receipts of ₹40 lakh crore, non-debt capital receipts of ₹2 lakh crore and interest payments of ₹15 lakh crore. Its primary deficit is: [Ref: Topic 12, p. 5]

- (a) ₹18 lakh crore
- (b) ₹5 lakh crore
- (c) ₹3 lakh crore
- (d) ₹20 lakh crore

Answer key

Q	Ans	Q	Ans	Q	Ans	Q	Ans	Q	Ans
1	b	4	c	7	b	10	a	13	a
2	b	5	c	8	d	11	d	14	d
3	c	6	a	9	c	12	b	15	c

CH-2

Introduction to Indian Financial Markets

Topic 1 — Indian Economy and Financial Markets

Financial markets reflect the real economy: growth drives company earnings, and household savings supply the capital that markets allocate.

Feature of the Indian economy	Implication for financial markets
Fast real growth (7.7% in 2025-26, new series)	Rising corporate earnings and demand for capital
Young, working-age population	Long investment horizons; growing demand for credit, insurance and pensions
High household savings	Large pool for deposits, mutual funds, insurance and small savings
Flexible inflation targeting	More predictable interest rates and bond yields
Formalisation and digital payments	Wider access to credit and investment products

- **Financialisation** — Households are shifting savings from gold and real estate to financial assets.
- **Domestic investors** — Regular SIPs and insurance and pension flows give markets a steady domestic buyer base.
- **Planner's role** — Wealth managers convert these savings into goal-based, suitable portfolios.

Remember this

- Financialisation of savings = shift from physical assets (gold, property) to financial assets.

Topic 2 — Financial System: Meaning, Components and Functions

The **financial system** is the network of institutions, markets, instruments and services that channels savings into investment.

Component	Examples
Financial institutions	Banks, NBFCs, insurers, mutual funds, pension funds, development finance institutions
Financial markets	Money market, capital market, foreign-exchange market, commodity derivatives market
Financial instruments	Deposits, Treasury Bills, bonds, shares, mutual fund units, derivatives
Financial services	Banking, broking, advisory, custody, insurance, payments
Regulators	RBI, SEBI, IRDAI, PFRDA, IFSCA

Functions

- **Mobilise savings** — Collect small savings from millions of households.
- **Allocate capital** — Direct funds to the most productive uses.
- **Payments** — Provide safe and quick settlement of transactions.
- **Risk transfer** — Pool and transfer risk through insurance, diversification and derivatives.
- **Liquidity and price discovery** — Let investors buy and sell quickly at fair, market-determined prices.

Basis	Money market	Capital market
Tenor	Up to one year	More than one year
Instruments	Call money, TREPS, repo, Treasury Bills, commercial paper, certificates of deposit	Shares, bonds, debentures, government dated securities
Main purpose	Short-term liquidity management	Long-term capital formation
Main regulator	RBI	SEBI (RBI for government securities)

- **Primary market** — New securities are issued, for example through an IPO; money goes to the issuer.
- **Secondary market** — Existing securities are traded among investors on stock exchanges.

Remember this

- Money market ≤ 1 year (RBI); capital market > 1 year (SEBI). Primary = new issue; secondary = trading.

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