Stock market perceptions on demonetization

Contact:
Madan Sabnavis
Chief Economist
madan.sabnavis@careratings.com
91-022-67543489

Anuja Shah
Economist
Anuja.shah@careratings.com
91-022-67543568

Mradul Mishra
mradul.mishra@careratings.com
91-022-6754 3515

The demonetization scheme or rather 'remonetization' is ending by the end of this month; and the impact on various industries would be different depending on the manner in which demand conditions and hence financial prospects change on this score. Typically industries where business is conducted more on cash basis at both ends - production cycle and point of sale; tend to be affected more than those industries where dependence on cash is low. While it is also argued that such effects would tend to be of a temporary nature and conditions will be mean reverting once normalcy is attained in terms of availability of currency. The stock market is a good indicator of how perceptions have been anchored across sectors during this period.

The ideal indicator of impact would be the financial performance of companies in any industry as changes in sales and profits could be interpreted in terms of how sectors were impacted. However, this information will be available only after the Q3 results are announced. Stock price movements could be a quick perceptions indicator, which admittedly would be affected by various other factors such as company specific developments, industry related issues etc. on a real time basis. This can nonetheless be used as an indicator of how sectors are expected to be impacted on account of demonetization.

Since November 8, however, there has been no major event in the country that could have guided stock prices. Inflation has been down and RBI policy stance has remained unchanged. The rupee has declined but this is more on account of the dollar strengthening. FPI flows have turned negative during this period as both equity and debt segments witnessed net outflows. This had an impact on the Sensex and hence is important, but would be a commonality across all sectors. The victory of Donald Trump in the US and the Federal Reserve's decision to increase interest rates has been extraneous factors that have affected this flow of funds. On the positive side, there was some progress made in the GST implementation on the compensation to be paid to states.

Movements in BSE's sectoral indices have been used in this exercise as proxies for market perceptions on how various industries have been impacted. The two time periods that are considered are October 1 to November 8 and November 8 to December 23. The period subsequent to December 23 has turned volatile with the market buzz that the Union Budget may be bringing long term equity gains under the tax regime, which was however been allayed by the government.

In the table, sectors have been segregated on the basis of highest changes in the relative sector index in the first period. The changes subsequently can then be interpreted as those that were influenced largely by demonetization. A positive growth in the first period followed by negative growth in the second should then be looked at as performance relative to the movement in the Sensex. If the decrease was substantially higher than that of the Sensex, then it may be surmised that demonetization has affected the sentiment here. Those which had negative growth rates prior to November 8 and had similar movements in the post November 8 phase could be taken as those industries which witnessed only continuity and would have had minimal impact from demonetization.

Movement in BSE's sectoral indices (%)

	Oct 1-Nov 8	Nov 8-Dec 23
SENSEX	**2.36**	**-5.62**
Healthcare	8.06	-4.43
Realty	5.55	-13.97
Capital goods	4.12	-5.97
IT	4.01	0.54
Telecom	3.40	-5.04
Consumer durable	3.23	-12.68
Power	2.37	-1.50
Auto	2.34	-10.64
Energy	2.13	0.59
Banks	0.28	-8.54
Infrastructure	-0.50	-2.30
FMCG	-0.58	-10.20
Basic Materials	-1.86	-10.65
Oil, gas	-2.42	-0.32
Central PSUs	-2.67	-1.34
Metals	-4.67	-4.81

Source: BSE

CORPORATE OFFICE:
CREDIT ANALYSIS & RESEARCH LIMITED
Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022.
Tel: +91-22-6754 3456 I Fax: +91-22-6754 3457 I E-mail: care@careratings.com I Website: www.careratings.com

Follow us on /company/CARE Ratings
/company/CARE Ratings

From the table the following may be deduced.

1. In the post November 8 period, the Sensex declined by around 5.6%. Sectors that declined at a higher could be those that were also affected by the demonetization process.

2. IT and Energy indices had witnessed positive increases compared to the others which declined. The positive perception to IT could be attributed partly to the boost that this sector will receive with the thrust being on technology and digitization. The energy sector is unlikely to have been affected by this scheme, and the change could be more due to factors pertaining to the industry.

3. The negative perception that has built up relate to:

   a. Realty: As cash transactions have been common in most transactions especially in the unorganized segment, the future movement of prices as well as demand is uncertain. It is felt further that in the short run demand would be affected as purchase decisions will be deferred, though in the medium term lower prices should stimulate demand.

   b. Consumer durable goods index has also received a setback as a large number of purchase transactions are in cash, especially in rural areas. With the kharif harvest being good, it was expected that this segment would witness a boost. However, with currency out of circulation temporarily, sales have been affected. This mood will change only after normalcy sets in. The rabi harvest would be the next touch point as this is when demand could again pick up provided the harvest is good and the currency situation improves substantially.

   c. Auto segment has also witnessed decline in share prices at a faster pace than the Sensex. This is another segment which deals in cash as several purchases are in this form. With attention being diverted more to handling the old notes, consumers have tended to cut back on such spending. However, like consumer durable goods, demand should pick up once the system gets in adequate currency.

   d. FMCG price index has also taken a hit, and this is reflective of lower volume of sales as this is one segment which is largely distributed across the smaller retail outlets which operate on cash. Also the SME segment which has a good presence here has been affected due to cash availability that has impacted their business levels as most procurement is also in cash, and limited availability has affected their prospects. While sales lost in this period will only be partly recovered, the companies in this group should revert to normal operations once the cash situation improves.

CORPORATE OFFICE:
CREDIT ANALYSIS & RESEARCH LIMITED
Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022.
Tel: +91-22-6754 3456 I Fax: +91-22-6754 3457 I E-mail: care@careratings.com I Website: www.careratings.com

e. Basic metals stock index includes to a large extent the cement companies along with chemicals and steel products. The pessimism here may be explained by the backward linkages with the realty segment which has been affected. However, the fact the government has been fairly aggressive in the final space should provide countervailing force to this mood, which should get corrected over time.

f. Banking stocks have taken a major hit post demonetization as they have been subjected to a series of policy changes which has led to excess liquidity, cost of liquidity, limited returns on funds and consequent possible impact on profits, increased possibility of NPA incidence on agri, SME and retail loans. Further, they have been stressed in the last two months in handling conversion of old notes to deposits and have not been able to effectively conduct their regular business which has led to an enhanced negative segment.

Stocks of these five sectors hence have been affected the most post demonetization based on market perception. But, this should gradually turnaround as normalcy returns, which should start from the end of Q1-FY18. These trends could be monitored closely to ascertain any change in sentiment as time goes by.