

Demonetization: Impact on Indian Economy, With Special Reference To Banking Industry

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Abstract: Demonetization means scrapping a currency unit of its status as legal tender. Demonetization is always regarded as a brave economic decision taken by any government. On 8th November, 2016, the Prime Minister of India surprised one and all when he announced the economy cleansing process in the form of demonetization to achieve multiple and multifaceted objectives. This brave political and economic decision was a war against black money, terrorism and corruption. The impact of this move has been felt across sectors and states with different intensities and has affected all walks of life and the entire economy.

At an aggregate level, this move has significantly impacted in eliminating the existing stock of black money, fake currency and will benefit the economy in the medium to long run. Demonetization if adversely impacted the GDP, Small business concerns, given hardships to general public in the short run but in the long run it will increase the tax revenues and will curb the parallel economy and will pave way for cashless economy. Demonetization decision has come up with big responsibilities and challenges for the bankers and the bankers have done a commendable job which is not less than a miracle.

Keywords: Demonetization, Digitalisation, legal tender, corruption, Cash less economy

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I. Introduction

Demonetization is a process by which a series of currency is declared as non legal tender for future transaction from a specified date. In other word, the series of currency become non acceptable as valid currency after demonetization. Very recently in an important move, the Government of India declared that the five hundred and one thousand rupee notes will no longer be legal tender from midnight, 8th November 2016. In the subsequent steps, the RBI issued Two thousand and Five hundred rupees new notes and became in circulation from 10th November 2016. As per the declaration, Notes of one hundred, fifty, twenty, ten, five, two and one rupee remain legal tender and remain unaffected by this decision. Demonetization is always regarded as a brave economic decision taken by any government. On 8th November, 2016, the Prime Minister of India surprised one and all when he announced that 2 units of Indian Currency notes Rs. 500 & Rs. 1000 denomination are no more legal tender in India to achieve multiple and multifaceted objectives. As per estimates the two denominations Viz: Rs 500 notes worth Rs 7,85,400 crore were in circulation, and the corresponding figure for Rs 1,000 notes was Rs 6,32,600 crore, adding up to Rs 14,18,000 crore (Rs 14 lakh crore). The two denominations accounted for about 86.4 percent of the total value of currency in circulation. This brave political and economic decision was a war against black money, terrorism and corruption. At an aggregate level, this move will significantly eliminate the existing stock of black money, fake currency and will benefit the economy in the medium to long run. India is not the only country that has tried demonetisation. Prior to India, several countries like Ghana (1982), Nigeria (1984), North Korea (2010) etc have tried Demonetisation but their economy collapsed. Although largely perceived as a sudden announcement will collapse the Indian economy but its impact on Indian economy will be clearer when more statistics will be available. Since Nov 8 the day of this historical decision more than twelve months have passed it is high time to understand and analyse the impact of demonetization on Indian economy. This paper is an attempt in such pursuit. This paper is divided in to three sections the first section deals with introduction followed by the immediate positives and negative on Indian economy due to demonetisation. Section third deals with the impact of demonetization on banking industry and the last section is the conclusion.

Research Methodology

The paper is based on secondary data. The data has been collected from internet, Newspapers, RBI Reports. Graph and percentile method has been used to analyze the data.

Objectives Of Paper

1. To analyze the current the immediate impact of demonetization on Indian economy;
2. To work out the probable consequences of the demonetization.

3. To study the impact of demonetization on banking industry.

Impact of Demonetization On Indian Economy

The Prime Minister of India shocked all by taking and announcing a bold and historic decision of demonetization affecting all walks of life and the entire economy. Although this decision will have a positive impact as some black money will be uncovered. No sane person with a slight financial and economic sense will undermine this decision. It is indeed a bold and a revolutionary decision. This has come as a blow to those who hold black money in cash form. This class of black money holders have been left with no choice except disclosing their money or foregoing with its value and this has created insomnia in them. A considerable portion of such cash held by money launders will show up. But the fact of the matter is that it has some negatives attached with it as well.

Postive Impact of Demonetization on Indian Economy

Big Blow To Iformal Channels:

Demonetization is a bold and extremely risky decision especially when it involves scrapping of Rs 500 and Rs 1000 currency notes to the tune of around 86.4% of the total money in circulation. With this decision everybody was stunned. This bold decision has economic impact and justification as almost 20% of the Indian GDP flows through informal channels outside the radar of banking and tax regulation authorities. These informal channels range from financing drug dealers to investing money in estate raised through corruption, there is a wide nexus of cash flow spanning gold trading, betting, terror financing and a whole bunch of many legal and illegal businesses. Demonetization is a big blow to such informal channels as they have to come in to the ambit of formal financial structure of the country.

Curtailling Fake Cyrrency:

One of the biggest issues that Indian economy is facing is the issue of fake currency. This issue too strongly justifies this huge system cleansing exercise. As per Indian statistical institute, as many as 250 out of every 10 lakh notes in circulation in India are fake and every year fake currency notes with the face value of Rs 70 crore are infused into the system. Addressing such grave currency imbalance deserved immediate action for sure and this issue is addressed by the process of demonetization.

Low Inflation And Lower Fiscal Deficit:

India is the only country in the world where circulation of currency is 12% of GDP while as in developed countries currency in circulation does not exceed 4% of total GDP. This excess currency in circulation results in high inflation and high fiscal deficit. Thus it was the need of the hour to suck excess currency from system to bring down inflation and contain fiscal deficit. It is pertinent to mention here that out of Rs 14 lac crore worth of Rs 500 and Rs 1000 notes that have been scrapped, roughly Rs 3 lac crores are not likely to be exchanged for new notes ever.

Low Interest Rates:

Demonetisation will reduce interest rates as there would be more liquidity in the system, the interest rate paid on deposited has been already reduced by many banks in the post demonetisation and the interest rates on loans will follow the pursuit. Though, it is not good news for those who park their money in banks but will definitely provide boost to credit expansion in the economy.

Taxation:

There would be enormous increase in the number of first time tax payers. It has been time and again clearly stated that abnormal increase in deposits would attract higher tax plus penalty. The latest notifications from government of India states that higher abnormal deposits would attract 60% tax and 25% to 50% of deposits will have a lock in period of 4 years.

Digitisation:

It is due to the shock given to the system, demonetisation will accelerate the digitisation of the financial economy and financial inclusion. The basic idea behind demonetisation is to create an environment of cash less economy. The people will slowly and steadily adapt themselves to unified payment interface to make online payments by virtue of their smart phones.

Increase In Demand For Alternative Modes Of Payment:

Curbs put on the cash transactions has pushed people to take route of alternative forms of payments like electronic transaction system, e-Wallets, e-banking, usage of debit and credit cards etc. The use of such forms of payment has seen a considerable increase. Precisely, it indicates that cashless transactions has received momentum and replaced the cash transactions even in day to day routine activities.

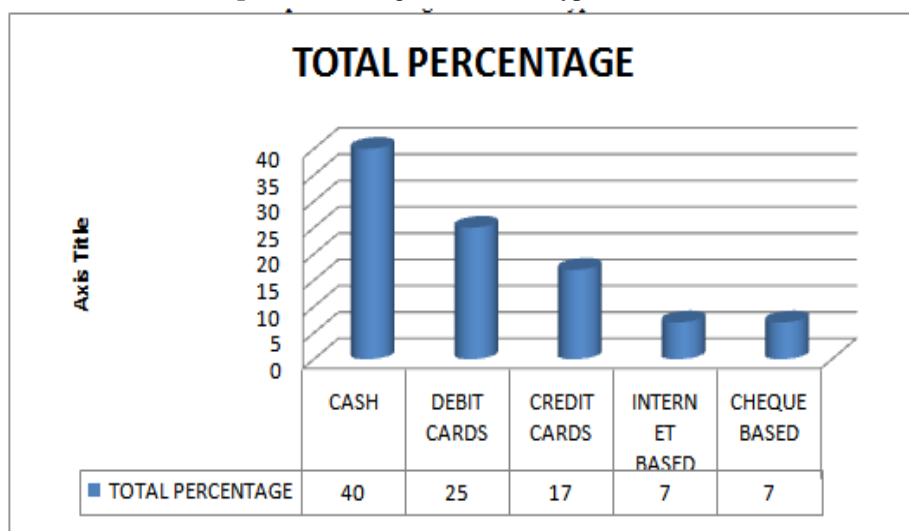
**Negative Impact Of Demonetization On Indian Economy
Effect On Gdp:**

The impact on GDP is going to be clearly negative in the short run. Most of the economists are of the view that GDP of the country will shrink by at least 2% due to reduction in overall spending. Former Prime Minister Manmohan Singh. — Who is also an economist during a debate in Rajya Sabha said, "The GDP of the country will decline by about 2 percent by what has been done. And this is an underestimate and not an overestimate." Experts have agreed with the observations of the former Prime Minister — and concurred that the decline in GDP could be as high as three or four percent.

Cash Starvation:

Given the level of cash dependence in Indian economy, the decision seems to be a bit early Almost 40% of transactions in India are still done through cash followed by debit cards 25% and credit cards 17% Internet based banking and cheque based transaction account for 7% each. In India cash as percentage of total consumer payments is around 98%, compared with 55% and 48% in the USA and in the UK respectively. Sucking an enormous amount of money in 50 days from a system, will leave economy absolutely dry and the risk of an economic slowdown will surely creep in. to add to the miseries, more than 80% of the total cash value in economy is contributed Rs 500 and Rs 1000 notes . The choked outflow set by the government in terms of weekly and daily ATM and manual withdrawal limits will only aggravate the problem.

Graph 1: Percentage of different types of transactions



Effect on Cash Based Sectors Of Economy:

The Indian economy broadly consists of 21 sectors. The effect of demonetisation varies from one sector to another. The cash based sectors like reality and jewellery are worst hit due to liquidity issues. The reality prices as per an estimate to fall by at least 25-30% while as the demand for gems and jewellery is expected to decline as big purchases are done on cash basis only. In the same manner private educational institutions are also hit hard as donation upto 40-50% are taken in cash only. The non government charitable institutions are also worst sufferers.

Foreign Tourists, Daily Wage Laborers And Middle Class Are Facing Great Difficulties:

Tourists' especially foreign tourists faced lot of difficulties during their stay as they were unable o purchase anything and were clue less what to do with the Rs500 and Rs 1000 notes in their possession. Similarly, daily wage labourers, and lower strata of the society suffered do to non availability of cash.

Suffering To General Public:

The general public has been left in lurch due to demonetization. Though exchange facilities are there, but diverting whole population to waste working hours in queues to seek exchange of invalid notes has deprived them of their opportunity to earn livelihood not only this they were put to stress for none of their faults.

Plight Of Senior Citizens:

People move in large numbers towards banks throughout the country with the purpose of exchanging invalid notes but unfortunately no special arrangements were made for senior citizens. The counters or the windows earmarked for their convenience were also occupied by the people due to heavy rush. It added to the miseries of senior citizens and they were also supposed to stand in the long queues for hours together before his or her turn comes. This all led to the death of about 100 persons.

Death Knell To Small Businesses:

The demonetization is expected to hit hard small business concerns especially in the rural areas, who borrow money from money lenders on interest and pay them back as and when they are able to do so. Since demonetization has considerably reduced the purchasing power of the poor people living in villages hence it has also adversely affected the income of small business men.

Birth To Corrupt And Deceitful Practices:

Old age people and the sections belonging to lower strata of society with meagre savings and remote locations have faced extreme difficulty in exchanging the now invalid currency notes. This has made a way for an array of corrupt and deceitful practices. People tried to adopt all means to exchange notes quickly without differentiating between ethical and unethical practices.

Impact On Banking Industry

It is said that banks are the blood vessels of an economy. Demonetization has affected and is affecting all walks of life and the entire economy but moreover this decision has more impact on general economic conditions, banks and general public. The prime minister of India Mr. Narendra Modi on November 8 in late evening television address declared almost 86% of the available currency in the country invalid. This decision has come up with big responsibilities and challenges for the bankers. First of all bankers will have to deal with enormous footfall of the people demanding exchange of notes. Restrictions have been imposed over the amount of money that one could withdraw from banks or ATMs. This also has to be dealt with. Keeping all this aside, one big challenge is to deal with the fraudsters and unscrupulous elements who would try to take undue advantage of this emergency situation and come with fake currency or fake documents to get their black money absorbed in the banking system. This delicate matter has to be dealt with. Bankers' has to prove very vigilant which they did on this front. This chaotic situation has also proved beneficial for banks as in view to adjust excess money or undeclared money, people may try to write off bad debts. they have also tried to adjust excess money or undeclared money in insurance policies, SIP's (systematic Investment Plans) in mutual funds, etc. all this has benefited banks. Deposits in current and saving accounts have increased to a great extent and NPA's (Non Performing Assets) has reduced all these are healthy signs for banking industry. Though, people in whole country have been left, in a state of shock and confusion by this decision. It is the banking industry which bears the brunt on two fronts: First dealing with the extraordinary rush at branches has resulted in public anger against them as they lack proper infrastructure and power to extend hassle free services to such a huge number of customers in the given time this amounts to breeding of disgruntled customers which is in neither way favourable for banks. Second, the banks had turned fundamentally weak. In other words, the demonetisation Drive to phase out five hundred and one thousand notes from the economy and for the first time pumping two thousand rupee notes in the financial system along with new notes of five hundred rupees has a huge impact on the banks which have reeling under tremendous pressure for the past few years on account of escalating non-performing assets (NPA's). The banks suffering losses in the past few quarters have been squeezed to 'exchange counters'. They have been forced to shift focus from recovery of bad loans, to mere currency exchange counters which has threatened even existence of some banks. It is worth mentioning that Reserve Bank of India (RBI) has already given clear cut directions to banks to clean their balance sheets by March 2017 by making appropriate provisions for even stressed loans which the RBI considers as good as non-performing assets. Even as the banks were engaged in strategising effective recovery mechanism to deal with bad loans at the same time announcement of demonetisation derailed their 'loan recovery' enthusiasm with entire focus shifted to tackle huge rush of people seeking deposits/ exchange invalid notes. One of the major visible benefits of demonetisation is that the banks see a huge surge in their deposits base, especially in low cost deposit segment as people were seen depositing invalid notes mostly in saving or Current accounts, more strong the base of deposits of banks, more is the liquidity position of the banks. This means the banks are able to lend more loans at lower interest rates. However, there is other side of the story. The increase in the deposit base increase

liability of the banks and they have to work extra hours to park these deposits in safe heavens where the investment is not only productive but also safe. Creating a healthy credit portfolio amid today's worst scenario of bad loans is a challenging task. So mounting deposit can also turn problematic for the banks. Curbs put on the cash transactions has pushed people to take route of alternative forms of payments like electronic transaction system, e-Wallets, e-banking, usage of debit and credit cards etc the use of such forms of payment has seen a considerable increase. Precisely, it indicates that cashless transactions has received momentum and replaced the cash transactions even in day to day routine activities. It has given a clear cut message to the banks to provide an electronic platform to cater the huge rush of e-transactions expected after demonetisation process. There are issues regarding infrastructural preparedness, security of the staff and branch premises but still banks have done an incredible job in making demonetisation process a big and grand success. What banks did and bear after shocking announcement of demonetization is really praiseworthy. The system administrators of all banks had to inform each staff member about the scheme. They had to issue official communication about the same. What banks did on the next day i.e. Nov 9 was out of imagination and not less than a miracle. The next day banks had to empty their ATMs of all the Old Denomination Notes (ODN) and perform necessary electronic operations to reset their all machines. At the same time all banks had to communicate a myriad report to the Reserve Bank of India regarding the amount of cash held by them. In the mean while, the information technology wings of all banks had to develop a software package for the exchange of old notes with the new one. It is worth mentioning here that this package had to be developed with such integration that it detects the amount of cash already exchanged by a person from any bank branch. It had to developed in such a way that it successfully uses and synchronize the information like PAN number, AADHAR number, etc. all these things had to be created overnight. Similarly, the core banking software which a bank uses to carry on its day to day financial transactions had to be instructed suitably so as to restrict the withdrawals as per the instructions from RBI all this a herculean task with limitations arising every now and then. It was altogether a new set of tasks put before every banker, just like first experience for a newly recruited staff but bankers tackled all these complicated issues efficiently and effectively. The other modification needed in the banking system was to recalibrate the ATMs so that the new currency with new features, different size and denomination, gets dispensed successfully all this needs ATMs to be modified in such a way that the facility to dispense new currency notes has been put in it all demands a sound technical operation. But the reality is this that bankers have stood up to the challenge sacrificing their holidays, skipping their lunch and dinner in service of people.

II. Conclusion

The impact of demonetisation can be understood fully when more statistics become available in the future times, but the economic consequences of the demonetisation measure have many short term, medium term and long term ramifications. It has disturbed the lives and day to day activities of people and has led to contractions in consumption, trading and household incomes. Savings are also affected as currency holdings are converted into bank deposits which has led to the increase in the liquidity of banks as a result of which interest rates has declined. Banks faced a great challenge but proved their mettle by making Demonetization process a success. To sum up India is not the only country that has tried demonetisation. Prior to India, several countries like Ghana (1982), Nigeria (1984), North Korea (2010) etc. have tried Demonetisation but their economies collapsed. Although largely perceived as a sudden announcement will collapse the Indian economy but such is not the case in reality Indian economy survived but it needs to be seen how far demonetisation will be effective in curbing black money and prevent growth of forfeiture currency notes. In this whole process baking sector played a magnificent role irrespective of all odds which deserves applaud and appreciation.

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