A STUDY ON THE IMPACT OF DEMONETISATION ON BOMBAY STOCK EXCHANGE

[1]R. Siva Kumar, MBA student, Saveetha school of management, India.
[2] p. William Robert, asst. professor Saveetha School of management, India.
[3] Dr. CH. Bala nageswara rao, Director, Saveetha School of management, India.

ABSTRACT

Demonetization is a monetary step in which a currency unit‘s status as a legal tender is declared invalid. On 10th November 2016, Indian Prime Minister declared that from today onward the Rs.500 and Rs.1000 denominated currency notes will not be legal tender. Indian economy is cash oriented economy because India has amongst the highest level of currencies in circulation at 12.1% of GDP. This has also been boosted by growth of high denomination notes, roughly 87% is in the form of Rs.500 and Rs1, 000 notes. The aim of demonstration was to curb the black money, corruption and terrorism .Indian economy is heavily dependent on cash as a result the country faced severe cash shortages with severe detrimental effects across the economy. This research paper aims to evaluate the impact of demonetization on sect oral indices of Bombay Stock Exchange. The collected data has been analyzed for the window period -15 to +15 from the announcement date. The result of the study finds that the cash dependent and consumption based sectors were negatively affected while the financial sectors were the biggest beneficiaries.

Keywords-Demonetization, Legal Tender, Black Money, Bombay Stock Exchange, Sectoral Indices

---

Introduction: -

Demonetization in 2016is a deliberate contraction forced on the economy. Demonetization is an act of stripping a currency unit of its status as legal tender. It occurs whenever there is a change of national currency, the current form or forms of money is taken back from circulation and retired, often to be replaced with new notes or coins. Sometimes, a country completely replaces the old currency with new currency. (Investopedia). Demonetization for India means 2016 Indian banknote demonetization in which Reserve Bank of India withdrawn the old Rs. 500 and Rs. 1000 notes as an official mode of payment. On 8thNovember 2016 the prime minister of India Mr. Narendra Modi announced the demonetization of all Rs. 500 and Rs. 1000 banknotes from Mahatma Gandhi series. There are many reasons why nations decide to demonetize their currency. Few reasons include combating inflation, to combat corruption (tax evasion, counterfeit currency) and to discourage a cash dependency in the economy. The same reasons were given by the Modi government. On 28October 2016, the total currency in circulation in India was Rs. 17.77 lakh crore (US$260 billion). In terms of value, the annual report of Reserve Bank of India of 31 March 2016 stated that total bank notes in circulation valued to Rs.16.42 lakh crore (US$240 billion) of which nearly 86% (i.e. Rs. 14.18 lakh crore (US$210 billion)) was 500and 1000 rupee notes. In terms of volume, the report stated that 24% (i.e. 2,203 crore) of the total 9,026.6 crore bank notes were in circulation. In the past many countries have attempted demonetization, some successfully and some unsuccessfully, but all of them were done when their economies were having major problems like hyper inflation in Germany in the 1920s. This is the first time that a perfectly healthy economy has attempted it and that too to target black money. Because this is a first, there are varied opinions amongst economists on what the impact will be in the future. The concept of demonetization is not new to India; similar measures have been taken in the past. In 1946, the currency note of Rs 1,000 and Rs 10,000 were withdrawn from circulation but that
Demonetization did not affect common people because high denomination currency was not accessible to the larger section of the society. But the notes were reintroduced in 1954 with an additional introduction of Rs 5,000 currency. (Sonali Pimputkar). The second phase came in 1978 when Prime Minister Morarji Desai announced demonetization of 1000, 5000 and 10,000 rupees notes on 16 January 1978 as a means to curb black money. Unlike Modi, Desai didn‘t have the backing of the RBI

Governor. In compare to 1978 demonetization the present 2016 demonetization made larger impact on day to day life of a common man and it is widely believed that the demonetization by the Morarji govt was announced with the intent to immobilize the funds of the opposition party but the present 2016 demonetization was announced for interest of the larger section of the society.

Although demonetization holds huge potential benefits in the medium to long-term, given the scale of operation, it was expected to cause transient disruption in economic activity. The immediate impact of removing so much money from circulation is of course will impact on several sectors that are driven by the black economy like real estate, construction etc. Indian equity markets observed falling trend since the government demonetized the 500 rupee and 1,000 rupee currency notes after midnight on November 8, 2016. The two benchmark equity indices—the Nifty 50 and the S&P BSE Sensex—fell on each trading day since the demonetization except for November 10 and November 22. While the Nifty 50 fell 6.3% from November 8 to November 22, the S&P BSE Sensex fell 5.9%during the same period. Due to the rise in the US dollar, the dollar equivalents of the Sensex and the Nifty fell more than 8% each. The S&P BSE 100 Index, which is comprised of 100 stocks compared to the Sensex‘s

30, fell6.6% during this period. Mid and small cap indices have been hit much harder than broader market indices. Even after a rise on November 22, the S&P BSE MidCap and the S&P BSE Small Cap indices fell 8.2% and 10.9%, respectively. The analysis in this paper suggests that demonetization has impacted various sectors of the Bombay Stock Exchange in varying degrees; however, in the affected sectors, the adverse impact was transient and felt mainly in November and December 2016.

Was demonetization necessary?

This move was long overdue. The growth of cash economy in proportion to the gross domestic product (GDP) – was less than 10 per percent until 2001, later it became almost 12 per cent of GDP in 2016. The cash GDP ratio should go down the way baking services are increasing day by day but it has increased as a result the high GDP Cash ratio propelled for denomination of high currency notes. The cash economy does not mean it is illicit economy, it's unorganized economy. Gurumurthy (2016) said that during the UPA regime the money that was circulating in the system was more than the money that was needed in the normal economy. More critically, the High Denomination Notes with the public more than doubled from 34 per cent in 2004 to 79 per cent in 2010. On November 8, 2016, it was 87 per cent. The average annual rise in HDNs was 51 per cent between 2004 and 2010 and the annual rise was 63 per cent by 2013-14. The Reserve Bank of India noted that two-thirds of the Rs.1,000 notes and one-third of the Rs.500 notes — that is over Rs.6 lakh crore now — never returned to banks after they were issued. The unmonitored HDNs roaming outside banks began driving up the gold and land prices by black cash and the stock prices through Participatory Notes (PNs) — which are largely hawala transfers out of India — that came back pretending as foreign investment in stocks. The PNs rose from Rs.68,000 crore in 2004 to Rs.3.81 lakh crore in 2007.The high rise of the stock market also contributed to all this. This extra cash component, in other terms the paradigm shifted from production to financialization of the economy caused the Asset Inflationary Growth rate instead of showing the real growth story. Modern economist deducts the non-asset price inflation from nominal growth to know the real growth. Therefore, the demonization was inevitable to force temporary decline in growth for reinstating real growth and jobs.

Objective of the Study

The objective of the research study is to examine the impact of demonetization on selected sectoral indices of BSE for the window period of -15 to +15 from announcement date of demonetization.

Research Methodology

The research study is based on secondary data. All information regarding sectoral indices has been collected from official website of Bombay Stock Exchange (www.bseindia.com).The data used in the study consist of daily prices of BSE Sectoral Indices prior 15 days of announcement and post 15 days of announcement.

Empirical Results

Table 1 depicts the impact of demonetization on sectoral indices of Bombay Stock Exchange. From Table 1, it is evident that that the worst hit sectors by demonetization are automobile, industries, consumer durables and the real estate sector. The banking sector, on the other hand, has had a positive impact.

Table 1

Sectors	Pre-Demonetization Returns	Post-DemonetizationReturns
BSE Auto	-0.07702798	-0.637841413
BSE Consumer Durables	-0.1870903	-0.596381694
BSE Telecom	-0.130624844	0.270275593
BSE BANKEX	0.07227618	0.296059767

BSE Information Technology	0.18516698	0.017757713
BSE Consumer Discretionary Goods & Services	-0.088498273	-0.535871513
BSE Realty	-0.153051207	-0.8694753
BSE Oil & Gas	0.172951773	0.140163347
BSE Metal	0.282599387	0.141244753
BSE Industries	-0.125648627	-0.437866327

BSE Auto

The result of BSE Auto shows that demonetization impact is negative on Auto Stocks, the pre-demonetization index return is-0.07702798 which becomes-0.637841413 after demonetization, it shows that demonetization severely affected the S & P BSE Auto because mean return fallen from pre-demonetization level. The reason might be that Normally, people pay by cash in small towns and cities for two wheeler. It is also true in Indian context that Auto and Luxury vehicles are one of the key beneficiaries of black money. Though, of late the govt, made it mandatory to quote PAN but still it was not possible to control the cash transactions. Before demonetization, the people knew different methods to cover up these purchases i.e. in some cases vehicle purchase was used to convert black money to white money. To summarize, there will be a slowdown in the auto sector and it seems that in near future stocks will not do well.

BSE Consumer Durables

The results are also very bad for also consumer durables, the pre demonetization return is -0.1870903 but post demonetization return has fallen up to the -0.596381694; both electronic and white goods are negatively impacted. The reason is rampant use of cash transactions with black money preferred cash payments to buy consumer goods. This effect can be seen by these sectoral indices of Consumer Durables.

BSE Telecom

The result shows that telecom sector gets boost during post demonetization period, the post demonetization index return (0.270275593) is higher than pre-demonetization return(-0.130624844) because due to cash crunch there was flood of digital payments. Almost all telecom players have mobile wallet offerings for digital payment. The increase in mobile wallet of telecom player might be the reason for betterment of telecom sector index return after demonetization.

BSE BANKEX

The result of BSE BANKEX shows banking sector is the biggest beneficiary of demonetization. The mean index return is0.07227618 before announcement of demonetization but after that, index observes high return (0.296059767). Banks were flush with the money. A lot of the black money will be deposited in bank accounts and the excess funds in the banking system will also help addressing the nonperforming assets (NPA) problem that many of the banks are facing due to bad loans. However it is still a moot point among those who like PSU bank vs. those who prefer private sector banks. No doubt that money will flow into all banks, may be a little more in public sector banks where all of the Jandhan accounts were opened. Nevertheless private sector banks will continue to enjoy competitive advantages as before. The demonetization is the beginning of digital payment era. The government will take all steps to make India a cashless economy. It will also positively impact the operational efficiency of the banks.TheUPI and Mobile wallets offered by the banks will support digital payment.RBI has stabilized and controlled outflow of money from banks, the inflow is helping in having a formal economy as compared to having an informal economy. As a result there is positive return in stocks of banking sector.

BSE Information Technology

The result of IT sector shows negative impact, the pre demonetization index return is 0.18516698and post demonetization index return is 0.017757713, but only demonetization can be held guilty for that, the US election also severely affected the IT stock due to fear of Donald Trump‘s future policies and tremors of

Brexit are beginning to subsidy. Demonetization probably impacts the least on stocks in this sector. For one, they get most revenue in Forex and secondly, they get everything via banking channels.

BSE Consumer Discretionary Goods & Services

The result of Consumer Discretionary Goods & Services shows that this sector also negatively affected. The pre demonetization return is -0.088498273 and post demonetization return is -0.535871513. The reason may be cash crunch faced by people. Hotels, alcohol, restaurants, consumer electronics, cigarettes etc. all are transacted by cash, so it is obvious that these companies will come under pressure.

BSE Realty

The result observes that real estate sector is severely affected, the pre demonetization return is - 0.153051207 and post demonetization return is much lower which is -0.8694753, Unaccounted cash has been sucked by the banks as part of demonetization, thus transacting through cash for these purposes is

Relatively impossible. Generally in India Real estate sector is used as a tool to convert black money into white money, so demonetization pushed those buyers who were ready to invest their black money in real estate. Thus there will be lower demand for the real estate properties in the market.

BSE Oil & Gas

The result shows that this sector does not see much of an impact. The demand has of course lowered which is marginal however; there are no adverse effects on the oil and gas sector. It is neither a positive situation nor negative. Things are in neutral state except for the minor shake due to the initial period of demonetization. The reason might be that Petrol pumps and gas refill stations were accepting old notes of Rs. 500 and Rs. 1000 up until 24th November.

BSE Metal

The analysis of metal sector shows that negative impact during the post demonetization period, the post demonetization return (0.141244753) is almost half of pre demonetization return (0.282599387), because High value cash transaction on metal is quite common is India; those who are involved in such activities have been highly impacted. This is also a safe haven so far for converting black money into white money. Converting investment or money into the form of gold and other precious metals is no more an easy task.

BSE Industries

The impact of demonetization is greatly seen on industries. The index observes the pre demonetization return is -0.125648627 and post demonetization return is -0.437866327. The unorganized industries are adversely affected than organized industries. The manufacturing sector observed severely affected. As the impact of demonetization is not just on one sector but on the industry on the whole, there is definitely an impact on all sectors either with short term effect or adverse long term effect.

Conclusion:

The research paper examines the impact of demonetization on selected sectoral indices of Bombay Stock Exchange. On the basis of empirical results we can conclude that the cash dependent and consumption based sectors have been negatively impacted, on the other hand the financial sectors are the biggest beneficiaries. Further it can be said that the demonetization impact will be far reaching on stock markets and stock investors. At this stage, things are not crystal clear and more clarity will emerge with the time.

Besides demonetization other factors also affected the BSE like Donald Trump‘s election as president of the US and the subsequent rise in US bond yields and the strengthening of the dollar. That has led to funds flowing out from emerging markets and India too has been affected. However, it seems that once the short term impact of demonetization is over, Indian equities will likely bounce back sharply. The wide spread negative returns across sectors after demonetization reflect the immediate negative sentiments attached with the overall economic activity. However, with Jean Druze calling demonetization a big gamble for India, the possibility of a favorable outcome cannot be ruled out. The possibility of these effects being temporary may seem to be a ray of hope. The stock market in India has fallen a bit more in comparison with emerging Asian markets. The SENSEX comprises large companies which might be affected as much by the step of demonetization. The significant impact of the demonetization will be in the unorganized sector which isn‘t reflected in the markets.

References

Singh, P., &Singh, V. (2016). Impact of Demonetizations on Indian Economy. Retrieved 10 January 2017 from http://data.conferenceworld.in/IFUNA18DEC16/P290-300.pdf

Shah, H. (2016). Demonetization and its impact on stock market. Retrieved 10 January 2017 fromhttp://www.traderguide.in/blogs/2353/demonetization-and-its-impact-on-the-stock-ma

Bhatia, N.(2017).Demonetization Impact on the Stock Market and Stock Investors. Retrieved 26 January 2017 fromhttp://www.nitinbhatia.in/stocks/demonetization-impact-stock-market/

Sharma, R. (2016).Demonetization: Impact on stock markets. Retrieved 15 December 2016 from http://www.blog.sanasecurities.com/demonetisation-impact-stock-markets/

Patel, M. (2016).How does the demonetization affect different sectors? Retrieved 15 February 2017 fromhttp://www.moneylife.in/article/how-does-the-demonetisation-affect-different sectors/48769.html

Chakravarty, M. (2017).How much has demonetization affected the stock market? Retrieved 20 January 2017 from http://www.livemint.com/Money/hRb1noUQV17fmP0o1GNQEJ/How-much-has- demonetisation-affected-the-stock-market.html

Vijay, P.K. (2016). Impact analysis of demonetization in India. Retrieved 10 January 2017 from http://www.moneycontrol.com/news/business/economy/impact-analysisdemonetizationindia-920030.html

Bhathija, K.&Eluri, K. (2016). Indian stock market outlook downgraded as banknotes ban hits economy - Reuters poll. Retrieved 5 March 2017 from http://in.reuters.com/article/india-stocks-poll-cash-ban- idINKBN13W0BC

Reserve Bank of India (2017).Macroeconomic Impact of Demonetization- A Preliminary Assessment. Retrieved from 15 March 2017
https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/MID10031760E85BDAFEFD497193995BB1B6DBE6 02.PDF

Krishnan, D. & Siegel, S. (2017) Survey of the Effects of Demonetization on 28 Slum Neighborhoods' in Mumbai. *Economic & Politically Weekly*, 52(3),

Sri-Kumar, K. (2017). What India's Demonetization Means for Investors. Retrieved 20 February from https://www.bloomberg.com/view/articles/2017-02-10/what-india-s-demonetization-means-for-investors

Roy, K.S. (2016). Winners and losers from demonetization A look at how the demonetization move will affect certain sectors and stocks in India. Retrieved 15 January 2017 from https://www.valueresearchonline.com/story/h2_storyView.asp?str=32446

Varun, A.P. (2016). Demonetization Effects And The Indian Market. Retrieved 5 March 2017 from https://www.bytekid.com/demonetization-effects-indian-market/

Pimputkar, S. (2016). India‘s History with Demonetisation: From 1946 to 2016. Retrieved 10 January 2017 from http://www.freepressjournal.in/featured-blog/indias-history-with-demonetisation-from-1946- to-2016/988212

Websites:

http://www.business-standard.com/article/markets/demonetisation-effect-markets-could-see-a-correction- say-analysts-116110801572_1.html

https://financebuddha.com/blog/demonetization-its-impact-so-far

https://www.fundzpark.com/general/effect-demonetization-stock-prices/

http://www.investopedia.com/terms/d/demonetization.asp

http://www.investarindia.com/blog/effect-demonetization-indian-stock-market/http://www.livemint.com/Money/hRb1noUQV17fmP0o1GNQEJ/How-much-has-demonetisation-affected-the-stock-market.html

http://marketrealist.com/2016/11/can-demonetization-impact-indian-economy/
http://www.motilaloswal.com/article.aspx/1157/Demonetizations-Effect-on-Share-Market
https://en.wikipedia.org/wiki/2016_Indian_banknote_demonetisation
http://www.ijtrd.com/papers/IJTRD7783.pdf http://mkerj.com/demonetisation-of-indian-currency-a-detailed-study-part-2/ http://www.thehindu.com/opinion/op-ed/Not-a-tragedy-but-the-remedy/article16798081.ece