

SPILL OVER OF DEMONETISATION: IMPLICATIONS FOR SHAREHOLDERS' WEALTH

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Abstract

This study attempts to analyse the effects of recent move of demonetisation of High Denomination Currency Notes (HDCNs) on the shareholders wealth of Indian investors. The current central government announced the withdrawal of HDCNs from Indian currency in circulation in a move to curb black money circulating in Indian economy by making Rs. 500 and Rs. 1000 currency notes not remaining legal tender from 9th November, 2016. This sudden move of central government has resulted into short-term contraction of money supply in the economy. The change in the money supply has resulted into redistribution of portfolios of Indian investors. The logistics of replacement of currencies has affected all walks of life. The earlier experiences of demonetisation in 1946 and 1978 has alternatively been negative and then positive for Indian stock market. Using ARDL model, a stable long-run relationship between money supply and stock market is established and it is observed that no direct impact of short-term contraction of money supply is observed on the investors' wealth unless it is channelled through changes in either the exchange rate or interest rates.

Keywords: Demonetisation, Shareholders' Wealth, ARDL, Money Supply.

JEL Classification: E52, G18.

Introduction

Fundamental Analysts perceive that the discounted value of future cash flows attributable to the stockholders anchors the market price of that stock. Any changes in either the cash flows or the discount rate will affect the fundamentals of stock. The economic theories have established strong relationship between money supply and stock price movements. King (1966) reported that macroeconomic factors influences stock prices to the extent of 50 percent on an average. Flannery & Protopapadakis (2002) have also concluded these factors to be the most important factors influencing the stock returns.

Monetarists' argument suggests that the changes in money supply affects the real interest rates in the economy, thereby affecting the economic activities through Transmission Mechanisms and the operation of investment multiplier. An alteration in the economic activities of the companies affects the future expected cash flows to the stockholders, which, in turn, affects the market prices of their shares. Thus, a positive relationship between money supply and stock prices are expected. Further, a change in the interest rate also affects the discounting process and thus, accentuates this positive relationship. However, the real side impact of any demonetisation move will also depend upon the relative share of connected and unconnected sectors of the economy (Waknis(2017)).

However, **Sellin (2001)** argues that the present stance of the monetary authorities reflects the future expectations about the monetary policy. People perceive a positive shock in the money supply as a precursor to the tightened monetary policy in future. The current rate of interest goes up in anticipation,

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