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Impact of Demonetization on Indian Stock Market

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Abstract

Demonetization is the act of stripping a currency unit of its status as legal tender. On 8 November 2016, the Government of India announced the demonetization of all Rs.500 and Rs.1, 000 banknotes of the Mahatma Gandhi Series. The sudden nature of the announcement—and the prolonged cash shortages in the weeks that followed—created significant disruption throughout the economy, threatening economic output. The move was heavily criticized as poorly planned and unfair, and was met with protests, litigation, and strikes. The aim of this project is to study the impact of demonetization and its effects on stock market. The historical data was collected for 54 companies from 13 different sectors. The data collected from 1 July 2016 to 28 Feb 2017 was analyzed to test whether there is a significant difference in average price, total traded quantity and total trades before and after demonetization.

Keywords: demonetization, impact, cash shortage, protests, litigation, data, normal distribution, one sample two tailed test, difference in trades

I Introduction

Demonetization is the 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 pulled from circulation and retired, often to be replaced with new notes or coins. The government has implemented a major change in the economic environment by demonetizing the high value currency notes – of Rs 500 and Rs 1000 denomination on 8th November 2016. The RBI issued Two thousand rupee notes and new notes of Five hundred rupees which were placed in circulation

from 10th November 2016. Notes of one hundred, fifty, twenty, ten, five, two and one rupee will remain legal tender and will remain unaffected by this decision. The government's goal (and rationale for the abrupt announcement) was to combat India's thriving underground economy on several fronts: eradicate counterfeit currency, fight tax evasion (only 1% of the population pays taxes), eliminate black money gotten from money laundering and terrorist-financing activities, and to promote a cashless economy. The aim of the action was to curb corruption, counterfeiting, and the use of high denomination notes for terrorist activities and especially the accumulation of black money, generated by income that has not been declared to the tax authorities. According to Dr.Balamurugan and Hemalatha (2017), the sudden move to demonetize Rs 500 and Rs 1,000 currency notes is not new. Rs 1,000 and higher denomination notes were first demonetized in January 1946 and again in 1978. The highest denomination note ever printed by the Reserve Bank of India was the Rs 10,000 note in 1938 and again in 1954. But these notes were demonetized in January 1946 and again in January 1978, according to RBI data. Rs 1,000 and Rs 10,000 bank notes were in circulation prior to January 1946. Higher denomination banknotes of Rs 1,000, Rs 5,000 and Rs 10,000 were reintroduced in 1954 and all of them were demonetized in January 1978. The move was enacted under the High Denomination Bank Note (Demonetization) Act, 1978. It was termed as "an Act to provide in the public interest for the demonetization of certain high denomination bank notes and for matters connected therewith or incidental thereto." The Rs 1,000 note made a comeback in November 2000. Rs 500 note came into circulation in October 1987. The move was then justified as attempt to contain the volume of banknotes in circulation due to inflation. However, in the days following the demonetization, banks and ATMs across the country faced severe cash shortages. The cash shortages had detrimental effects on a number of small businesses, agriculture, and transportation, while people seeking to exchange their notes had lengthy waits, and several deaths were linked to the rush to exchange cash but 36 years before during the situation of demonetization, higher value notes were almost I'm possible to possess by the common man given the value of these amounts then. It has been a choppy ride for the Indian equity markets that had been hit by the demonetization and the surprise victory of Donald Trump in the US Presidential elections, exactly a month ago on November 8. India's Nifty (down 3.5%) was the second worst performing index in Asia after Philippines, and the fourth globally – after Mexico (down 5.9%), Brazil (4.3%) and Philippines (down 3.9%). The frontline benchmark indices – S and P BSE Sensex and the Nifty50 – that lost around 7.5% during the month, though

have managed to recoup some losses. The Nifty50 index, for instance, hit an intra-day low of 7,916 levels on November 21 has clawed back to 8,200 levels by December 08.

II. Methodology

Stock market data for various sectors are collected from National Stock Exchange. The data collected from July 2016 to Feb 2017 was assumed to be in normal distribution and analyzed to test whether there is a significant difference in average price, total traded quantity and total traded value before and after demonetization. The data was analyzed using one sample two tailed test

III. Literature Review

Demonetization announced on November 8, 2016 was aimed at addressing corruption, black money, counterfeit currency and terror financing. 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. In addition to its impact on the agrarian sector, demonetization also had a significant impact on the informal sector, which currently employs more than 80% of India's workforce, including through micro, small and medium enterprises (MSME). MSMEs are heavily cash dependent, often managed by individual proprietors with small turnovers, limited reserves and access to finance. According to Peter and Reema (2017), demonetization caused serious disruptions to such businesses, many of which were already struggling due to the steady decline in credit flows and a surge in non-performing assets in rural banks. This reportedly led to a substantial drop in production. According to Dr.Sumathy and Savitha (2017), demonetization has affected every Indian, but it has hit the agricultural sector the hardest. Agriculture in

India accounts for 50% of the workforce. Farmers, who are the backbone of our national economy, were severely affected by the note demonetization of which invalidated 86% of India's currency. Most of them will get loans from cooperative banks which now don't have cash to supply them. So farmers cannot buy seeds, fertilizers and other things required for farming The cash transactions in this economy are far more than the total number of electronic transactions done on a daily basis. Agriculture is truly dependent upon cash transactions via cash is direct burden to the farmers markets because they should purchase all their agriculture inputs even bigger landholders may face problems such as paying daily wages to the farmers and purchasing agricultural needs for growing

crop. According to GeetaRani (2016), the production for some companies has been impacted by the non-availability of select raw materials (e.g., agri- commodities). Companies are also cutting down production to adjust for the unanticipated rigger levels of unsold finished goods across the supply chain. Supply chains are further getting affected by the cash crunch faced by transportation vendors. Traders and distributors are unable to pick up stock because of the liquidity crunch, which is leading to manufacturers extending the credit period. Demand disturbances are likely to have an impact on the credit-repayment ability of traders and distributors in the near future, leading to defaults. There are 118.9 million cultivators across the country (or 24.6% of the total workforce of over 481 million) and 144.3 million are agricultural laborers, with over 600 million Indians dependent on agriculture. According to Dr.Rathore (2017), demonetization has severely hurt this sector, which includes farmers and daily wage laborers, and employs 93 per cent of India's workers. Indian farmers use cash transaction for buying seeds and fertilizers, for trading products and also for trading commodity. Daily agriculture laborers are paid in cash and cash is used daily for buying utility items and grocery. With 78 branches per million people in rural and semi-urban areas and the total number of KCC in India are 79.6 million, around 80 per cent of farmers are bound to suffer. The Indian real estate sector has been facing significant challenges in the past few years in terms of sales and overall growth. As against general perception, real estate prices actually increased across the country during the demonetization quarter going by latest House Price Index figures released on RBI's website. According to Dr.Balamurugan and Hemalatha (2017), the all India House Price Index (HPI) increased by 2.3% from 234.9 for second quarter of 2016-17 to

240.2 in Q3 (October to December 2016) of 2016-17 as per provisional figures. This quarter would reflect the impact of demonetization of the old Rs 500 and Rs 1000 notes by the government on November 8, 2017. The rubber market, already in the doldrums due to factors like fall in price and collapse of a few prominent rubber marketing societies, has been dealt a severe blow by demonetization. The domestic rubber market reeling under the impact of demonetization has not gained anything from the rise in the prices in the international market which have hit a three-year high. The tight supply-demand situation, expectations of further firming up of crude oil prices and buoyant demand from China have helped in scaling up the prices in the global markets. Thelatest figures from automobile sector are also painful enough for rubber growers in the country. Natural rubber is used more in the tyres of commercial vehicles. On account of demonetization commercial

vehicles sales is down by 11.58 per cent in November this year. Meaning reduced consumption from the industry.

IV. Conclusion

The demonetization undertaken by the government is a large shock to the economy. The impact of the shock in the medium term is a function of how much of the currency will be replaced at the end of the replacement process and the extent to which currency in circulation is extinguished. By analyzing trades data of various sectors, it is found that the impact of demonetization varies from one sector to another. From the analysis of results, following conclusions are made. Average price

• About 44.44% of total companies analyzed, showed a difference in average price after demonetization, when average price and total trades showed a significant difference.

• 50% of the companies showed an increase in average price after demonetization and 37.04% of the total companies had a significant increase in average price.

• From the sector-wise analysis, automotive, cotton, paper, rubber and steel showed an increase in average price while cement, clothing, foods, real estate, retail, sugar, tea and textiles showed a decrease after demonetization

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