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Ambit
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INVESTOR COMPASS

MAY 2023

GROUNDHOG DAY!

Dear Patron,

It is often said that history doesn't repeat itself but it often rhymes. The term ***'Groundhog Day'*** refers to a situation in which a series of unwanted events appear to be recurring in a similar way.

The world though extremely complex can be simplified to an extent via observing and learning from similar past historical events. The inability to predict the probability of key historical events has been a fallacy for humans (let alone investors) for ages, be it predicting natural disasters, outburst of diseases or recessions. While predicting such events is difficult, understanding the outcomes and reaction to the same serves as an important guide.

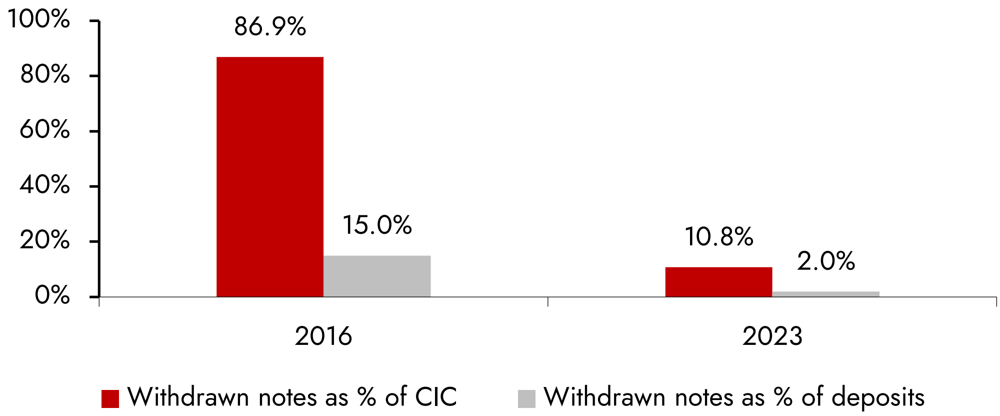
This edition of our *Investor Compass* focuses on the recent RBI decision to withdraw Rs.2,000 notes from circulation. We take a look at the likely consequences from this action while drawing parallels from the 2016 de-monetization event and most importantly how it might affect our portfolio companies.

The event – Withdrawal and not de-monetization (yet)

- RBI on 19th May, 2023 announced the withdrawal of Rs. 2,000 notes from circulation, adding that the notes will continue to be legal tender. The existing Rs 2,000 notes can be deposited or exchanged in banks until September 30, 2023, with a limit of Rs 20,000 at a time for exchange.

- This event, which is being compared to the 2016 Demonetization, differs materially as Rs2000 notes continues to be legal tender. In addition to the same, the intensity of the impact is expected to be limited (if any) since these notes constitute 10.8% of Currency in Circulation and 2% of deposits, unlike 86.9% / 15% during 2016 **(Refer Exhibit 1)**. Moreover, the time-frame for this withdrawal is 4 months compared to immediate impact during de-monitization

Exhibit 1: Impact of withdrawal of Rs2,000 notes is expected to be limited given the lower share of CIC and Deposits



Source: Ambit Asset Management, RBI

In an ideal world, the above event should be a non-event provided everyone in India acts rationally as there is no change in acceptance or usage of Rs.2,000 note. However, going by historical precedence along with our assessment of on-ground trends we anticipate some impact (if any) on Banking and pockets of Consumer Discretionary sectors

A. A positive Impact on Banking sector due to:

- **Increase in Liquidity** – Increase in near term banking liquidity due to anticipated currency deposits of ~Rs3tn by Sept'23. Withdrawal of liquidity, however, will be phased out over next 3-4 quarters.
- **Growth and business activity** – Total Rs2,000 notes in circulation is ~Rs3.6tn constituting ~2% of overall system deposits. While there is a restriction of Rs20,000 on the exchange of these notes, there is no restriction on deposit for the same. We anticipate it as a marginal positive for deposit growth of banks in term near-term. It is important to note that deposit growth for banks has been lagging loan growth thus far.
- **Impact on NIM's –** Deposits with banks is likely to increase in near term to the tune of ~Rs1.5-2tn (net of exchange) which will lead to fall in higher cost Certificates of Deposits (CD) issuances and likely easing of deposit rates, thereby impacting NIMs positively.
- **Impact on G-Sec Yield –** The increase in deposits is likely to ease G-Sec yields as banks look to park these deposits in Government bonds

B. Consumer Discretionary, Retail and even Real Estate may see some panic spending:

In addition to the short term impetus on banks, based on current ground level checks the number of enquiries for gold, high-end discretionary products and pockets of real estate have increased sharply post the announcement by RBI. Consumers may advance future high-ticket purchases in order to utilize the withdrawn notes.

Conclusion:

We do not anticipate any major adverse impact on any of our portfolio companies because of the above event.

On the contrary, we anticipate the banking sector to be a beneficiary of the above. While the current event cannot be compared to the 2016 demonetization, we see a likelihood of repeat of the human behaviour (though on a smaller scale) which may aid short term demand of several discretionary and building material companies in the portfolio. Overall we envisage the above event to be neutral to slightly positive to our portfolio companies.

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