



## Looking Beyond India's Demonetization

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On November 8, 2016, the day of the U.S. election, India announced the demonetization of all 500 rupee (roughly \$7.40) and 1,000 rupee (roughly \$15) banknotes of the Mahatma Gandhi Series. This represented 85% of the currency in circulation in India, and presented a tremendous shock to a market in which 70% of transactions are cash.

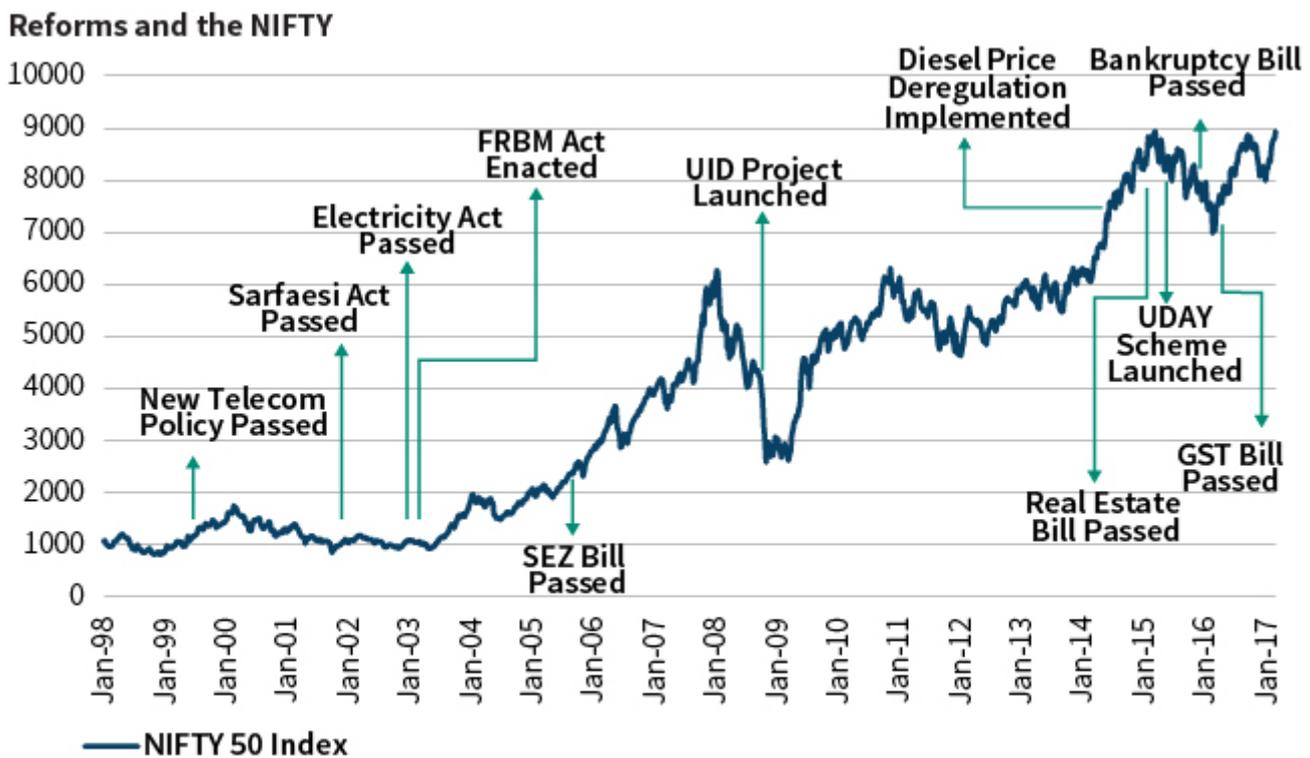
However, in our view, the long-term benefits of this measure outweigh the near-term setbacks. The \$2 trillion of demonetized currency that re-entered the banking system resulted in an increase of total system deposits and led to an improvement in the future fiscal balance and a broadening of the tax net to include a large share of the black economy.

In addition, a majority of companies beat expectations on both top and bottom lines during the most recent reporting season, indicating that the actual impact of the currency demonetization was smaller than feared.

In our view, India continues to offer attractive investment opportunities. It has the best demographics among emerging markets, with a working-age population ratio expected to peak in 2030 (compared with 2010 in China, 2008 in Russia, and 2020 in Brazil). It has a supportive macro backdrop, with declining inflation and interest rates. And, it has a reform-minded government focused on improving the ease of doing business.

Indeed, Prime Minister Narendra Modi has been delivering on this reform agenda, with even more to come, and the market has responded to the passage of new legislation. The goods and services tax (GST) is the latest and most important, and rollout will not even begin until this summer.

The chart below shows the change in the NIFTY 50 Index (NIFTY), which tracks the performance of Indian equities.



Source: William Blair, BofA Merrill Lynch Global Research, as of February 2017.

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