

Impact of Demonetisation

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Brief background

- ❑ The announcement was made by Hon. Prime Minister of India Narendra Modi in an unscheduled live televised address to the nation at 20:15 Indian Standard Time (IST), in a bold move to fight black money, terrorism and counterfeiting, Rs.500 and Rs.1000 notes were demonetised WEF 9/11/2016. As per official data, till March 2016, Rs.14 Trillion out of Rs.16 Trillion worth currency issued by the RBI were in the denominations of Rs.500 and Rs.1,000. This works out to about 10.5% of GDP.
- ❑ The banknote denominations of `100, `50, `20, `10 and `5 continued to remain as legal tender and were unaffected by the policy.
- ❑ However, exceptions were given to petrol, CNG and gas stations, government hospitals, railway and airline booking counters, state-government recognized dairies and ration stores, and crematoriums to accept the old `500 and `1000 banknotes until 11 November 2016, which was later extended to 14 November 2016 and once again to 24 November 2016. International airports were also instructed to facilitate an exchange of notes amounting to a total value of `5000 for foreign tourists and out-bound passengers
- ❑ The Reserve Bank of India laid down a detailed procedure for the exchange of the demonetised banknotes with new `500 and `2000 banknotes.
 - Citizens will have until 30 December 2016 to tender their old banknotes at any office of the RBI or any bank branch and credit the value into their respective bank accounts.
 - Cash withdrawals from bank accounts were restricted to `10,000 per day and `20,000 per week per account from 10 to 13 November 2016. This limit was increased to `24,000 per week from 14 November.
 - For immediate cash needs, the old banknotes can be exchanged for the new `500 and `2000 banknotes as well as `100 banknotes over the counter of bank branches by filling up a requisition form along with a valid ID proof. This exchange is restricted to once per person. Initially, the limit was fixed at `4000 per person from 8 to 13 November 2016. This limit was increased to `4500 per person from 14 to 17 November 2016. The limit was reduced to `2000 per person from 18 November 2016.

Source: Destimoney Research

Impact on various asset classes due to Demonetisation

Impact on asset classes			
	Next 6 months	6 months – 1 year	1 – 3 years
Bank Fixed Deposit	Negative	Negative	Negative
Gold	Positive	Positive	Neutral
Real Estate	Highly Negative	Highly Negative	Negative to Neutral
Debt Mutual Fund	Highly Positive	Very Positive	Very Positive
Equity Mutual Fund	Volatile	Very Positive	Highly Positive
Balanced Mutual Fund	Neutral	Very Positive	Highly Positive
Stock Market	Volatile	Very Positive	Highly Positive

Source: Destimoney Research

Impact on various sectors due to Demonetisation

Sectors	Impact		
	Next 6 months	6 months - 1 year	1 - 3 years
Auto	Highly negative ↓	Marginally negative ↓	Return to stability ↻
Banks And NBFC's	Positive ↑	Neutral ↔	Neutral ↔
Oil & Gas	Positive ↑	Neutral ↔	Neutral ↔
Retail	Marginally negative ↓	Neutral ↔	Neutral ↔
Consumer durables	Marginally negative ↓	Neutral ↔	Neutral ↔
Cement	Highly negative ↓	Marginally negative ↓	Positive ↑
Jewellery retail	Highly negative ↓	Marginally negative ↓	Neutral ↔
Real Estate	Highly negative ↓	Marginally negative ↓	Neutral ↔

Source: Destimoney Research

Reason of impact on various sectors due to Demonetisation

- ❑ **Auto:** In the two-wheeler industry- around 35-45% purchases are made via financing, while the rest are through cash, or are simply "unaccounted". In passenger vehicles segment 70-80% of sales is done through Financing so this segment could be less impacted. For Tractors around 65% is done through financing so it will also be less impacted. Given that majority cars sales happen on finance basis, we do not expect long term impact on demand.
- ❑ **Banks:** Deposit in the short term may rise, but in the long term, its effect will come down. The savings with the banks are actually liquid cash people stored. It is difficult to assume that such ready cash once stored in their hands will be put into savings for a long term. These are not voluntary savings aimed to get interest. It will be converted into active liquidity by the savers when full-fledged new currency supply take place. This means that new savings with banks is only transitory or short-term deposit. It is not necessary that demonetization will produce big savings in the banking system in the medium term. Most of the savings are obtained by biggie public sector banks like the SBI. They may reduce interest rate in the short/medium term. But they can't follow it in the long term.
- ❑ **Oil & Gas:** Immediate impact of demonetization on oil marketing companies is positive as the fuel sales has increased meaningfully. Also, at the dealers end working capital situation has improved as some of the big debtors have cleared their dues . We believe that oil and gas companies will not get impacted materially, if the cash crunch because of demonetization is short-lived.
- ❑ **Retailing:** Retailers could see some impact on their business in the short-to-medium term due to reduced cash transactions. The luxury segment is likely to be hit because of the historically high incidence of black money acceptance in this segment. However, credit / debit cards and e-wallets should come to the rescue. Overall, the domestic consumption story remains intact, with no threat to the overall strength and growth of the Indian retail industry.

Source: Destimoney Research

- ❑ **Consumer durables:** In the short term, demand growth for durables would slow down as cash transactions account for 70-75% of the overall sales of consumer durables. Over the medium to long term, the impact will be neutral as penetration for most durables in India remains low and consumers would adjust to other forms of payments.
- ❑ **Cement:** Nearly 60% of cement demand comes from real estate and absence of cash can impact the real estate sales and construction. It is also likely to impact the pace of construction as most of the payments for material and labor are settled in cash. Lower-than-expected demand is also likely to put pressure on cement prices in the near term. Over longer term, cement demand growth is expected to be led by continued focus of government on infra spending and rural demand revival post healthy monsoons
- ❑ **Jewellery retail:** The industry is bound to feel the pinch in the near term as around 80% of the gems & jewellery purchases in India are made in cash. The move is good for the organised industry. Anecdotally, there's always a huge panic among distributors -business may be impacted in the short term with liquidity choking up, thereby impacting revenue growth. There will be a shift from unorganised to organised sector in the jewellery industry leading to stable growth on a long term basis.
- ❑ **Real Estate:** Demonetisation should bring down real estate prices, at least in the short to medium term because of involvement of cash in the sector. Luxury real estate prices could drop by up to 30% as sellers will struggle to offload properties to generate liquidity. In the long run as banks are awash with money following demonetisation as customers deposited tonnes of cash, home loan rates may come down in the coming months, helping push property sales.

Source: Destimoney Research

Conclusion

- ❑ An elevation of uncertainty is always a negative for equity markets. Markets will recover in the medium-term as the uncertainty eases out. While there exists a possibility of a broad based decline, there will be some sectors (with linkages to the unorganised economy) that would feel the brunt while some niche technology sectors related to fin-tech and e-commerce could gain. The long-term outlook remains positive.
- ❑ **While sectors** with linkages to the unorganised economy are likely to be affected, technology and financial services are expected to gain in the medium to long term. consumer durables and non-durables is expected to feel the heat. In the short to medium-term, large denomination purchases will likely be made via electronic purchases rather than through brick and mortar outlets. This will impact the retail sector adversely. The real estate sector is likely to see a significant negative impact in the medium- to long-term, particularly in the repurchase market. Areas of sub-sectoral impact will be felt in luxury cars, SUVs, gems, jewellery, gold and high-end branded products. On the positive side, there is likely to a reset of spending patterns as this move represents indirectly a significant push towards a cashless economy. Businesses in the Oil & Gas, Banking Sector, fin-tech sector, including payment banks, mobile wallets, electronic transfer providers, etc., are expected to see gains.
- ❑ **While on the asset classes** perspective debt mutual funds may strengthened due to demonetisation, which is seen as an disinflationary. Aggressive fixed income investors could invest in dynamic bond funds, income funds and gilt funds, which will benefit from falling rates (or yields). Equity market is expected to be volatile in short term because of uncertainty and slow down in economy. But in long term, GDP and Corporate Earnings are expected to do well which will lead to higher growth in Equity market. Banks are offering low interest on FD's which intend to less deposits in the FD's. Public are parking their savings in Savings Account because of lowering FD rates as public does not want to park their savings for a fixed time in the banks as they may withdraw the money from their account.

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