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Demonetization risk in banks and share markets

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***Abstract*---**Demonetization refers to the removal of a certain type of currency from circulation as legal tender (for example, 500 and 1000 currency notes). Risk management entails recognizing and analyzing different types of risk exposure, as well as adopting preventative measures to mitigate the risk. This research focuses on the different types of contracts and risks that investors face in the stock market, as well as risk in the banking sector.

***Keywords*---**share market, demonetization, banking sector.

Introduction

Demonetization is described as the return of circulating cash, but in the case of India, it refers to the return of 500 and 1000 rupee notes. The Indian markets were severely harmed as a result. It is estimated that 80% of liquidity has been drained. The country is in a state of high risk and uncertainty as a result of this occurrence. Simply put, money was travelling in the wrong direction in the economy.

Risk is share markets

Share markets are well renowned for their risk and return, but demonetization has increased their volatility. Many equities approached lower boundaries on the 9th of November morning (the night after demonetization) and trading was halted. There was also a significant drop in the value of shares as a result of the increased uncertainty. There was a significant movement in open interest (OI), indicating that people were netting the contract due to the high level of uncertainty.

Bank risk

With regard to demonetization, the risk to banks is regarded as a serious risk. The fact that people were paying back all of their obligations reduced NPAs for all banks, which was a good thing, but it was also a drawback. Banks were generally

left with large amounts of deposits at the end of the day, but no loans were being made. This was not the only risk involved; there were many others as well.

Literature Review of Risk Management

In financial institutions, risk management is more significant than in other sections of the country. Despite the fact that it is complicated. In an uncertain environment, the banking sector and other similar financial institutions are at danger. According to the Turnbull report, the author was the project director who created a new fundamental approach to risk. It explains how the various Turnbull ideas have become the cornerstone of risk management and how they might be improved." (2001; Anthony Carey).

"Financial institution risk management focuses on managing return and hazard in modern financial institutions. The central theme of risk management is that the risks faced by financial institution managers, as well as the methods and markets through which these risks are managed, are becoming increasingly similar, regardless of whether the financial institution is acting as a noncommercial bank or a commercial bank, an investment bank, a savings bank, or a loan provider, or an insurance company. Even though each sector's logical nature, such as quality securitization, international banks off balance sheet banking" (Saunders, Cornett, and colleagues, 2006).

Commercial banks can use an eight-step risk management process to manage risk, which includes exposure identification, data gathering, and risk quantification, management objectives, product and control guidelines, risk management evaluation, strategy development, implementation, and performance evaluation (e.g. Baldoni, 1998; Harrington and Niehaus, 1999).

“According to financial theory, risk control has become one of the most important concerns for financial firms. They require appropriate arithmetical tools to compute and forecast the magnitude of the likely moves of financial markets, particularly in derivative markets. Classic theories, on the other hand, are based on simple assumptions like Gaussian statistics and lead to a regular dryness of real dangers." Bouchaud and Potters (Bouchaud and Potters, 2000).

"The information in this article will assist you in making financial risk management decisions. The is based on two key principles: a "Sharpe rule" that evaluates prospective changes in a financial sector's or portfolio's expected risk of return profile and the improvement of a constant likelihood of default, and a "Sharpe rule" that evaluates the leverage of a financial sector or portfolio. Rules are not limited to return distributions; they also include a wide range of aberrant distributions. This method could be used with value at risk or portfolio standard deviation as the risk metric." (1999, Dowd).

"This article illustrates how corporate treasurers employ credit derivatives. In recent years, financial corporations have become more comfortable with the idea of hedging their exposure with traditional derivative instruments. Take, for example, the danger of a currency depreciation. Credit risk, interest rate, and, on the other hand, the approval of a more onerous tame are all factors to consider.

While there are options for credit risk management, such as the use of traditional insurance products and (LOC) letters of credit, these options are not always practical" (Freeman, Cox et al. 2006).

Risk can also be divided into systematic and unsystematic categories. Unsystematic risk is linked to a specific asset or firm and cannot be diversified, though its parts can be reduced through mitigation and transferring techniques. Systematic risk is linked to the overall market or economy and can be mitigated in a large diversified portfolio, whereas unsystematic risk is linked to a specific asset or firm and cannot be diversified (Santomero, 1997).

The danger of losing money as a result of changes in financial market rates (interest and exchange rates), as well as bond, equity, and commodity prices. The volatility of underlying risk variables, as well as the sensitivity of the bank's portfolio to changes in those risk factors, constitute a bank's market risk exposure (Hendricks and Hirtle, 1997).

Basic Types of Contract in Share Market

Futures contract is a contract in which the purchasing and selling of shares is done in the future. For example, if you want to buy oil for your company and you need it 3 months from now, but you're scared that oil prices will skyrocket, you can enter into a 3 month future contract to buy, which would cost you less. However, there is a chance that you will lose money on this contract. However, it is a responsibility to perform the contract in this contract.

Option contracts are places that are more dangerous. It is classified as a derivative in the stock market. It contains four types of buyers and sellers: call buyers, call sellers, put buyers, and put sellers.
The call buyer has the choice to buy, whereas the call seller is obligated to sell.
The put buyer has the opportunity to sell the stock, whereas the put seller is obligated to acquire it. In either instance, though, the buyers must pay the premium to the seller.

Interpretation

The stock market is a marketplace where buyers and sellers trade specific stocks. And it opens at 9:30 a.m. every day and closes at 3:30 p.m. (Monday to Friday). The stock market is a place where millions of people lose money every day, but a million people win. The trend will move from bullish to bearish or vice versa on a regular basis. However, the stock market experienced an earthquake on November 9th morning.
Now having look at price history of **NIFITY**

Daily prices Feb 9, 2016 - Feb 7, 2017 Update

Date	Open	High	Low	Close	Volume
Nov 11, 2016	8,456.65	8,460.60	8,284.95	8,296.30	-
Nov 10, 2016	8,555.60	8,598.45	8,510.70	8,525.75	-
Nov 9, 2016	8,067.50	8,476.20	8,002.25	8,432.00	-
Nov 8, 2016	8,540.00	8,559.40	8,480.10	8,543.55	-
Nov 7, 2016	8,535.75	8,535.85	8,481.45	8,497.05	-
Nov 4, 2016	8,503.60	8,504.00	8,400.25	8,433.75	-
Nov 3, 2016	8,499.85	8,537.65	8,476.15	8,484.95	-
Nov 2, 2016	8,542.80	8,549.50	8,504.85	8,514.00	-
Nov 1, 2016	8,653.15	8,669.60	8,614.50	8,626.25	-
Oct 28, 2016	8,625.00	8,653.75	8,581.75	8,638.00	-

Show rows: 10 61 - 70 of 246 rows

When we look at the above table, we can see that there is a significant discrepancy between the closing on November 8th and the opening on November 9th.
Moving with the price history of **SENSEX**

Daily prices Feb 9, 2016 - Feb 7, 2017 Update

Date	Open	High	Low	Close	Volume
Nov 11, 2016	27,344.85	27,344.85	26,777.18	26,818.82	-
Nov 10, 2016	27,605.05	27,743.46	27,457.05	27,517.68	-
Nov 9, 2016	26,251.38	27,397.38	25,902.45	27,252.53	-
Nov 8, 2016	27,537.26	27,646.84	27,406.76	27,591.14	-
Nov 7, 2016	27,552.27	27,591.15	27,398.72	27,458.99	-
Nov 4, 2016	27,465.55	27,498.91	27,193.61	27,274.15	-
Nov 3, 2016	27,518.06	27,600.74	27,399.26	27,430.28	-
Nov 2, 2016	27,679.32	27,679.32	27,500.81	27,527.22	-
Nov 1, 2016	27,966.18	28,029.80	27,845.63	27,876.61	-
Oct 28, 2016	27,983.14	28,000.14	27,789.84	27,941.51	-

Show rows: 10 61 - 70 of 246 rows

When we look at the above table, we can see that there is a significant discrepancy between the closing on November 8th and the opening on November 9th.

We can witness a massive full in the starting price of both NIFTY and SENSEX in both of the above examples. People who held long positions in the stock were crying, while those who held short positions were making money.

This had a bigger impact on foreign investments, resulting in a rise in the dollar's value.

People from other countries were selling their equities in India and buying the dollar in the order book, causing the dollar's value to rise. The other factor was the Fed's rise, which prompted FIIs to return to Europe to invest.

The Indian rupee is now trading at a discount to the US dollar.
On 9th November the dollar situation was as such
Open: 1 USD = 66.1703 INR
Close: 1 USD = 66.4529 INR
Average: 1 USD = 66.618 INR
Lowest: 1 USD = 66.4391 INR
Highest: 1 USD = 66.7969 INR

As we all know, currency volatility will be modest, but when looking at the date of November 9th, it is incredible to observe such fluctuation in currency.
The default risk increased significantly as a result of people incurring such large losses that repayment became extremely impossible.
As a result, risk management is concerned with managing risk, but producing profits or losses still rely on luck. If your luck is lousy, no matter how much you hedge, you will lose money.

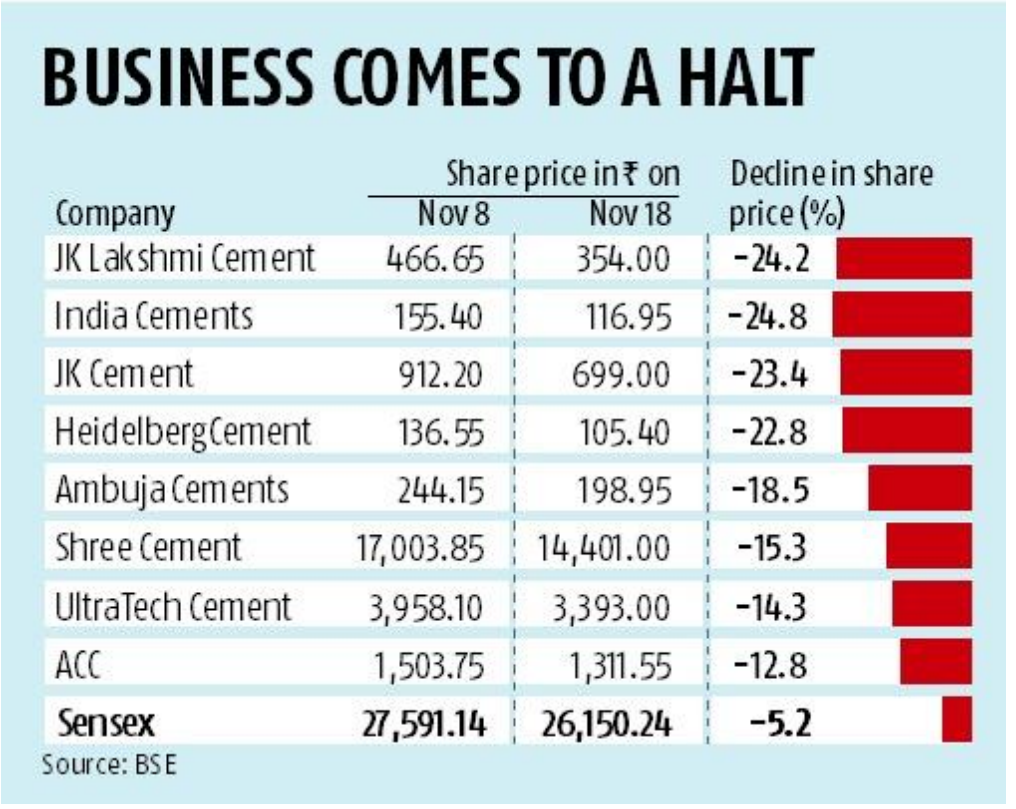
TAKING STOCK

Banks' share price movement since demonetisation

	Nov 8 ₹/share	Nov 18 ₹/share	(%) change
PSU banks			
Union Bank of India	129.55	157.25	**21.38**
Bank of Baroda	149.0	176.7	**18.59**
Bank of India	109.0	121.45	**11.42**
State Bank of India	252.34	277.7	**10.04**
Canara Bank	296.6	326.3	**10.01**
Punjab National Bank	140.6	149.7	**6.47**
Private banks			
IndusInd Bank	1,213.0	1,101.0	**-9.24**
ICICI Bank	283.2	264.55	**-6.59**
Kotak Mahindra Bank	810.95	779.3	**-3.81**
YES Bank	1,223.95	1,179.85	**-3.61**
Axis Bank	490.8	473.45	**-3.54**
HDFC Bank	1,254.6	1,211.6	**-3.43**

Source: BSE

There was an assumption that demonetization would be beneficial to banks, but it turned out to be detrimental as well. When we look at the banking sector's stocks, we can see that PSU banks have recovered considerably, but private banks are still having difficulties. Because of the heightened uncertainty, private banks are taking longer to recover, however PSU banks are rebounding more quickly because everyone knows that the government would not default on its obligations, whereas private banks may default.



When we look at the stocks of large corporations, we can see that they have had a negative impact. We can see from the chart above that the values of cement company shares have been steadily declining. Not only cement company shares, but all company shares have been declining as a result of increased business uncertainty.

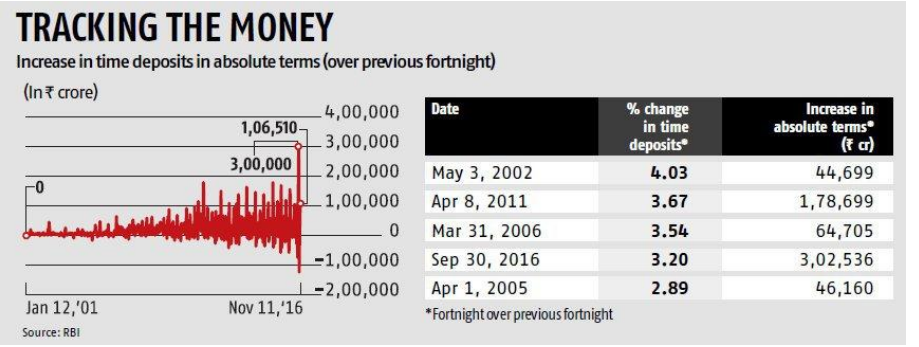
Banking

When it comes to the banking industry, many people believe that it is beneficial for banks to be able to gather enormous sums of money, but as time has passed, people have realised that no one is taking out loans, so what are banks going to do with that money?

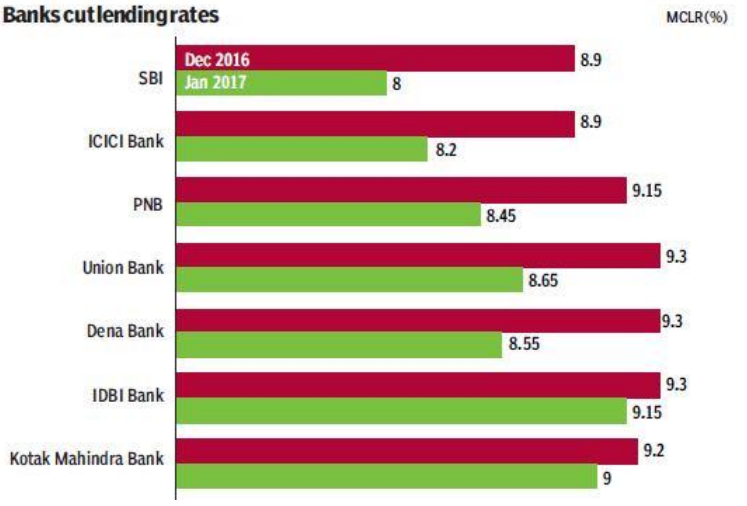
Typically, if a bank receives a deposit of 5%, it will lend that money to another individual at an interest rate of 8%. As a result, this is how banks used to work. However, as soon as the economy was hurt by demonetization, individuals stopped taking out loans, and the RBI did not decrease interest rates. As a result, this was one of the key issues that banks had to deal with.

Liquidity was completely suffocated. According to reports, the information was sent to banks prior to the increase in the circulation of 100rs notes, but the banks treated it in a casual manner and did not execute it; otherwise, the situation may have been mitigated to some extent.

The shift in deposit rates is depicted in this graphic.



When we look at the above statistics, particularly that graph, we can see that there is a modest percentage gain but a large quantity of growth in depositors.



The graph above shows how different institutions have reduced their lending rates. Based on a comparison of December 2016 and January 2017 loan rates, we can say that there has been a significant fall in lending rates. Despite the fact that SBI has granted a 0.9 percent decrease, which is a significant amount, we can still conclude that money circulation is minimal.

Suggestion

- People who want to work in the stock market should be given proper training and help.
- To stabilise the economy, the RBI should implement sound monetary policies.
- Employees of banks should be open and honest when providing information to the authorities.
- To foresee and mitigate risk, proper and effective procedures must be created.

- People should be careful not to take long holdings in shares that are worth a lot of money.
- The government should educate the public on the current predicament.

Conclusion

Risk management is all about managing risk, but your luck plays a role. Now is not the time to protest against demonetization because it has already occurred. It's important to consider how to overcome the causes of it, especially because it had such a significant influence on Indian markets. When weighing the benefits and drawbacks of demonetization, there are far more drawbacks than benefits. Anyway, stock markets were attempting to regain stability, although it will be difficult to do so quickly given the severity of the blow. When it comes to banks, we can say that demonetization has raised fraud rates. It comes as a shock to learn that our RBI governor's recent initiatives, There was no rate cut announced. We don't know what the strategy is, but because they are more knowledgeable than we are, we hope that whatever they do to the economy will be successful.

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