

Demonetization Impact on Indian Economy Impact on three sectors of economy

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Abstract: Demonetization is a tool to battle Inflation, Black Money, Corruption and Crime, discourage a cash dependent economy and help trade. Its policy of the government by banning Rs. 500 and Rs.1000 currency notes has influenced all almost all the corner of the economy. Its effect on Banking Sector is significant as Bank is a center for channeling the legal tender money to all needs of the society. The reason for this move was simple: India's Ministry of Finance claimed that 500 and 1,000 rupee notes are being used to finance terrorism, fund illegal drug sales, fuel the black market, drive counterfeiting, and pay bribes. This so-called "black money" had reputedly built up to such epic proportions that Prime Minister Modi declared that enough was enough, that he would take it upon himself to wash his country's currency supply in one fell swoop. Demonetization can be said as a „Surgical Strike“ on Black Money, Terrorism, Fake Currency, Unorganized trading, Real Estate, Share market etc. on the other hand if we talk about the Indian industry on a broader way it can be categories in three parts Manufacturing sector, Service sector and Agriculture sector. After demonetization only Agriculture sector shows some positive improvement while if we talk about the manufacturing and service sector both were crashed down and these will affect the whole Indian market in 2017 also. The biggest beneficiaries of demonetization are Banks. It made the banks to accept the deposits without any cost of promotion and drastically increased liquidity position of the banks. The present study is made out of available literature on post demonetization. It portrayed the effect of demonetization on three Sectors.

Introduction:

On November 8, 2016, it was decided to demonetise high value currency notes of denomination of ₹ 1000 and ₹ 500 (called specified bank notes - SBNs). Such notes, valued at ₹ 15.4 trillion, constituted 86.9 per cent of the value of total currency in circulation. The decision was in continuation of a series of measures taken by the Government of India during last two years aimed at eliminating corruption, black money, counterfeit currency and terror funding. The decision was guided by the aim of reaping its enormous potential medium-term benefits in the form of reduced corruption, greater digitisation of the economy, increased flow of financial savings and greater formalisation of the economy. All of these would lead to higher GDP growth and tax revenues that could be used by the Government for inclusive and stronger economic growth within the norms of fiscal prudence, besides contributing to overall improvement in business environment.

India has traditionally been a cash intensive economy. According to an estimate, about 78 per cent of all consumer payments in India are affected in cash.

1. It was, therefore, obvious that currency squeeze during the demonetisation period would have had some adverse impact on economic activity, although such impact was expected to be transient. It encompassed the recent decision of the central government on Demonetization and its gradual effect on Indian banking sector. Key Words: Demonetization, Banks, Liquidity, digitization. I. Introduction Banks are core part of any economy. They channelized the money to the smooth functioning of different sectors. Initiatives of Green Banking, made the banks to transform conventional banking services into modern banking services. The products and services are offered through electronic devices with the help of internet. Now a day, bank services are catered at the finger tip of customers. Surgical Strike on Black Money called 'Demonetization' brought enormous changes in all the sectors of the country.

Banks are not exceptional from the influence of Demonetization and it made vibrations in the operations as well as products and services of Banks. It created greater demand to digital banking services where cashless transactions are prioritized. Day to day operations of Banks are affected and found tough in Management of liquidity and Employees. It made greater influence on Management of liquidity and its demand raised by customers in exchanging of their banned currency notes while minimizing risk and maximizing quality of service. At the same time meeting the guidance of Reserve Bank of India was challenging. Demonetization has disturbed the bank operations and made the employees to work under unconditional stress in extended

working hours of a day. Most of the banks were not able to discharge other banking services while exchanging the banned currency notes. Hence, the present study is made to figure out the influence of demonetization on banking sector. It showcases post demonetization effect on banks and its operations.

II. They opined that demonetization has short term negative impact on different sectors of the economy and such impacts are solved when the new currency notes are widely circulated in the economy. They also argued that the government should clear all the problems created due to demonetization and help the economy to work smoothly.

It made even a non income group people to visit bank and have an account. It increased number of account holders in banks while increasing deposit corpus. Similarly, Demonetization has brought some operational issues to Banks. It disturbed Banks' Employees, Operational Costs and Profitability. The following are negative influences of Demonetization.

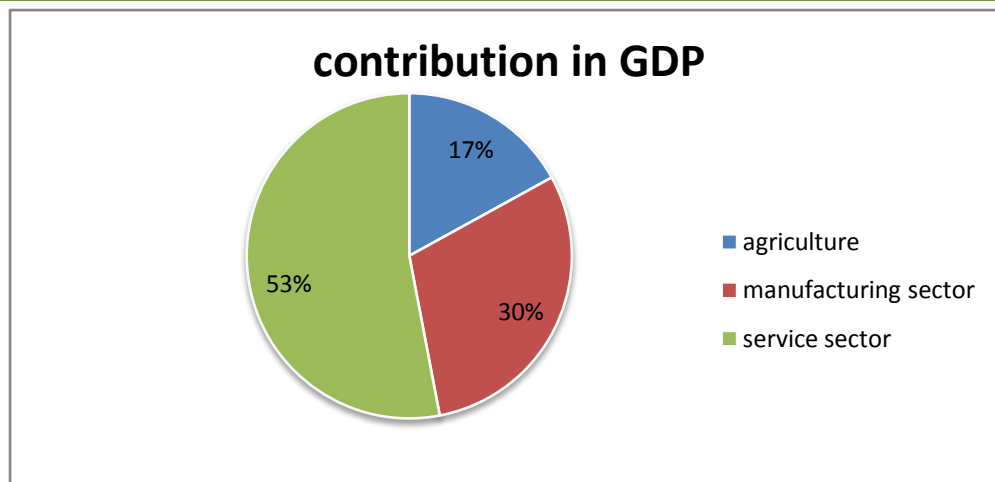
1. Cash Reserve Requirement: 100% CRR on incremental deposits meant that banks did not earn any interest on Rs. 3 Lakh crore of deposits for nearly a fortnight.
2. Waived off ATM Charges: ATM charges were waived off during banned note exchange and banks incurred a loss of Rs. 20 in every transaction.
3. Waived off Merchant Discount Rate: Banks incurred loss of 1% discount charges from merchants on using of every card transaction.
4. Non Selling of Loans: Banks were focused on exchanging currency notes and they were not able to sell any loan products. During demonetization, some SME businesses had seen their sales drop by 50-80 percent and could default in their installments to banks. This led the banks to consider it as NPA and affected its level in banks.
5. Stress on Employees: Bank Employees were put under pressure and overtime work environment. It depressed them and kept imbalanced life style. Few cases were found where the employees committed suicide due to work pressure.

Economy Circumstances and Affects:

- 1) Effect on parallel economy The removal of these 500 and 1000 notes and replacement of the same with new 500 and 2000 Rupee Notes is expected to - remove black money from the economy as they will be blocked since the owners will not be in a position to deposit the same in the banks, - Temporarily stall the circulation of large volume of counterfeit currency and - curb the funding for anti-social elements like smuggling, terrorism, espionage, etc.
- 2) Effect on Money Supply With the older 500 and 1000 Rupees notes being scrapped, until the new 500 and 2000 Rupees notes get widely circulated in the market, money supply is expected to reduce in the short run. To the extent that black money (which is not counterfeit) does not re-enter the system, reserve money and hence money supply will decrease permanently. However gradually as the new notes get circulated in the market and the mismatch gets corrected, money supply will pick up.
- 3) Effect on Demand The overall demand is expected to be affected to an extent. The demand in following areas is to be impacted particularly:
 - Consumer goods and Real Estate and Property
 - Gold and luxury goods
 - Automobiles (only to a certain limit)

All these mentioned sectors are expected to face certain moderation in demand from the consumer side, owing to the significant amount of cash transactions involved in these sectors.

- 4) Effect on Prices Price level is expected to be lowered due to moderation from demand side. This demand driven fall in prices could be understood as follows: Consumer goods: Prices are expected to fall only marginally due to moderation in demand as use of cards and cheques would compensate for some purchases.
- 5) Real Estate and Property: Prices in this sector are largely expected to fall, especially for sales of properties where major part of the transaction is cash based, rather than based on banks transfer or cheque transactions. In the medium term, however the prices in this sector could regain some levels as developers rebalance their prices (probably charging more on cheque payment).
- 5) Effect on various economic entities With cash transaction lowering in the short run, until the new notes are spread widely into circulation, certain sections of the society could face short term disruptions in facilitation of their transactions.



Effect on GDP The GDP formation could be impacted by this measure, with reduction in the consumption demand. However with the recent rise in festival demand is expected to offset this fall in overall impact. Moreover, this expected impact on GDP may not be significant as some of this demand will only be deferred and re-enter the stream once the cash situation becomes normal. 7) Effect on Banks As directed by the Government, the 500 and 1000 Rupee notes which now cease to be legal tender are to be deposited or exchanged in banks (subject to certain limits). This will automatically lead to more amounts being deposited in Savings and Current Account of commercial banks. This in turn will enhance the liquidity position of the banks, which can be utilized further for lending purposes.

After Demonetization all the three sectors faces negative impacts

6) These sections are:

- ❖ Agriculture and related sector
- ❖ Small traders
- ❖ SME
- ❖ Services Sector
- ❖ Households
- ❖ Political Parties
- ❖ Retail outlets
- ❖ Professionals like doctor, carpenter, utility service providers, etc.

The nature, frequency and amounts of the commercial transactions involved with these sections of the economy necessitate cash transactions on more frequent basis. Thus, these segments are expected to have the most significant impact post this demonetization process and the introduction of new notes in circulation. 6) However, to the extent that households have held on to these funds for emergency purposes, there would be withdrawals at the second stage. 8) Effect on Online Transactions and alternative modes of payment : With cash transactions facing a reduction, alternative forms of payment will see a surge in demand. Digital transaction systems, E wallets and apps, online transactions using E banking, usage of Plastic money (Debit and Credit Cards), etc. will definitely see substantial increase in demand. This should eventually lead to strengthening of such systems and the infrastructure required.

According to the RBI's (Reserve Bank of India) Annual Report for April 2015 to March 2016, the value of the currency notes at the end of March 2016 was 16.42 trillion Indian rupees. The 500 rupee and 1,000 rupee currency notes formed 86.4% of the value. In one stroke, the government removed 86.4% of the currency in circulation by value. In terms of volume, the currency notes of these two denominations formed 24.4% of a total 90.27 billion pieces. Also, RBI data showed that as of March 2016, 632,926 currency notes were counterfeit—known as an FICN (Fake Indian Currency Note). As a proportion of NIC (Notes in Circulation), the 1,000 rupee and 500 rupee notes were the highest. Nullifying these FICNs was also part of the demonetization move. Now we talk about the impact of Demonetization on Indian Economy Sector. First economy can be bifurcated in three broad segments Agriculture Sector, Manufacturing Sector and Service sector all these three sectors contributed in Indian GDP. Agriculture Sector Contribute 17% in GDP Manufacturing Sector Contribute 30% in GDP Service Sector Contribute 53% in GDP After Demonetization all the three sectors faces negative impacts.

Even though demonetization move created adverse short-term policy impact the real impact of must be assessed in the medium/long term. The reduction in overall investments, both in the formal and informal sectors, would certainly reduce economic growth potential. However, the move need to be followed up with ensuing actions to remain effective. These actions relate primarily to structural changes to make the system more lawful, reducing too much bureaucracy, make the tax system simple and transparent. In addition, a greater effort is required to include the informal sector and ensure effectiveness and the illegal activities such as generation of black money and corruption should not be channeled back into the economy.

1. Demonetization is not a big disaster like global banking sector crisis of 2007; but at the same time, it will act as a liquidity shock that disturbs economic activities.
2. **Liquidity crunch (short term effect):** liquidity shock means people are not able to get sufficient volume of popular denomination especially Rs 500. This currency unit is the favourable denomination in daily life. It constituted to nearly 49% of the previous currency supply in terms of value. Higher the time required to resupply Rs 500 notes, higher will be the duration of the liquidity crunch. Current reports indicate that all security printing press can print only 2000 million units of RS 500 notes by the end of this year. Nearly 16000 mn Rs 500 notes were in circulation as on end March 2016. Some portion of this were filled by the new Rs 2000 notes. Towards end of March approximately 10000 mn units will be printed and replaced. All these indicate that currency crunch will be in our economy for the next four months.
3. **Welfare loss for the currency using population:** Most active segments of the population who constitute the 'base of the pyramid' uses currency to meet their transactions. The daily wage earners, other labourers, small traders etc. who reside out of the formal economy uses cash frequently. These sections will lose income in the absence of liquid cash. Cash stringency will compel firms to reduce labour cost and thus reduces income to the poor working class.

There will be a trickle up effect of the liquidity chaos to the higher income people with time

4. **Consumption will be hit:** When liquidity shortage strikes, it is consumption that is going to be adversely affected first.

Consumption ↓ → Production ↓ → Employment ↓ → Growth ↓ → Tax revenue ↓

5. **Loss of Growth momentum-** India risks its position of being the fastest growing largest economy: reduced consumption, income, investment etc. may reduce India's GDP growth as the liquidity impact itself may last three -four months
6. **Impact on bank deposits and interest rate:** Deposit in the short term may rise, but in the long term, its effect will come down. The savings with the banks are actually liquid cash people stored. It is difficult to assume that such ready cash once stored in their hands will be put into savings for a long term. They saved this money into banks just to convert the old notes into new notes. These are not voluntary savings aimed to get interest. It will be converted into active liquidity by the savers when full-fledged new currency supply take place. This means that new savings with banks is only transitory or short-term deposit. It may be encashed by the savers at the appropriate time. It is not necessary that demonetization will produce big savings in the banking system in the medium term. Most of them. savings are obtained by biggie public sector banks like the SBI. They may reduce interest rate in the short/medium term. But they can't follow it in the long term.
7. **Impact on black money:** Only a small portion of black money is actually stored in the form of cash. Usually, black income is kept in the form of physical assets like gold, land, buildings etc. Hence the amount of black money countered by demonetization depend upon the amount of black money held in the form of cash and it will be smaller than expected. But more than anything else, demonetization has a big propaganda effect. People are now much convinced about the need to fight black income. such a nationwide awareness and urge will encourage government to come out with even strong measures
8. **Impact on counterfeit currency:** the real impact will be on counterfeit/fake currency as its circulation will be checked after this exercise. Demonetization as a cleaning exercise may produce several good things in the economy. At the same time, it creates unavoidable income and welfare losses to the poor sections of the society who gets income based on their daily work and those who doesn't have the digital transaction culture. Overall economic activities will be dampened in the short term. But the unmeasurable benefits of having more transparency and reduced volume of black money activities can be pointed as long term benefits.

Conclusions

The demonetization undertaken by the government is a large shock to the economy. The impact of the shock in the medium term is a function of how much of the currency will be replaced at the end of the replacement process and the extent to which currency in circulation is extinguished. While it has been argued that the cash that would be extinguished would be “black money” and hence, should be rightfully extinguished to set right the perverse incentive structure in the economy, this argument is based on impressions rather than on facts. While the facts are not available to anybody, it would be foolhardy to argue that this is the only possibility. As argued above, it is possible that these cash balances were used as a medium of exchange. In other words, while the cash was mediating in legitimate economic activity, if this currency is extinguished there would be a contraction of economic activity in the economy and that is a cost that needs to be factored in while assessing the impact of the demonetization on the economy and its agents.

The impact of Demonetization on Indian economy's different sectors. GDP of Country slightly decreases as compare with the previous year but we cannot say it will be same in future also. —This intervention is a one-time draining of this current stock of black money but unless the root causes of corruption are removed, corruption will continue.

If the money disappears, as some hoarders would not like to be seen with their cash pile, the economy will not benefit. On the other hand if the money finds its way in the economy it could have a meaningful impact. However experiences from different countries shows that the move was one of the series that failed to fix a debtburdened and inflation-ridden economy.

It is likely that there would be a spurt in the banking deposits. While interpreting the phenomenon, however, one has to keep in mind that a large part of their deposits were earlier used for transactional purposes. For example, if a small trader deposits 2 lakh Rupees in the Jan Dhan account since the currency in which he held these balances in for transactional purposes has been scrapped, it would be incorrect to interpret this as success of the program in bringing in people who were hiding black money. Nor can they be interpreted as additional balances that the banking sector can lend out on the same basis as earlier deposits, since the deposits now would remain in accounts for much shorter periods that deposits based on savings would be.

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