
Demonetization in India: An Analysis of Impact on Indian Economy

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ABSTRACT-

On the 8th of November, 2016 when the sun had descended below the horizon and the light of day had completely faded, when people were returning back home from a long day at work, a misty light of a new economy was brewing over the country. All Rs.500 and Rs.1000 banknotes of the Mahatma Gandhi Series ceased to be legal tender in India from 9 November 2016. 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 has impacted various sectors of the economy in varying degrees; however, in the affected sectors, the adverse impact was transient and felt mainly in November and December 2016. The impact

moderated significantly in January 2017 and dissipated by and large by mid-February, reflecting the fast pace of remonetisation. The latest CSO estimates suggest that the impact of demonetization on GVA growth was modest 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. As of December 28, official sources said that the Income Tax department detected over 4,172 crore of un-disclosed income and seized new notes worth 105 crore as part of its country-wide operations. The department carried out a total of 983

search, survey and enquiry operations under the provisions of the Income Tax Act and has issued 5,027 notices to various entities on charges of tax evasion and hawala-like dealings. The department also seized cash and jewellery worth over 549 crore out of which the new currency seized (majority of them 2000 notes) is valued at about 105 crore.

Key word: Surgical Strike note ban, economist, expert, opinion. I

I. INTRODUCTION –

With effect from 8th Nov. 2016 Tuesday Midnight PM Shri Narendra Modi Ji Banned the Currency notes of 500 and 1000. It is a strict decision of banning regular 500 and 1000 rupee notes from circulation which is a result of finding 1.25 lakh crore black money. Within 3 days of that striking decision: - 35000 Crore Rs. Deposited in banks and approximate 1500 Crore Rs Black Money were destroyed. 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 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. There is an one important thing exist on economics, which is remonetisation, in which forms of payment is restored as legal tender. There are so many reasons, why governments demonetized their nation's currency. Some reasons are like resisting inflation, resist corruption, and discourage a cash system in the country. In November 2016, The Indian government has taken a bold step to demonetize the 500 and 1000 Rs (fully ban). Currency notes, these two biggest denominated notes accounted 80% of the currency supply. The government's main objectives of note ban is, to eradicate counterfeit currency, resist tax evasion, destroy the black money, and terrorist financing activities, and to encourage the country towards the cashless economy. This decision taken by government is for welfare of the nation, but so many questions comes in mind that, would note ban decision actually eradicate the black money, if does then at what extent black money will come out. 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.

II. Objectives of the study

- 1) To know about actual present outcomes of the note banned decision.
- 2) To know the potential of the note ban decision.
- 3) To estimate the consequences for future of the note ban decision.
- 4) To analyze the impact of Demonetization on different sectors of economy.

III. Scope of the study –

Through this study we will be able to know about the future conditions of the economy. This study will help to know the present and future condition of the economy and they can take rational decision on their income and expenditure. Any businessman can also take the wise decision so that he will be able to generate more revenue and can earn the profit in the actual market scenario. Finally everybody would be able to know the impact of note banned decision on Indian economy as well as Indian markets.

IV. Methodology-

Data collection- Secondary data has used for the study. Secondary data is collected from library, text books, and journals, articles from news papers and from relevant websites available on internet.

Measures- Based on situation specific scenarios, expert's opinions, and use of internet for information search.

The present study is quantitative in nature and secondary data will be used for the purpose of analysis.

V. Experts and Economists views about demonetization-

(1.) **Arun Jaitely**-(Current Finance Minister of India)

According to Indian Express Mr. Arun Jaitley gives his opinion that the demonetization is good for economy, Indian banks were facing NPA problem since last many years, now banks will have more money to lend for many sectors of the economy.

(2.) **Kaushik Basu**- (Leading economist; Senior Vice President and Chief Economist at The World Bank)

According to Indian express, Mr. Kaushik Basu said that government of India made policy that any person who deposits money beyond the limit of 250000, have to pay huge penalty. This policy created a new black market, in which large amount of illicit cash broken in to smaller parts and deposited by the members of team;

which is a legal way of illegal activity. Mr. Basu said this move is hurting innocent people who has no illegal money but they have built up cash reserve over a long period of time.

(3.) Dr. Manmohan Singh- (Former Prime Minister; eminent economist; former RBI governor)

According to Indian express, the former prime minister, RBI governor, and economist Dr. Manmohan Singh said in Rajya Sabha that this demonetization is organized loot. In his speech he said that, the way the scheme has been implemented will harm the agricultural sector in India, it will also harm the small scale industry and informal sectors of the economy.

(4.) Amartya Sen- (Leading economist; Noble Laureate; recipient of the Bharat Ratna)

According to Indian express, Professor Amartya Sen said that millions of innocent people have deprived from their money and being suffered to get their own money back.

(5.) Arun Shourie- (Former economist at the World Bank; recipient of the Padma Bhushan and Union Minister)

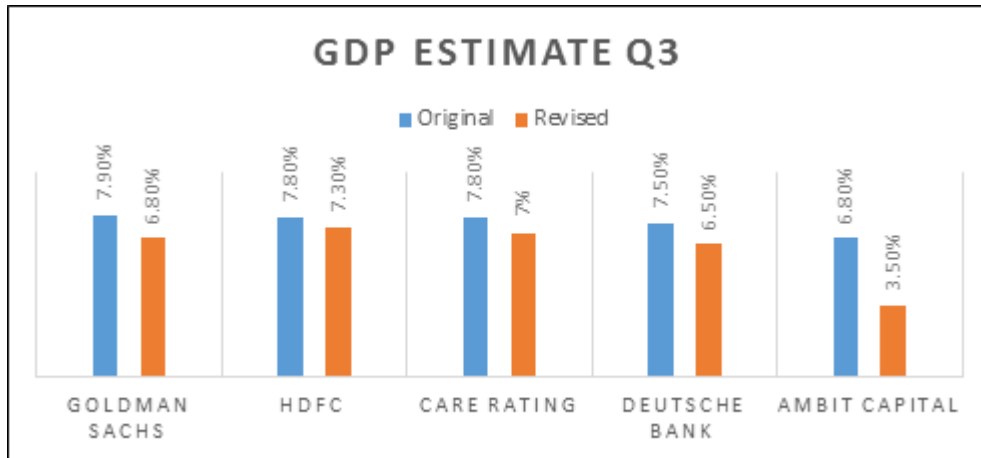
According to Indian express, Mr. Arun Shourie said in an interview with NDTV, that this note banned policy made by present Indian government is not poke on black money,

because the owner of black money converted their money into tangible and intangible assets. The persons who have huge black money, they never keep money in cash, they never keep money under the mattress, or in gunny bags. They invested their black money in properties, jewelries, stock markets or in other assets.

VI. Impact of demonetization on Indian economy-

(A.) GDP-

In the near-term, this move Impact economic activity across sectors with pronounced slowdown across sectors irrespective of the extent of usage of cash. Risk aversion is likely to inch up manifold. Over the next 6 months, most sectors (except I T & Pharma) will face growth challenges, and in particular hurt discretionary spends, gold and real estate purchases. According to the government's latest growth estimates, the pace of growth impacted by slowing growth in the manufacturing and mining sectors and also construction activity. This estimate is in line with the forecast of India's central bank, Reserve Bank of India, which in its last monetary policy had forecast GDP growth to be at 7.1 percent for the twelve months ending March.

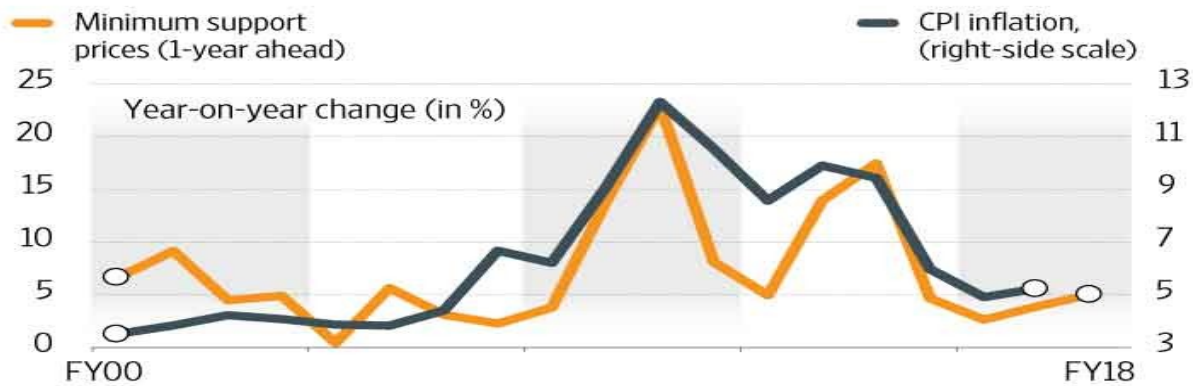


(B.) INFLATION-

Downward pressure on prices due to lower demand, especially in rural areas where share of cash transaction is high. Retail inflation climbed to a 5-month high of 3.81% in March 2017, from 3.65% in January, while wholesale inflation eased

to 5.7%, from 6.55% in January, according to official figures. Although still within the Reserve Bank of India’s (RBI) medium-term target of 4%, concerns about inflation hitting 5.5-6% by the last quarter of the year has prompted the bank to change its policy stance from “accommodative” to “neutral”.

MINIMUM SUPPORT PRICE VS CPI INFLATION



Note: We use the CPI weights of each food item to estimate the weighted average MSP. FY17 CPI data are for Apr-Oct.

Source: CEIC and Nomura Global Economics.

(C.) LIQUIDITY AND RATES –

Improved liquidity in the banking system is positive for lending rate cuts. The possibility of

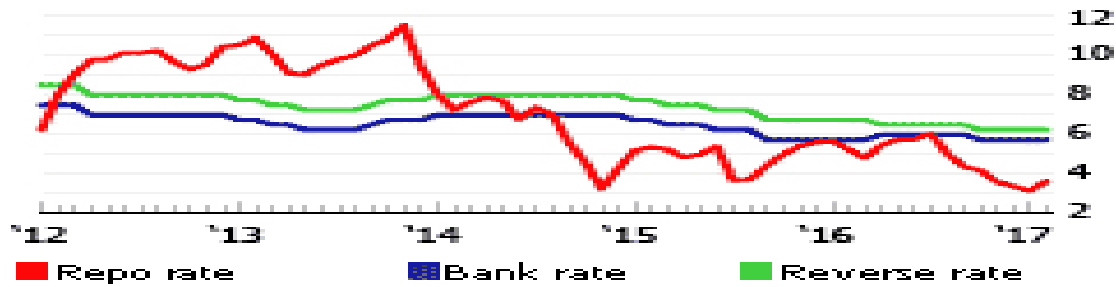
50 bps of rate cut by the RBI has also opened up if demand slowdown becomes severe. This should further support decline in G-sec yields

(10 year G-sec yield has already declined 30 bps).

The demonetization caused a surge in banking sector deposits, opening up more funds for

lending. The [State Bank of India](#) has already started cutting lending rates by 90 basis points to 7.75% for overnight maturities and to 8.15% for three-year tenures.

Interest Rates & Inflation (%)



Source: Reserve Bank of India

(D.) CURRENT ACCOUNT DEFICIT –

Discretionary consumption slowdown is likely to impact non-oil non-gold imports. After the initial surge in gold demand (as cash is converted to gold), gold imports should also start to slow. Thus, the decline in imports should be positive for CAD.

(E.) FISCAL DEFICIT –

Most of the gains (higher direct tax collections and RBI surplus if any) will accrue in FY 18. On the other hand, indirect tax collections is likely to be impacted in the near-term due to demand slowdown. Thus, there is going to be near-term pressure on government finances.

VII. FACT AND FINDINGS

A.) Impact of Demonetization on Agriculture Sector:-

Agricultural growth in India contracted 0.2% in 2014-15 and grew no more than 1.2% in 2015-16, largely because of back-to-back droughts. It was expected to grow at 4% in this year as per CRISIL Report, but due to Demonetization this forecast is proven wrong because Farmers are running out of Cash to buy Seeds, Fertilizer, Equipments, and Wages payment to workers and Commission to Agents etc. Because of Cash shortage daily supply transport system has also suffered which was result in 25 to 50 % reduction in sales. Following is the main reasons;

I. Farmers are not educated and aware about how to work on E-Payment System, Recent study by RBI Says 78% of the population do not use internet in which almost 80 to 85 % are Farmers.

II. In most of the Villages Proper Banking system is not Developed yet and Villagers are need to go to the cities for the same because of that Farmer's most of the time is engaged in exchanging the old notes in Banks.

B.) Impact of Demonetization on Business sector:-

As per the study IPP says Growth in Business sector 0.7% in October 2016 but after 8th Nov.2016 Demonetization shows a different picture because of this decision labour turnover is also increased as lack of Production because of law demand of products people were purchase only if it necessarily required, for this I have studied on following business sector

I. Textile industry

Most of the Brands and Retailers Report 40 to 60 % drop in sales after Demonetization in first few weeks but from December onwards this drop is slightly decrease, but still we can say the impact of this decision has affect the industry in 2017 also for at least 3 to 4 months.

II. Real Estate:-

Demonetization smashed the real estate market and it will result in 50% drop down and it will remain for further 5 to 6 months. While the short-term impact is negative, Experts hoping that rate cuts in the coming months would boost home sales. The real estate developers were focusing their efforts to attract customers by offering additional free benefits like jewellery, electronic items, automobiles, holiday package and appliances on the purchase of housing units. Builders also offered the price guarantee,

rental assurance, and buyback schemes to bring confidence in the sector.

III. FMCG Products:-

Consumer expenditures also affected by that decision now only those products are purchased which was necessary for daily consumption and mostly the small traders like 'kirana store', 'small bodies', 'thela wala' etc. they all have done their daily transactions only in cash and because consumer has less cash in his pockets the daily sells of these traders drop down by 20 to 30 %. It is also a short term impact in future things get normal. Purchase of personal care items such as toilet soaps, toothpaste and shampoo had seen the greatest fall by retailers. According to consumer point of view, one out of five housewives had reduced spending by 50% or more. They had cut spends across categories for impulse categories such as biscuits, salty snacks compared to everyday essentials like atta, rice, pulse, sugar.

C.) Impact of Demonetization on Service Sector:-

Service sector is hit very hard by Demonetization decision in November 2016 worst Slump in nearly three year is noted.

The Nikkei India Services Purchasing Managers' Index (PMI), which tracks services sector companies on a monthly basis, stood at 46.7 in November, down from 54.5 in October. The Index slipped into contraction territory for the first time since June 2015 and pointed to the sharpest reduction in output for almost three years. On other hand if we talk about Banking Sector this is the only sector which was

benefited by that decision in many aspects, this move will pull a large chunk of first time users to banks, who will have to use the system at least once to exchange their old notes for new ones. According to a study conducted by Moody's, people tend to continue using banking services once they have crossed the 'first-time user' mark. This development will increase bank deposits by 1 to 2 percent compared to what they were before the demonetization scheme.

VIII. CONCLUSION

The present study shows the impact of Demonetization on Indian economy's different sectors. As GDP of Country slightly decreases as compare with the previous year but we cannot say it will be same in future also. Although Demonetization has create so many hurdles for the citizens of India. Citizens of India faced so many problems due to the demonetization drive; they faced queue problems in the banks and ATM'S for depositing and withdrawing money. Citizens of India faced problem of less consumption of goods due to the lack of cash liquidity. Several businesses disrupted due the lack of liquidity, business owners as well as consumer faced so many problems. When government took this bold decision about the demonetization in India, government didn't know that Indian citizen will have to face this kind of problem for a long time. But government has given so many remedies to the citizens of India for time to time. On the other hand, Indian financial market, real estate market, FMCG Sector, Auto assets backed loans etc. all are declined for a short time. Some economics expert said that

positive impact of demonetization will showed in future. Government has also increased the withdrawal limits. The queues in front of banks and ATMs have reduced. Somehow black money also comes out. Now we should wait and watch the overall impact of demonetization drive. —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. It is sort of like a dialysis, more of a short term cleaning up than a solution of the problem. It needs to be repeated periodically.¶

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