

Demonetization: A Boon or Bane to the Indian Economy

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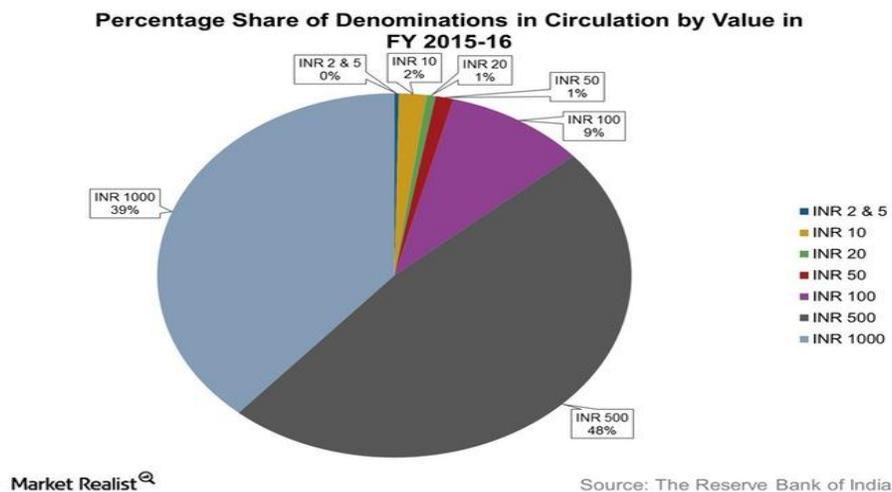
Abstract

As we know that a surprising decision was taken by prime minister Modi on 8 November, 2016 to curb the black money, terrorism, corruption and smuggling from Indian economy. On 8 November 2016 the policy of the demonetization of 500 rupee and 1000 rupee banknotes was enacted by the Indian Government. He announced that from 8 Nov., 2016 these two currencies will not be considered as legal tender. Where this step benefits the economy somewhere, there is some negative impact also on the Indian economy. So, this lecture is to know the impact of demonetization on different sectors of the Indian economy. Secondary data is collected through different sources like RBI reports, CSO, India, journals etc. This lecture discussed the impact of demonetization which gives positive as well as negative feedback. There is a creation of cashless economy due to the demonetization initiatives.

Keywords: Demonetization, GVA, CPI, MCLR etc.

Introduction: Demonetization means withdrawal of particular form of currency from circulation. In 2002 the currencies of twelve European countries were demonetized and replaced with the Euro and

now on 8 November 2016 the policy of the demonetization of 500 rupee and 1000 rupee banknotes was enacted by the Indian Government.



RBI's Annual Report from April 2015 to March 2016 found the value of currency notes on end March 2016 was 16.42 trillion INR. 86.4% part of the values was covered by the 500 rupee and 1,000 rupee and this was eliminated by government in one knock.

Date	Banknotes in circulation	Rs 500 and Rs 1000 banknotes in circulation
31 March 2016	16.42trillion (US\$240 billion)	14.18 trillion (US\$210 billion)

On 28 October 2016 the total banknotes in circulation in India was Rs17.77 trillion (US\$260 billion). The Government of India devised an Income Declaration Scheme (IDS), which opened on 1 June and ended on 30 September 2016. Under the scheme, the black money holders could come clean by declaring the assets, paying the tax and penalty of 45% thereafter.

Review of Literature

Bansal, CMA. J. (2017). Discussed a paper to know the impact of demonetization on Indian economy. He discussed that currency was demonetized due to its use for finance terrorism, fund illegal drug sales, fuel the black market, drive counterfeiting and pay bribes. He called demonetization as a 'Surgical Strike' on black money. He found that after demonetization there were some positive changes only in agriculture sector and other sectors crashed down that will affect Indian economy in 2017.

Kumar, N. & Sharmila. (2016). Made an attempt to study the impact of demonetization on Indian economy. She analyzed that demonetized can help to the economy in various ways, on the other hand she said that it created problems for the poor sections because they get the income on daily wages basis and also they don't know about digitalization process. She found that demonetization will affect the Indian economy in short period.

Objectives of the Study:

- To know the impact of demonetization on Indian economy.
- To know the impact of demonetization on Inflation.
- To know the impact of demonetization on Banking Sector.
- To know the impact of demonetization on financial markets.

Research Methodology

This study is based on Secondary data, the data is collected from various sources:-

- Reports of RBI
- Reports of Central Statistics Office , India
- Publications
- Journals
- Internet

➤ **Impact of Demonetization on Indian Economy**

Demonetization will hit the economy

As this is evident from the review that demonetization will affect the economy in short period and also it is observed by recognizing the GDP and GVA growth rate of the Indian economy. The service sector, which dominates economic activities and involves a sizable chunk of cash transactions, will likely be hit the hardest.



SOURCE: TRADINGECONOMICS.COM | MINISTRY OF STATISTICS AND PROGRAMME IMPLEMENTATION (MOSPI)

Growth of Indian Economy

Growth of an economy is represented by the GDP of that economy. Growth in the Indian economy remained solid in the year 2016 (the latest available).

According to this report, there are possibilities of fall in economic conditions due to demonetization. As a result, GDP and GVA growth in the quarters from

September to December 2016 and January to March 2017 are considerably lower than preceding years.

A drop in flexible spending has harmed companies operating in this space. However, a rise in tax flow and lower interest rates, are likely to assist the Indian economy develop stronger.

➤ Impact of Demonetization on Inflation

Measures of inflation in India

To measure the inflation, CPI (Consumer Price Index) is considered by the RBI. But, earlier WPI (Wholesale Price Index) was considered as primary measurement of

inflation, However it is still in consideration for indication. RBI uses CPI to make the decisions regarding monetary policy. By January 2016, it was supposed to keep inflation below a target of 6%, which it was able to do. Its next target was to keep inflation at or below the 5% mark by March 2017.

INDIA INFLATION RATE



SOURCE: TRADINGECONOMICS.COM | MINISTRY OF STATISTICS AND PROGRAMME IMPLEMENTATION (MOSPI)

Impact of demonetization

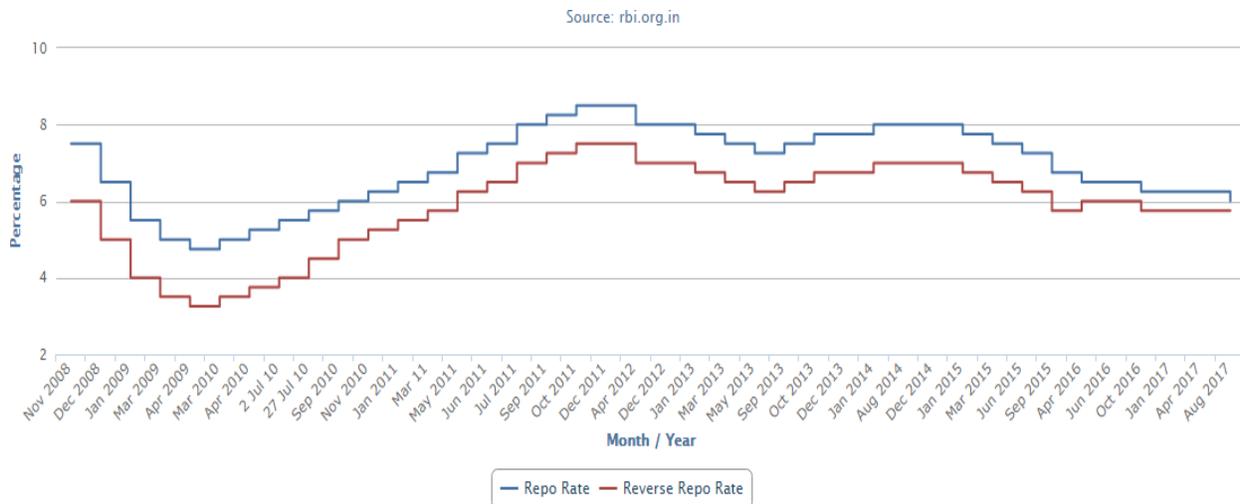
A negative effect is experienced after demonetization on inflation. Spending habits of consumers are also going down since Nov. 9. They only concentrating on the essential needs like health needs, energy needs etc. Mostly sectors like real estate sector are slowing down drastically. Metropolitan and Tier 1 cities reported up to a 30% fall in home prices. 47.3% of the CPI constitutes for food item inflation which is measured by the changes in the Consumer Food Price Index. According to this data the

supply and demand of food items fell down. This is to shown a downward pressure on inflation.

➤ Impact of demonetization on Bank rates

Repo rate cut

There was a meeting held of RBI on October 4, 2016 in which committee of Monetary Policy took a decision to cut the country's repo rate by 25 basis points i.e. 6.3%. At all, the cuts rate for the year stands at 50 basis points.



RBI lends to commercial banks at repo rate which is the key monetary policy of RBI. The reverse of the repo rate is the “reverse repo rate” at which banks give money to the central bank. When there is a change in the repo rate, it boosts or diminishes the rates of commercial banks also. Rates like the ‘reverse repo rate’ and the ‘marginal standing facility’ are permanent beside the repo rate. The rate impacts the movement of the rupee, which impacts the revenue of exporters and tech companies.

More rate cuts to follow

After demonetization the rates of inflation also affected as it is likely to fall. Deposit rates are also reduced by the banks as well as lending rates also fell down.

Rates are already on the decline

After demonetization people started to deposit the demonetized currency in the banks and on November 21, 2016, according

to RBI reports there were more than 5 trillion rupee deposited. At 68.2 rupees to one US dollar, it translates to \$75 billion in deposits in just eight banking days. Banks also have been seen a rise in term deposit accounts since the demonetization. Due to these factors, commercial banks like State Bank of India, ICICI Bank, HDFC Bank, and Punjab National Bank, among a host of others, sharply reduced their deposit rates.

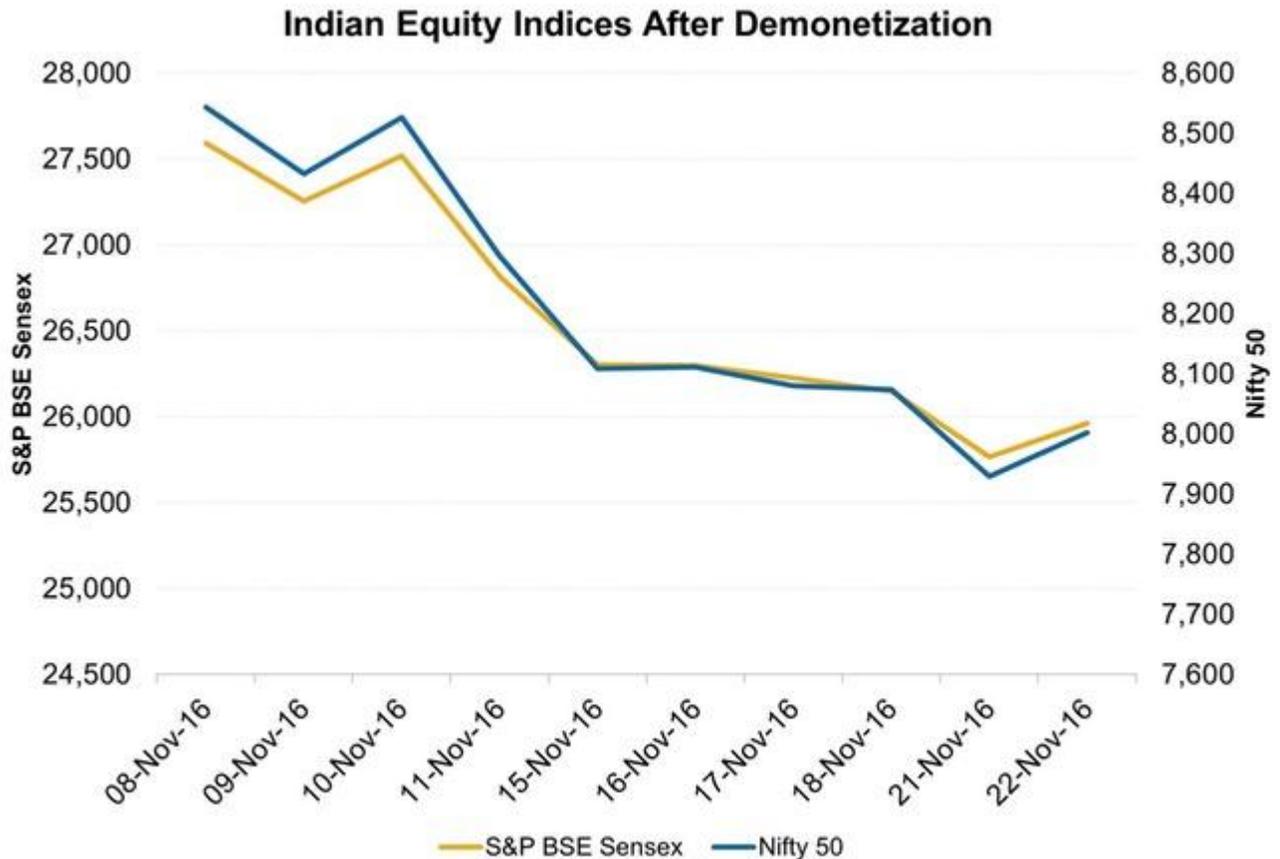
Falling Loan burden

Earlier, Base Rate was used by the banks but now MCLR is sanctioned for giving the loan. As we discussed above about cutting deposits, banks also reducing their lending rates. This reduction in lending rates attractive consumers to take out loans for getting exclusive consumer discretionary items like vehicles, houses and others etc.

➤ Impact of demonetization on Financial markets

Equities fall, but prospects are better
Since the demonetization, Equity markets also have been fluctuated by falling trend. Equity market includes 2 yardsticks i.e. Nifty 50 and the S&P BSE Sensex. These are falling down on each day since the

demonetization except on Nov. 10, 2016 and Nov. 22. Till 22 Nov. Nifty 50 fell by 6.3% and BSE Sensex fell by 5.9%. Due to the rise in the US dollar, the dollar equivalents of the Sensex and the Nifty fell more than 8% each.



Market Realist

Source: Exchanges

As a combined effect of demonetisation and US presidential election, the stock market indices dropped to an around six-month low in the week following the announcement. The day after the demonetisation announcement

Stock Market Indices	Crashed
BSE SENSEX	1689 points
NIFTY 50	541 points

➤ **Impact of demonetization on other sectors**

Commercial real estate: In commercial real estate's there is not much role of cash transactions, so there is hardly less impact on Commercial estates transactions.

Residential real estate: As these estates deal in cash transactions so it is affected by the demonetization. Impact of the demonetization in this sector can be seen in large cities, tier II and tier III cities.

Retail real estate: Demonetization reduces the circulation of money transactions due to which its impact can be seen in short period in retail real estate sector. The luxury section is likely to be hit more because of more cash transactions in this area. Overall, the domestic consumption story remains intact, with no threat to the overall strength and growth of the Indian retail industry.

Agriculture Sector: Transactions in this area are heavily dependent on cash and were adversely affected by the demonetisation. Due to scarcity of the new currency, many farmers have not sufficient cash to purchase seeds, fertilisers and pesticides needed for the **plantation**.

Railways: As of November 2015, Indian Railways did not have the option to make

payment with cards at the counters. After the demonetization move, the government announced to make card payment options available.

Conclusion:

In conclusion, it can be said that Demonetization as a cleaning exercise are producing several good things in the economy. Its impact has been seen on many sectors in the Indian economy in which some have positive effect and some of them have negative effect. At the same time, it creates several problems for 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 actives have been dampened in the short term. But the immeasurable benefits of having more transparency and reduced volume of black money activities can be pointed as long term benefits.

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