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## “Impact of Demonetisation on Indian Stock Market”

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### **Abstract:**

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.

On 8 November 2016, the Government of India announced the demonetisation of all 500 and 1,000 banknotes. The main objective is to know the Impact of Demonetisation on Indian Stock Market. The research design is descriptive research design. The secondary data was mainly collected from RBI's web site and nseindia.com. This study covers a period of only 50days, 30 days and 10days before and after 8-november-2016. we used Pair sample t-test and regression to analyze the data. The result of the study indicate that short term period (before and after 10 days and 30 days) effect of demonetisation is highly negative correlation and gradually (before and after 50 days) there is no correlation. From this study we can say that demonetisation doesn't impact on impact on Indian stock market.

### **About Demonetisation**

On 8 November 2016, the Government of India announced the demonetisation of all 500 and 1,000 banknotes. The government claimed that the action would curtail the shadow economy and crack down on the use of illicit and counterfeit cash to fund illegal activity and terrorism. 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 criticised as poorly planned and unfair, and was met with protests, litigation, and strikes.

Prime Minister of India announced the demonetisation in an unscheduled live televised address at 20:00 Indian Standard Time (IST) on 8 November. In the announcement, He declared that use of all rs500 and rs 1000 banknotes would be invalid past midnight, and announced the issuance of new rs. 500 and rs 2000 banknotes in exchange for the old banknotes.

The BSE SENSEX and NIFTY 50 stock indices fell over 6 percent on the day after the announcement. In the days following the demonetisation, the country faced severe cash shortages with severe detrimental effects across the economy. People seeking to exchange their bank notes had to stand in lengthy queues, and several deaths were linked to the inconveniences caused due to the rush to exchange cash.

### **Background**

The Indian government had demonetised bank notes on two prior occasions—once in 1946 and then again in 1978—and in both cases, the goal was to combat tax evasion by "black money" held outside the formal economic system. In 1946, the pre-independence government hoped demonetisation would penalise Indian businesses that were concealing the fortunes amassed supplying the Allies in World War II. In 1978, the Janata Party coalition government demonetised banknotes of 1000, 5000 and 10,000 rupees, again in the hopes of curbing counterfeit money and black money.

In 2012, the Central Board of Direct Taxes had recommended against demonetisation, saying in a report that "demonetisation may not be a solution for tackling black money or economy, which is largely held in the form of benami properties, bullion and jewellery." According to data from income tax probes, black money holders kept only 6% or less of their wealth as cash, suggesting that targeting this cash would not be a successful strategy.

On 28 October 2016 the total banknotes in circulation in India was ₹ 17.77 trillion (US\$260 billion). In terms of value, the annual report of Reserve Bank of India (RBI) of 31 March 2016 stated that total bank notes in circulation valued to ₹ 16.42 trillion (US\$240 billion) of which nearly 86% (around ₹14.18 trillion (US\$210 billion)) were ₹ 500 and ₹ 1,000 banknotes. In terms of volume, the report stated that 24% (around 22.03 billion) of the total 90266 million (9026.6 crore) banknotes were in circulation.

In June, the Government of India had devised the Income Declaration Scheme, that lasted till 30 September 2016, providing an opportunity to citizens holding black money and undeclared assets to avoid litigation and come clean by declaring their assets, paying the tax on them and a penalty of 45% thereafter.

### **Advantage of Demonetisation**

1. The biggest advantage of demonetization is that it helps the government to track people who are having large sums of unaccounted cash or cash on which no income tax has been paid because many people who earn black money keep that money as cash in their houses or in some secret place which is very difficult to find and when demonetization happens all that cash is of no value and such people have two options one is to deposit the money in bank accounts and pay taxes on such amount and second option is to let the value of that cash reduced to zero.
2. Since black money is used for illegal activities like terrorism funding, gambling, money laundering and also inflating the price of major assets classes like real estate, gold and due to demonetization all such activities will get reduced for some time and also it will take years for people to generate that amount of black money again and hence in a way it helps in putting an end this circle of people doing illegal activities to earn black money and using that black money to do more illegal activities.

3. Another benefit is that due to people disclosing their income by depositing money in their bank accounts government gets a good amount of tax revenue which can be used by the government towards the betterment of society by providing good infrastructure, hospitals, educational institutions, roads and many facilities for poor and needy sections of society.

### **Disadvantage of Demonetisation**

1. The biggest disadvantage of demonetization is that once people in the country gets to know about it than initially for few days there is chaos and frenzy among public as everybody wants to get rid of demonetized notes which in turn sometimes can lead to law and order problem and chaotic situation especially in banks and ATMs which are the only medium to change the old currency units to new currency units.
2. Another disadvantage is that destruction of old currency units and printing of new currency new units involve costs which has to be borne by the government and if the costs are higher than benefits then there is no use of demonetization.
3. Another problem is that majority of times this move is targeted towards black money but if people have not kept cash as their black money and rotated or used that money in other asset classes like real estate, gold and so on then there is no guarantee that demonetization will help in catching corrupt people.

### **Impact of Demonetisation on various sectors**

#### **Banking**

In the first four days after the announcement of the step, about ₹3 trillion (US\$45 billion) in the form of old ₹ 500 and ₹ 1,000 banknotes had been deposited in the banking system and about ₹ 500 billion (US\$7.4 billion) had been dispensed via withdrawals from bank accounts, ATMs as well as exchanges over the bank counters. Within these four days, the banking system has handled about 180 million (18 crore) transactions. The State Bank of India reported to have received more than ₹ 300 billion (US\$4.5 billion) in bank deposit in first two days after demonetisation. A spike in the usage of debit card and credit card post demonetisation was also reported.

Between November 10 and November 27, banks reported exchange and deposits of demonetised banknotes worth ₹ 8.45 trillion (US\$130 billion) (exchange of ₹ 339.48 billion (US\$5.0 billion) and deposits of ₹ 8.11 trillion (US\$120 billion)). During this period, an amount of ₹ 2.16 lakh crore (US\$32 billion) had been withdrawn by people from their accounts.

In Malda, a district believed to be a transit-point for fake Indian currencies, a large sum of cash deposits in dormant accounts were also reported. According to The Economic Times, more than 80 percent of fake currency in India originates from Malda district in West Bengal.

### **Hawala**

Mumbai Police reported a setback to Hawala operations. Hawala dealers in Kerala were also affected. The Jammu and Kashmir Police reported the effect of demonetisation on hawala transactions of separatists.

### **Railways**

As of November 2016, Indian Railways did not have the option to make payment with cards at the counters. After the demonetisation move, the government announced to make card payment options available at railway counters in the country. The railways placed an order for 10,000 card reader machines in January 2017.

### **Cash shortage**

The scarcity of cash due to demonetisation led to chaos, and most people holding old banknotes faced difficulties exchanging them due to endless lines outside banks and ATMs across India, which became a daily routine for millions of people waiting to deposit or exchange the ₹ 500 and ₹ 1000 banknotes since 9 November. ATMs were running out of cash after a few hours of being functional, and around half the ATMs in the country were non-functional. Sporadic violence was reported in New Delhi, but there were no reports of any grievous injury, people attacked bank premises and ATMs, and a ration shop was looted in Madhya Pradesh after the shop owner refused to accept ₹ 500 banknotes.

The CMD of Punjab National Bank said that panic after demonetisation started fading on 19 November 2016. As of 18 December 2016, there were still long queues at banks and ATMs. Three months after the withdrawal of banknotes, a quarter of the ATMs were still short of cash.

### **Stock market crash**

As a combined effect of demonetisation and US presidential election, the stock market indices dropped to an around six-month low in the week following the announcement. The day after the demonetisation announcement, BSE SENSEX crashed nearly 1,689 points and NIFTY 50 plunged by over 541 points. By the end of the intraday trading session on 15 November 2016, the BSE SENSEX index was lower by 565 points and the NIFTY 50 index was below 8100 intraday.

### **Transportation**

After the demonetisation was announced, about 800,000 truck drivers were affected with scarcity of cash, with around 400,000 trucks stranded at major highways across India were reported. While major highway toll junctions on the Gujarat and Delhi-Mumbai highways also saw long queues as toll plaza operators refused the old banknotes.

Nitin Gadkari, the Minister of Transport, subsequently announced a suspension of toll collections on all national highways across India until midnight of 11 November, later extended until 14 November and again until midnight of 18 November, and yet again till 2 December.

### **Agriculture**

Transactions in the Indian agriculture sector are heavily dependent on cash and were adversely affected by the demonetisation of ₹500 and ₹1,000 banknotes. Due to scarcity of

the new banknotes, many farmers have insufficient cash to purchase seeds, fertilisers and pesticides needed for the plantation of rabi crops usually sown around mid-November. Farmers and their unions conducted protest rallies in Gujarat, Amritsar and Muzaffarnagar against the demonetisation as well as against restrictions imposed by the Reserve Bank of India on district cooperative central banks which were ordered not to accept or exchange the demonetised banknotes.

The demonetisation led to unavailability of cash to pay for food products. The reduction in demand that arose in turn led to a crash in the prices of crops. Farmers were unable to recover even the costs of transportation from their fields to the market from the low prices offered. The prices dropped as low as 50 paise per kilo for tomatoes and onions. This forced the farmers across the country to dump their products in desperation. Some farmers resorted to burying unsold vegetables. Agricultural produce such as vegetables, foodgrains, sugarcane, milk and eggs were dumped on roads. Some farmers dumped their produce in protest against the government.

### **Business**

By the second week after demonetisation of ₹500 and ₹1,000 banknotes, cigarette sales across India witnessed a fall of 30–40%, while E-commerce companies saw up to a 30% decline in cash on delivery (COD) orders. Several e-commerce companies hailed the demonetisation decision as an impetus to an increase in digital payments. They believe that it would lead to a decline in COD returns which is expected to cut down their costs.

The demand for point of sales (POS) or card swipe machines has increased. E-payment options like PayTM and Instamojo Payment Gateway, PayUMoney has also seen a rise. According to data of Pine Labs, the demand for its POS machines doubled after the decision. Further it states that the debit card transactions rose by 108% and credit card transactions by 60% on 9 November 2016.

### **Drop in industrial output**

There was a reduction in industrial output as industries were hit by the cash crisis. The Purchasing Managers' Index (PMI) fell to 46.7 in November from 54.5 in October, recording its sharpest reduction in three years. A reading above 50 indicates growth and a reading below shows contraction. This indicates a slowdown in both, manufacturing and services industries. The PMI report also showed that the reduction in inflation in November was due to shortage in money supply.

The growth in eight core sectors such as cement, steel and refinery products, which constitute 38% of the Index of Industrial Production (IIP), was only to 4.9 percent in November as compared with 6.6 percent in October.

### **Income tax raids and cash seizures**

The Finance Ministry instructed all revenue intelligence agencies to join the crackdown on forex traders, hawala operators and jewellers besides tracking movement of demonetised currency notes. Income Tax departments raided various illegal tax-evasive businesses in Delhi, Mumbai, Chandigarh, Ludhiana and other cities that traded with demonetised currency. The Enforcement Directorate issued several FEMA notices to forex and gold traders. Large sum of cash in defunct notes were seized in different parts of the country. In Chhattisgarh liquid cash worth of ₹ 4.4 million (US\$65,000) was seized.

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As of December 28, official sources said that the Income Tax department detected over ₹ 4,172 crore of un-disclosed income and seized new notes worth ₹ 105 crore as part of its country-wide operations. The department carried out a total of 983 search, survey and enquiry operations under the provisions of the Income Tax Act and has issued 5,027 notices to various entities on charges of tax evasion and hawala-like dealings. The department also seized cash and jewellery worth over ₹ 549 crore out of which the new currency seized (majority of them ₹ 2000 notes) is valued at about ₹ 105 crore. The department also referred a total of 477 cases to other agencies like the CBI and the Enforcement Directorate (ED) to probe other financial crimes like money laundering, disproportionate assets and corruption.

### **Seizures of ₹ 2000 notes**

Huge amounts of cash in the form of new notes were seized all over the country after the demonetisation. As of December 2016, over 4 crore in new banknotes of ₹ 2000 were seized from four persons in Bangalore, ₹ 33 lakh in ₹ 2000 notes were recovered from Manish Sharma, an expelled BJP leader in West Bengal, and ₹ 1.5 crore was seized in Goa. 900 notes of the new ₹ 2000 notes were seized from a BJP leader in Tamil Nadu. Around ₹ 10 crore in new notes were seized in Chennai.

As of 10 December, ₹ 242 crore in new notes had been seized. It was noted in the media that while people were dying in queues to obtain a few thousand rupees in cash, persons with the right connections were able to amass crores of rupees in new notes, thus rendering the demonetisation exercise futile.

It was announced by the government that the seized notes will be brought into the mainstream as soon as possible to ease out the cash problem. Earlier, agencies kept all seized material, including cash seizures, in their strong rooms as evidence till the case was adjudicated by the courts. The seized money was then deposited into the Consolidated Fund of India. Sometimes, income tax cases took years to resolve, still all seized material was kept in safe lockers of the tax department.

### **Job losses**

There was a loss of jobs due to demonetisation, particularly in the unorganised and informal sector and in small enterprises.

### **Literature and Views on Demonetisation:**

**Nischint Chawathe** (Financial analyst, Kotak Institutional Equities) Demonetisation of 86 per cent of currency in circulation will have significant short-term shock on most sectors. Demand curve is expected to remain weak in the medium term. Private investment should weaken further; a deflationary environment will require more monetary and fiscal intervention. Rate cuts may be on the way, but that can't help change risk aversion in the short term. **Govindarajan Chellappa** (MD- head of India research, Jefferies) The causes for disruption in financing activity would vary across segments ranging from deceleration consumption demand, concern about decline in collateral values and inability to provide an alternative payment mechanism when availing loans. These factors will likely affect near-term growth prospects. Timeline for restoration of normalcy is less clear, for now.

**Dr. Manmohan Singh** (Former Prime Minister; eminent economist; former RBI governor) Speaking at the Rajya Sabha, Dr. Singh has called demonetisation an “organised loot” , a “legalised plunder” and a “monumental mismanagement”. He even said that the National income would fall by 2 per cent, which in his mind was “an underestimate”. **Amartya Sen** (Leading economist; Noble Laureate; recipient of the Bharat Ratna) Calls the move authoritarian: In an interview with The Indian Express, Professor Sen said, “Only an authoritarian government can calmly cause such misery to the people - with millions of innocent people being deprived of their money and being subjected to suffering, inconvenience and indignity in trying to get their own money back.” **Says that the government claims that unless proven otherwise, all are potential hoarders of black money:**

**Neelkanth Mishra (MD-equity research, Credit Suisse)** says that as a positive move for the economy and long-term growth. The government is cracking down on black money, while the implementation of GST will ensure more tax compliance and reduce the amount of money in the shadow economy. However, it will be disruptive in the short term, as India is largely a cash-driven economy. **Devendra Joshi** (Strategist-Asia Pacific, HSBC) The current round of demonetisation is likely to disrupt the small business ecosystem in the near term, as the segment operates largely in cash. We see challenging times for real estate, small businesses and commercial vehicle finance. We don't see non-performing loan risk for consumption businesses but retail demand, especially for housing, may slow down.

**Arun Shourie** (Former economist at the World Bank; recipient of the Padma Bhushan and Union Minister) If the government was planning this for months, how could it be possibly so ill-prepared? In an interview with NDTV, Shourie asked by the government could not anticipate any problems when they finish off 85 percent of the currency value in India. “Small and medium enterprises, transport sector, the entire agricultural sector—I can't reach them. I can't reach 6 lakh villages. They did not think about this?”

**Arun Jaitley** (Current Finance Minister of India; Senior Advocate, Delhi High Court) Eventually, the government will be able to invest more money in agriculture and social sector: “A lot of money that operates in the shadow economy will now become a part of the banking structure itself. Banks will have a lot more money to support the economy. Private sector investment, which was so far lacking, will now get back into the economy. The banks which were struggling because of the NPA problem will have a lot more money to lend for agriculture, infrastructure sector, social sector, trade and industry.”

**Bibek Deb Roy** (Leading economist; Member of the NitiAyog, a policy think-tank for the GOI) In an interview with Karan Thapar, Deb Roy spoke about the note banning and its repercussions. His take on the impact on daily wage laborers and loss of jobs: “What happened on November 8 is part of a broader jigsaw. There are several other measures that have happened. The Indian economy, in certain sectors, is going through a slowdown. If these figures are going to be taken seriously, you have to demonstrate to me...that these job losses are because of 8th of November alone and not because of other things ”

**Arvind Virmani** (Leading economist; Former India's representative at IMF; Former Chief Economic Adviser, GOI) Useful method; secrecy was a per-requisite: “This is a useful method of flushing out black money, given that a large percentage of cash holding is in these two

denominations. The manner in which it was implemented is not surprising – such actions are always secret till announced, so that insiders do not take advantage of the information at the cost of the outsiders,” he told The Wire. However, he agreed it would have a negative impact on the small businesses:

**SurjitBhalla** (Chairman, Oxus Investments, Previously worked at the World Bank) Calls it a “bold step” on PM’s part: Bhalla wrote in The Indian Express that, “There should be no question that this BJP policy is bold and courageous. The trading community has long been identified as the BJP’s core constituency and Prime Minister NarendraModi has gone against this powerful support group. So let us give Modi a considerable amount of credit for taking a bold step for the country — genuinely in the name of the nation.”

**It’s bigger than the GST:** In the same piece he argued, “The fight against corruption and black money in India has just begun. If successful, this will go down as the biggest reform in India, bigger than the GST (though the two are related) and bigger than the industrial policy reform of 1991. But, and there is a but, while the policy is very effective in its attack on past black money, it is silent on the creation of money.”

#### **RESEARCH METHODOLOGY:**

The main objective is to know the Impact of Demonetisation on Indian Stock Market. The research design is descriptive research design. The secondary data was mainly collected from RBI’s web site and nseindia.com. This study covers a period of only 50days, 30 days and 10days before and after 8-november-2016. we used Pair sample t-test and regression to analyze the data. Hypothesis tested for the research is  $H_0 = 0$  There is no impact of demonetisation on NSE.  $H_1 \neq 0$  :There is impact of demonetisation on NSE.

#### **DATA ANALYSIS:**

Impact of Demonetisation on NSE (Nifty) market 50 days

**Table: 1 Paired Samples Correlations**

		N	Correlation	Sig.
Pair 1	Before 50 day of demonetisation of Nifty & After 50 day of demonetisation of Nifty	50	-.106	.462

**Table: 2 Paired Samples Test**

	Paired Differences					t	df	Sig. (2-tailed)
	Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
				Lower	Upper			
Pair 1 Before 50 day of demonetisation of Nifty - After 50 day of demonetisation of Nifty	4.95866	2.79153E5	39478.19816	4.16531E5	5.75200E5	12.560	49	.000

From above table we can interpret that There is No correlation before and after 50 days of demonetisation on stock market. There is 4.95% change (difference) in the mean of before 50 day of demonetisation and after 50 day of demonetisation. Significant value is 0.000 which is less than 0.05 so we reject null hypothesis and accept alternative hypothesis. There is impact of demonetisation on NSE. T value is 12.56 it means after demonetisation positive

**Impact of Demonetisation on NSE (Nifty) market 30 days**

**Table: 3 Paired Samples Correlations**

	N	Correlation	Sig.
Pair 1 Before 30 day of demonetisation of Nifty & After 30 day of demonetisation of Nifty	30	-.388	.034

**Table: 4 Paired Samples Test**

	Paired Differences					t	df	Sig. (2-tailed)
	Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
				Lower	Upper			
Pair 1 Before 30 day of demonetisation of Nifty - After 30 day of demonetisation of Nifty	4.89340E5	2.59310E5	47343.23223	3.92512E5	5.86168E5	10.336	29	.000

From above table we can interpret that There is negative(-0. 388) correlation before and after 30days of demonetisation on stock market. There is 4.89% change (difference) in the mean of before 30 day of demonetisation and after 30 day of demonetisation. Significant value

is 0.000 which is less than 0.05 so we reject null hypothesis and accept alternative hypothesis. There is impact of demonetisation on NSE. T value is 10.33 it means after demonetisation positive

**Impact of Demonetisation on NSE (Nifty) market 10 days**

**Table: 5 Paired Samples Correlations**

		N	Correlation	Sig.
Pair 1	Before 10 day of demonetisation of Nifty & After 10 day of demonetisation of Nifty	10	-.712	.021

**Table: 6 Paired Samples Test**

	Paired Differences					t	Df	Sig. (2-tailed)	
	Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference					
				Lower	Upper				
Pair 1	Before 10 day of demonetisation of Nifty - After 10 day of demonetisation of Nifty	4.94347E5	3.73199E5	1.18016E5	2.27376E5	7.61317E5	4.189	9	.002

From above table we can interpret that There is strong negative(-0. 712) correlation before and after 10days of demonetisation on stock market. There is 4.94% change (difference) in the mean of before 10 day of demonetisation and after 10 day of demonetisation. Significant value is 0.002 which is less than 0.05 so we reject null hypothesis and accept alternative hypothesis. There is impact of demonetisation on NSE. T value is 4.189 it means after demonetisation positive

**CONCLUSION**

The objective behind demonetisation is reducing the black money in India. But its implication is not proper way so its affect the various sector like Financial Market, Banking, Hawala, Railway, Cash Shortage, Transportation, and Agriculture. In short term period (before and after 10 days and 30 days) effect of demonetisation is highly negative correlation and gradually (before and after 50 days) there is no correlation. From this study we can say that demonetisation doesn't impact on impact on Indian stock market.

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