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DEMONETISATION AND ITS IMPACT ON INDIAN FINANCIAL MARKETS

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Abstract
Due to recent Demonetization in India, the old currency notes of INR 500 and INR 1000 which were 86% of the currency in circulation were taken out of the economy. This sudden and gigantic step has not only affected black money and terrorism but also all the sectors of economy. This research is focused on the demonetization and its impact on financial markets-capital market and money market which includes mutual fund, life insurance, NBFC, foreign currency, stock index and stock prices; bank's credit growth, interest rates, payments methods, role of cooperative banks, negative involvement of Jan-dhan accounts before, during and after demonetization. This research focused on understanding perception of Bank employees towards demonetization understanding the post demonetization impact on various financial sectors. In this study primary data is collected with the help of a survey rolled to bank employees to know the impact of demonetization.

Keywords: Demonetization, Financial Market.

Introduction
In an important move, the Government of India declared that the five hundred and one thousand rupee notes will no longer be legal tender from midnight, 8th November 2016. They will be just pieces of paper with no value. Notes of one hundred, fifty, twenty, ten, five, two and one rupee remained legal tender and remained unaffected by this decision. This is not for the first time that India has experienced demonetization.

Demonetization
Demonetization is an act of removing a currency from its status of legal tender; this causes a change in the national currency of a country. In this step current circulated currency is pulled back from the circulation; it is replaced with other new notes and can only be exchanged at the banks. Demonetization can be partly and fully; sometimes countries completely changes the old notes with new notes and with changed denomination. The government being sovereign can take such decision.

Review of Literature
Each policy has its own cost and benefits, same is the case with demonetization as well. There is a positive expectation regarding this step as it will act as a tool to curb out corruption, fake money and terrorism, but again that outcome is dependent upon the proper execution of the policy**. Insight, (2016)** stated that this step was taken for three motives viz; to remove Parallel economy, terror financing and circulation of fake currency. This study found that this step will keep a check on black money that is kept in cash and forms only 4% of the total black money, rest the black money is kept in the form of land, buildings, gold and in abroads. So this policy will have a limited scope only**. Ramdurg & CS, (2016)** were also of the view that the tool of Demonetization can be used to eradicate parallel economy. Demonetization is one of the big steps initiated by Government in addressing the various issues like black money, counterfeit currency, corruption, terrorism etc. History of demonetization in India and around the world is addressed. Lesson from historically demonetization guides us how to redefine economy of country by overcoming the earlier causes for failure. Demonetization obliviously brings many inconveniences to common people but it is for only short term. However the long term benefits of demonetization overrides the short term challenges. Government initiatives like Income Declaration Scheme 2016, Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act 2015, Joint Declaration of AEOI between India and Switzerland to address black money etc. in redefining Indian economy are to be appreciate and these initiatives leaves their footsteps as part of history. **Tax Research Team, (2016)** analyzed the short term and medium term impact of demonetization in the economy. The demonetization done by the government is a large shock to the economy. The short term impact of this step can be assessed as how much currency is replaced as compare to the extinguished currency from the circulation. This study stated that it is considered that this process will help to abolish black money. Black money is unauthorized illegal money generated with the help of illegal resource and is undisclosed to the government. Demonetization will be help full in eradicating black-money, as this process will help to disclose the hidden funds, demonetization will help in reducing the hidden cash. Moreover current step of demonetization is taken after initiating the process of making identity of people in the form of Aadhar card, secondly by providing a better platform in the form of opening bank account under Jan Dhan Yojna. So it seems like this step would be beneficial in curbing black-money out of economy. **Kaur, (2016) was also** it illustrated mostly all the positive impacts of demonetization. This study stated that this step will help in regulating the prices of real estate, will help in reducing interest rate, and will keep a check on inflation besides it will show a negative impact on GDP for short time duration. This step will have positive impacts on sectors like Banking and Infrastructure in the medium to long term and might have negative impacts on F Consumer Durables, Luxury items, Gems and Jewellery, and Real Estate in medium term.

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This move can lead to improved tax compliance, better fiscal balance, lower inflation, lower corruption, complete elimination of fake currency and another stepping stone for sustained economic growth in the longer term. **Sabnavis, Sawarkar, & Mishra, (2016)** was of the view that government will reduce the money supply in the economy initially but gradually it will get its pace back and supply of money will be normal. Due to decrease in money supply purchasing power of consumers will be less, there will be decrease of demands of various commodities, due to decrease in demand prices of various commodities will tend to be go down and it will hamper the various economic activities in many sectors like gold, luxurious items, real estate and many more industries where there is need of huge funds to do transactions. This process will ultimately reduce Gross Domestic Product (GDP) in the economy. But this study stated that these are the transitory effects ultimately in the long run this step will help to reduce the level of counterfeit currency in the economy. Govt. will be benefitted by this step as this step will help in of reducing liability and increasing finances for the government. With this step Govt. will be able to get money to finance their expenditures without borrowing from the markets. This study stated that this step will be beneficial for sectors like banking and infrastructure for medium time period; negative impacts on gems and jewellery, consumer durables, luxurious items and real estate in short to medium time duration. But this step will help to improve tax implications, lowering inflation, lowering corruption, black money and bringing growth and development in the economy in the long time period**.**

There are many studies to measure the impact of demonetization on Indian economy as a whole, but there are very few studies to analyse the impact of demonetization on Indian Financial Market. So this study is focused to analyse the impacts of demonetization on Indian Financial market.

Objective of the Study
The objective of the study is to analyze the impacts of Demonetization on Indian Financial Market. This includes these various objectives-

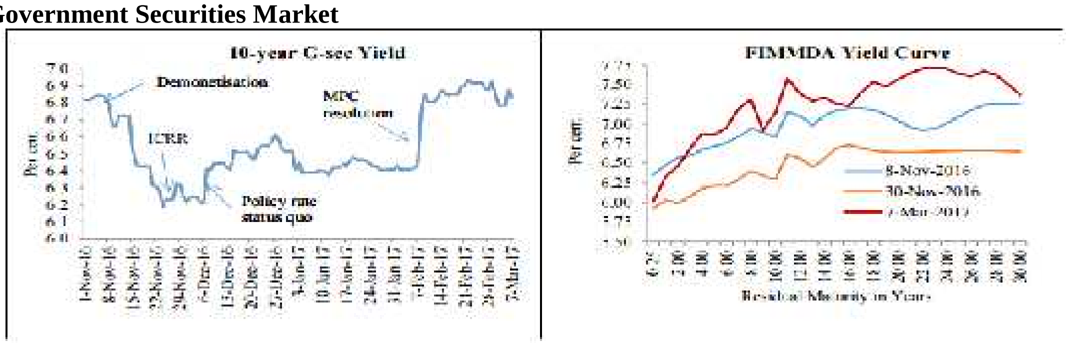
- To analyze the impacts of demonetization on Money Market, Long term Govt.-sector and Bond's market, Banking, Stock Market, Mutual Funds, Insurance, foreign exchange and on cash less transactions.

Research Methodology
In this study both primary and secondary data is used to find out the impacts of demonetization on Indian Financial Market. Secondary data is collected from various banking sites, site of RBI and from various Books, Articles, Blogs, Papers, and other available sources regarding various financial indicators like interest rate, repo rate and bank credit etc. Primary data is collected by the use of a survey regarding the impacts of demonetization filled from bank employees and tried to know their perception toward demonetization. In this study sample size was taken as 30, survey was get filled by 50 bank employees.

Analysis
Impact on Money Market
Despite large surplus liquidity, active liquidity management by the Reserve Bank ensured that the weighted average call money rate (WACR) – the operating target of monetary policy – traded around the repo rate (during November 8 to November 25), but with a softening bias (23 bps on an average). With the announcement of the incremental CRR of 100 per cent on November 26, banks borrowed aggressively on November 28 (November 26 and 27 being holidays) from both the Reserve Bank and money markets to meet the additional reserve requirement. This pushed up the WACR above the repo rate on November 28. However, this impact was short-lived and the WACR started trading again with an easing bias (21 bps on an average) from December 1, reflecting the persisting surplus liquidity conditions.

Overnight MCLR, overnight CBLO, overnight market repo, notice money rate, 91 days T Bills, 182days T Bills and 364 days T Bills rates are also decreased by 14 to 90 bps after demonetization which is represented in the chart. 3-month CD rates softened by about 22 bps while the 3-month CP rate declined by 9 bps post demonetization. This is shown in the figure given below-

Impact on Government Securities Market



The 10-year gilt yield softened from 6.80 per cent (November 8, 2016) to as low as 6.18 per cent (November 24, 2016). It rose to 6.33 per cent on November 28 with the announcement of the incremental CRR effective November 26, which helped maintain integrity of the yield curve. Following the MPC's decision to pause on December 7, the 10-year benchmark yield hardened by 21 bps and traded in a range-bound manner but with a hardening bias up to end-December. This was also supported by global developments, including US monetary policy tightening and subsequent hardening of US yields driving FPI outflows from EMEs, including India, and higher crude prices. Between end-December 2016 and early February 2017, however, the benchmark yield traded with a softening bias on continuing surplus liquidity conditions and the reduction in the government borrowing programme for January-February 2017.

Bond yields firmed up significantly over two successive days after the announcement of the change in the monetary policy stance from accommodative to neutral on February 8, 2017 by the Monetary Policy Committee (MPC). Yields have remained firm thereafter. The spread between 30-year and 10-year yields declined from 41 bps on November 8, 2016 to 35 bps on November 30 and further to 23 bps on March 7, 2017

Impact on Banking Credit

Under normal conditions bank credit generally picks up in November for agriculture, manufacturing and services sectors as well. Last year in November bank credit had gone up, compared with the previous month. However with demonetization being announced in the beginning of November this year, bank credit growth has been affected. The gross Bank credit has gone down in November 2016 over October 2016. Almost major sectors excluding housing have shown a contraction in bank credit in November 2016

Credit in services sector was affected adversely, particularly credit for retail trade. This was more due to the backward effect of lower household consumption on account of the non-availability of cash which affected the purchasing pattern. The contraction seen in Services in November 2016 was significantly larger than the reduction seen in the corresponding period last year. Personal Loans including education, vehicle loans, etc. also were impacted as demand in these sectors declined same happened with Farm loans too.

Impact on Bank's Interest Rates

Bank's Lending Rate

To understand the impact of demonetization on lending rate, instead of taking any specified loan rates, MCLR is taken here for comparing pre demonetization (7th November,2016) and post demonetization (7th January, 2017) interest rates of various banks. MCLR- Marginal Cost of Lending Rate is the benchmark lending rate at which a bank prices all its loans.

Banks have cut their MCLR ranging from 15bps to 90bps. No rate cuts were given in this period by RBI in the monetary policy. So we can say that excessive deposits due to demonetization have influenced banks to cut their lending rates.

Bank's Borrowing Rate

To understand the impact of demonetization on borrowing rate, One year Fixed Deposits rates are taken here for comparing pre demonetization (7th November,2016) and post demonetization (7th January, 2017) interest rates of various banks. Banks have cut their FD rates ranging from 5bps to 30bps. No rate cuts were given in this period by RBI in the monetary policy. So excessive deposits due to demonetization have influenced banks to cut their borrowing rates.

Impact on Bank Employees

A survey was done on 30 employees of various banks and their responses are represented below.

As per **Graph A**, 73% Employees said they faced moderate inconvenience, 20% faced severe inconvenience while there were only 7% employees who didn't face any inconvenience. Such problems they faced were as follow-

- Paucity of work force as well as machines to open sufficient number of counters to tackle the crowd.
- There was non-availability of relieving hands to enable them to attend natures call as well as have their Tiffin.
- Even female employees are asked to perform the duties by sitting late in the night without following the norms laid under Shop and Establishment Act where they are supposed to be escorted to their destination if they perform their duties beyond 8pm.
- Even after facing such hurdles and working overtime, 87% of staff didn't get any incentives for that period while 13% staff got incentives. **(Graph G)**

As per **Graph C**, 73% of employees said their banks were not supplied with enough cash. There were also insufficient numbers of scanner machines to detect forged/fake notes. There was short supply of Rs100 denomination notes and non-

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supply of new Rs 500 denomination notes which led to abusive language from the customers on the staff for not being able to give them required cash due to reasons beyond their control. RBI and government were changing guidelines on regular basis and without any notice so 60% of employees said they were not getting such changed guidelines on time and 40% of staff said they were getting new the guidelines on time **(Graph D).** 54% bank employees also felt that Jan Dhan accounts were misused during this move **(Graph E)** while 33% didn't agree with that and 13% couldn't say anything about it. This is also supported by data that in just 45 days after demonetization, the amount of deposits got doubled in those accounts. 87% staff felt RBI and Government were well prepared while implementing this move while 13% employees couldn't find them well prepared **(Graph B).**

As shown in **Graph H**, 43% believed this move should have been implemented in several phases not suddenly and directly without any prior notices while 57% said the way it implemented, in one go, is better. Though they faced inconvenience, 87% of the surveyed employees felt that this move will help in strengthening banking sector in India. While 13% didn't feel the same. **(Graph F)**

Impact on Cash-Less Transactions

After the announcement of demonetization, digital activity levels were low in the initial weeks as people were busy depositing/exchanging SBNs. However, in December 2016, digital payment activity increased alongside progressive remonetisation. The usage statistics show that the y-o-y growth for major modes of electronic payments was good in October 2016, mainly on account of festive season. The continuance of that high growth with a further pick up in some components from November to January 2017 was positive fallout of demonetization. However, the pace of growth moderated somewhat in February 2017.

Impact on Equity Market

Demonetization coincided with the US presidential election results announced on November 8, 2016. The victory of Donald Trump amplified concerns surrounding more protectionist trade policies in the US, on top of expectations of tightening of US monetary policy, and possibly looser US fiscal policy. Reflecting these developments, the Indian equity market plummeted, with the BSE Sensex declining by 3.5 percent (up to December 30, 2016) from its level on November 8, 2016. Disappointing quarterly earnings results from some blue-chip companies also impacted the equity market.

Although the equity market was affected by both domestic and global factors, the impact of demonetization alone can be gauged from the movement in indices of cash sensitive sectors such as FMCG, consumer durables, auto and realty vis-a-vis the overall index. As against the decline of 3.5 per cent in the BSE Sensex (from November 9 to December 30), the BSE realty index declined by 14.4 per cent, followed by consumer durables (-9.9 per cent), auto (-9.0 per cent) and FMCG (-5.3 per cent) indicating market expectation of a sharp fall in demand for these products, as they were disproportionately driven by cash transactions. However, the impact on sectoral indices was transitory as they have since recovered most of the lost ground. As against the overall increase of 8.9 per cent in the BSE Sensex between March 7, 2017 and December 30, 2016, the BSE consumer durables index increased by 23.0 per cent, followed by realty (18.8 per cent), FMCG (8.7 per cent) and auto (7.2 per cent) during this period. On the whole, while consumer durables, FMCG and realty indices are now higher than their pre-demonetization levels, the auto sector is marginally lower. The equity market was buoyed by the encouraging corporate sector results for Q3. The results of the listed companies for Q3 of 2016-17 suggest that the corporate sector remained resilient as sales and net profits improved at an aggregate level as also for manufacturing companies. Within manufacturing, sales of cash intensive sectors such as FMCG and motor vehicle companies got impacted in Q3 vis-à-vis the previous quarter. However, the companies in the real estate sector registered positive sales growth in Q3 in contrast to the sharp contraction in the previous quarter.

The share prices of most of the large listed NBFCs also registered a significant decline between November 8, 2016 and December 30, 2016 mainly due to the cash intensive nature of their businesses and delayed repayment. However, the share prices of most of such companies have recovered fully/partially after December 2016.

Impact on Mutual Funds

Reduction in deposit interest rates by banks after demonetization enhanced the relative attractiveness of debt oriented mutual funds (MFs). As a result, there were net inflows in income/debt schemes during November 2016-January 2017 in contrast to net outflows during November 2015-January 2016. This was reflected in a sharp increase in the overall resources mobilized by mutual funds during November 2016-Janauary 2017 in contrast to outflows in the same period of last year.

Impact on Life Insurance Companies

Premiums collected by life insurance companies more than doubled in November. Premiums collected by Life Insurance Corporation of India (LIC) increased by more than 140 per cent (y-o-y) in November 2016 as compared with less than 50 per

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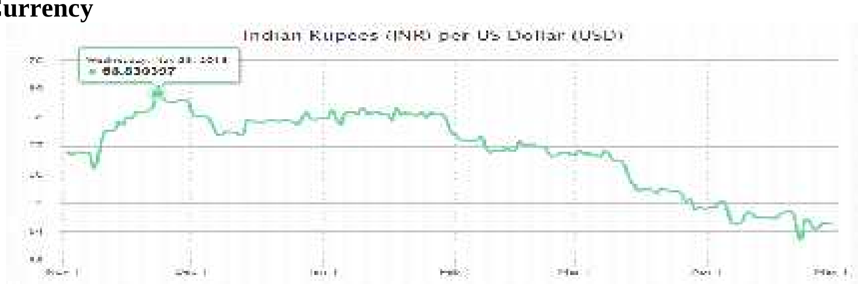
cent by private sector life insurance companies. About 85 per cent of the total collections by LIC in November 2016 were under the ‘single premium’ policies, which are paid in lump sum, unlike the non-single premium policies that can be paid monthly, quarterly or annually. LIC 22 of India effected a downward revision in the annuity rates of its immediate annuity plan Jeevan Akshay VI purchased from 1st December 2016, which might have created a spurt in collections in the month of November 2016 for LIC of India. The impact, however, seemed to be a one-time jump with the collections tapering subsequently.

Impact on Foreign Currency



Period	Stronger	Weaker	Same
Before Demonetization	93	67	1
After Demonetization	143	17	1

INR reached historic low immediately after demonetization but it started strengthening after that and as described in the table; INR was stronger than 93 currencies before demonetization while it is now stronger than 143 currencies.

Conclusion

Demonetization has shown short term negative and long term positive impact in major sectors of finance. Gross bank credit in November 2015 increased for 444.2 Rs billion from October 2015 while the same October to November change in the credit (which almost every year has positive figure) amounted to -1060.2 Rs billion. Banks have cut their MCLR from 15bps to 90bps after demonetization. Banks have cut their FD rates from 5bps to 30bps after demonetization. Money market rates are decreased (14-90 bps) after demonetization. Government Securities and Bond prices were decreased exactly after demonetization for a few days but they were again increased significantly after some days. Stock prices were decreased in the month of demonetization but it recovered after that. Digital transactions were also lowered in volume and value immediately after Demonetization but that too recovered. Mutual fund Investments were significantly increased after demonetization. Very high amount of premium was received by insurance companies in the month of demonetization. In this study short term (month) negative and long term positive impacts were also seen on value of INR. So it can be said that demonetization is having more positive impacts than the negative impacts.

Scope and Limitations

As it has been only a few months of demonetization, scope of the study is limited to data of that short period. Study includes detailed impact analysis of only various financial markets, not of other areas like real estate, commodities or economic parameters like GDP, inflation etc. Sample size used for survey limited so it may not represent a large portion of population.

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