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Impact of Derivative Trading on Volatility of the Underlying: Evidence from Indian Stock Market

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The present paper examines the impact of introduction of derivatives trading on the underlying spot market volatility of seventy two scripts using symmetric and asymmetric GARCH methods. To separate the effect of market pervasive factors influencing volatility, return on NSE nifty is included in the mean equation. Further, in order to capture the impact that introduction of derivatives has had on the volatility of the underlying, a dummy variable which takes up value zero pre introduction of derivatives and one post introduction is included while specifying the volatility dynamics. The results indicate the existence of asymmetric response to new information. Further, the results hint at an increase in the efficiency of processing new information. Overall, there is a strong evidence of a reduction of volatility after the introduction of derivatives trading.

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