

Impact of Demonetization on Indian Economy

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Abstract – This paper has to analyze the impact of demonetization on Indian Economy. The present paper shows the impact on different sectors of economy whether it is positive or negative. Before 2016, the Indian currency was demonetized first time in 1946 and second time in 1978. Then on 8th November, 2016 currency is demonetized third time by the Modi Government. Secondary data is collected for this paper. The required data is collected for this paper. The required data is collected from the published sources like magazines, newspaper, reports. The study covers the impact of demonetization Inflation, Gross Domestic product (GDP), Export-Import and other areas which are affected from it. This paper presents the results which come in India after demonetization and some results are more useful which helps in the growth of India.

Keywords: - Demonetization, Black Money, Corruption, Tax Evasion, Cashless Transaction.

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OBJECTIVES OF THE STUDY

The following are the objective of the study:-

- (1) To analyze the impact of demonetization in Indian economy.
- (2) To analyze the findings and results of the demonetization.

Sources of Data:-The secondary data is collected for the study. The required data was collected from the RBI website, Journal, newspapers and the like etc.

Introduction:-Demonetization is the act of stripping a currency unites of its status as legal tender. It means there is a change in the national currency. India's Prime Minister Narendra Modi announced the decision of Indian government to cancel the legal tender character of INR 500 and INR 1000 banknotes. These ceased to be legal tender from the mid-night of 8th of November 2016. People have been given up to December 30, 2016 to exchange the notes from the circulation and replace to these with a new set of notes of INR 500 and INR 2000. In India, similar demonetization has been done in the past. It has been done:-

- In January 1946, wherein banknotes of INR 1000 and INR 10,000 were withdrawn.
- In January 1978, where in bank notes of INR 1000, INR 5000 and INR 10,000 were withdrawn the past.

Then in 2016, the next demonetization was done. In short term, the cash in circulation would be substantially squeezed and for some time, a limit is placed on the amount that individual can withdraw. There are some reasons or causes for demonetization.

- To eliminate the black money from the economy.
- To reduce the fake currency and Terror funding from the economy.
- It also helps in the reduction of corruption.

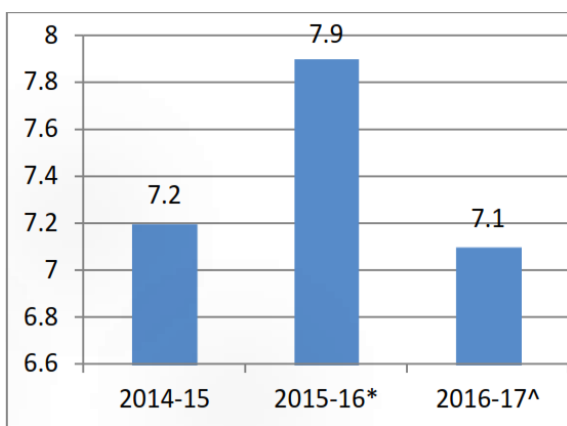
According to RBI's (Reserve Bank of India) annual report for April 2015 to March 2016, the value of currency notes at the end of March 2016 was 16.42 trillion Indian rupees. The total value of old INR 500 and INR 1000 notes in the circulation is of about 86.4% of the value. Through the Demonetization, the government removed 86.4% of the currency in circulation by value. This means that the total cash has to pass through the formal banking channels to get legitimacy. In July 2010, the World Bank estimated the size of shadow economy for India at 20.7% of the gross domestic Product (GDP) in 1999 and it rising to 23.2% in 2007. But India do not achieve to it because there is too much unaccounted value of currency is present in the market. Now after the announcement of demonetization by the government this money is accounted because all money is pass through the banking channel. After paying the relevant tan and

penalties in the unaccounted Value of currency then it is deposited in the banks.

Impact on different sectors:-

As we see that after demonetization, almost every sector is affected from it some are in negative way and some are in positive way. Demonetization has a direct impact on sectors dealing with cash-vendors, taxi drivers, daily wage earners and small traders. The system of all these are depend on cash and the demonetization too much affected from the demonetization there is a limit for some time for withdrawing the amount of cash from bank. So the small traders, daily wage earners too much affected from the demonetization. There are many other sectors with are affected from it. These sectors are as follows:-

1) GDP (Gross Domestic Product) :-In India, a financial year being in April and ends in March of the following year. During the first quarter of 2016-2017, the GDP (Gross Domestic Product rose 7.1% but after demonetization it is estimated that the GDP goes down in the last two to three quarters. But according to CSO estimate, which does not take into account demonetization puts real GDP growth at 7.1% for the whole year. Economics survey expects that economic output in 2017-18 would likely be between 6.75% and 7.5%. That is on the assumption that the economy will bounce back to normalcy and the effects of demonetization would not spill over into the next year. It is an expectation. However, a are expected to help the Indian economy grow stronger.



*provisional
^First advance estimate
Source; Economic Survey & CSO

2) Inflation:- Due to Demonetization, the 86.4% of the value of currency notes in circulation going out of our financial system which affect to the supply and demand of food items fell down. It is also estimated that the inflation goes down in next months also like -In January retail inflation falls to 3.17% due to

declining prices of food items including vegetables and pulse. Retail information, which is measured in terms of consumer Price index (CPI), was 3.14% in December 2016. So CPI fall down in January and overall consumer food Price index was down at 0.53% in January as against 1.37% in December.

3) Impact on Bank Deposits and Interest Rates:-Banking sector is that sector which is too much affected from demonetization because all work whether it is deposit or withdraws of cash is done with the help of banks. After demonetization, a huge chunk of currency is deposited in the banks. Given the huge surge in liquidity post demonetization, man major banks lowered their interest rates up to deposit of 1 year to 6.5% from 6075% on maturities ranging from one year to years. But expected that after some time, the whole system is under control.

4) Black money and Corruption:-The step of demonetization will also help to taken out the black money from Indian economy. As predicted by ICICI securities Primary Dealership the government’s plan to remove INR 500 and INR 1,000 notes from circulation will disclose up to INR 4.6 Lakh crore in black money. So after removing the black money from the system, corruption will reduced automatically.

Arithmetic of Demonetization of High-Denomination

Notes in circulation(value in INR billion)	7854	6326	14180
Notes with bank together with other govt. agencies @30%	2356	1898	4254
Notes with public @70%	5498	4428	9926
Conversion by public for New notes with old (%)	60	40	
Total value of converted by public (INR billion)	3299	1771	5070
Scenario 1: Total value not converted by public @50% (INR billion)	2199	2657	4856
Scenario 2: Total value not covered by public @ 50% of 20% of black money (INR billion)			4520
Scenario 3: Replicating 1978, with 25% not coming back.	1374	1107	2482

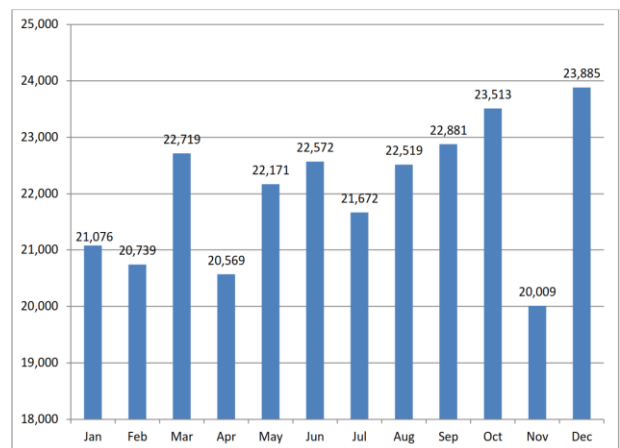
Source: SBI Research, RBI

As we shown in table the public holding of high denomination notes worth Rs 9926 billion as on march 2016. In table, there are three scenario are shown in which scenario 1 and 2 assumed that 50% of the notes of higher denomination do not return to the system. It is estimated that 60% of Rs. 500 and 40% of Rs.1000 notes are exchanged from the Banks, Post offices and RBI before March 31, 2017. So according to roughly estimate Rs. 4.5 lakh crore money could disappear from the system.

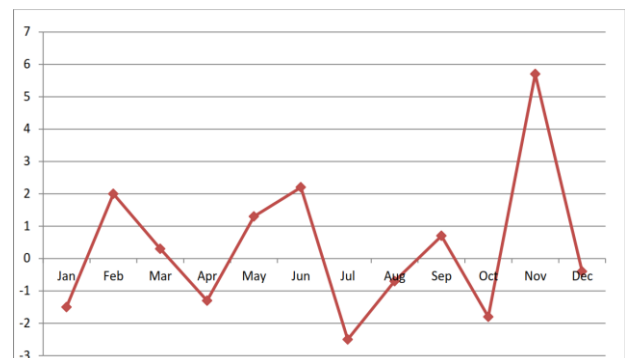
- 1) **Impact on Market:**It is obvious that demonetization also affect to our market. The two major benchmark equity indices are Nifty so and S & P BSE Sensex in India. After spreading the news of Demonetization, the both indices fell down. Nifty 50 fell 6.3% from November 8 until November 22 and same situation with S& P BSE Sensex. But after November 22, the indices goes up. Hence, once the short-term impact of demonetization is over, Indian equities will likely bounce back sharply.
- 2) **Tax Revenue:** - Demonetization positively affect to the tax revenue of the government. There is a 200% Penalty on any abnormally high deposits. So, a large part of that deposit submits to government in the form of penalty and tax. This result in increase in government revenue and helps in the reduction of budget deficit. Like –In January 2017, the government’s net indirect tax collection grew 16.9% while direct tax collection showed a growth of 10.79% at Rs. 5.82 Lakh crore. Personal income tax grew by 21% while corporate income tax by 11.7%. So, we can say that Demonetization could be the taxation policy before the Goods and Services tax (GST) rolls out.
- 3) **Impact on Gold:-**Demonetization of Rs. 500 and Rs. 1,000 denomination notes also affects to the gold for some time period, the prices of gold goes up because after this news those who have black money and money which is not accountable wants to change it. According to national secretary of India Bullion and Jewellers Association (IBIA), the registered jewelers sold estimated 15 tonnes of gold ornaments on November 8 and 9. But today condition is some stable.
- 4) **Impact on Foreign Investment:-** India’s FDI (Foreign Direct Investment) in April-December period rose 22% to \$35.8 billion from the year earlier. Total FDI from the reinvested earnings, inflows into unincorporated bodies and other capital from April to December is pegged at \$48 billion against \$55.5 billion for the whole of the last fiscal year. It means Demonetization and slower growth has not deterred foreign investment and it is estimated that India could get highest FDI in financial year 2017.
- 5) **Real Estate:** -In real estate sector, the most transactions are settled in the form of cash. Due to Demonetization, there would be reduction in cash transactions in real estate. This is likely to reduce to real estate prices and make is affordable to some extent. So, in short term the prices to real estate come down

but the Long term impact is estimated to be positive.

- 6) **Effect on Government spending:-** If government ripe out the benefit of demonetization, it may be positive for economy. Because government has the huge money for investing on infrastructure, agriculture and industry which extends to the growth of whole economy and there is also possibility that there is a reduction in fiscal deficit.
- 7) **Export and Industry Growth:-** Demonetization do not impact too much to export. In 2016, the export of India fluctuate, sometime it goes down but in December it shows a rising trend but industry growth suffer the biggest setback in terms of growth rate in this financial year. In December, 2016 industry growth goes to too much down to -0.4 which is a biggest loss for industry.



Export in 2016 in million USD



Industrial Growth in 2016

- 1) **Effect on Elections:-** Demonetization affected to elections and it is a very big shock for political parties. In elections, a huge amount of donation is given in the form of cash Like- In Uttar Pradesh and

Punjab elections, a Large volume of cash donations are given. In Punjab Election 2017, people are in favour of the demonetization as it would control the flow of money, election commission makes sure that the flow of cash would be under control and the black money won't flow easily. As like Punjab, other states Goa and Uttar Pradesh elections are also affected from Demonetization and we have an assumption that the upcoming elections of 2017 will be force and transparent.

- 2) **Cash shortage:-** The scarcity of cash due to demonetization Led to chaos, and most people facing very difficult for exchanging them due to endless lines outside banks and ATMs across India. It became a daily routine for millions of people wasting to deposit or exchange the INR 500 and INR 1000 banknotes since 9 November, 2016. Many ATM's have no cash and many of them are non-functional. Mostly big cities Like Delhi, Mumbai faces too much ATM starts doing work properly and in next two to three quarters the situation are under control.
- 3) **Agriculture:-** Indian agriculture sector are heavily dependent on cash and were adversely affected by the demonetization of INR 500 and TNR 1000 banknotes. Due to Demonetization, many farmers have insufficient new bank notes for purchasing seeds, fertilizers and pesticides needed for purchasing seeds, fertilizer and pesticides needs for the plantation of rabi crops. There is an unavailability of cash to pay for food products. The reduction in demand that arose in turn led to a crash in the prices of crops. This forced the farmers across the country to reduce the prices of their products and due to it some farmers and their unions conducted protest rallies against the government.
- 4) **Deaths:-** As of 15 November 2016, the attributed death toll was 25 and 33 deaths as of 18 November. These deaths can be directly or indirectly linked to the sudden move of demonetization. Some people were died due to Lack of medical help because many hospitals refused to accept the old banknotes. Several people were reported to have died from standing in bank line for hours to exchange or deposit their old banknotes and some people were died only due to this shocking news.
- 5) **Impact on Tourism:-** Tourism sectors is also affected by demonetization. Tourist faces the cash shortage at airports and hotels and in India many national monuments entry points don't have card payment facility which is a very big problem for tourists.

These are the sectors which are impacted through Demonetization.

FINDINGS OF DEMONETIZATION

As we see that Demonetization of Nov. 2016 affect to almost all sectors of the economy because a huge portion of currency is changed. Due to this cash crunch, India ground to a halt. Some businesses are shut down, taxi and rickshaw drivers did not have any way to receive payments, hospitals were refusing the old bank notes from patients, some families had difficulty in buying food and weeding's are too much affected from it. But after all these hurdles most of the public is in favour of Demonetization. We don't say that Demonetization affects only negatively, it gives some positive results also. So, the positive results which we find due to Demonetization includes:-

(i) Build a digital Economy:-

In India, most of the country was firmly entrenched in cash economy but after this demonetization many people using digital methods like debit and credit cards, e-wallets etc. Now even small traders, rickshaw drivers, vegetable hawkers using the electronic way for paying the amounts. During that period, Paytm because it is done easily. In the path of digital economy our present prime minister, Narendra Modi Launched a BHIM (Bharat interface for money) App in 30 December, 2016. This is an mobile app which facilitate e-payments directly through banks. 125 Lakh people have adopted the BHIM app so far. So, the Demonetization make to the economy cashless.

(ii) Expand the tax dragnet:-

Due to Demonetization, Economy take a step towards the digital economy which is a big benefit for India's government. All transactions through electronic means are traced, mean more tax revenue the fiscal deficit of country decreases and build a strong economy.

(iii) Online Activities:-

The step of government also increases the online activities. Many transactions are done through online method. Today, mostly forms, applications are field through online method. Doing work field through online started before the demonetization but demonetization but demonetization boost to this activity.

All these are the important results of the demonetization. Other than these activates, our new budget is also affected from it. New Budget for 2017-18 was released on 1 February, 2017 by Prime Minister Arun Jaitley. Due to Demonetization many sectors are affected from it like real estate, construction, transport and several other sectors. Every individual has some expectations from the

budget. After considering all situation, finance minister reduce the existing rate of taxation for individual assesses between income of Rs. 2.5 Lakh to Rs. 5 Lakh to 5% from the present rate of 10%. This is a good reward for individuals who respects to the step to demonetization of government and make it effective.

CONCLUSION

Lastly we can say that it is an historical step taken by the Modi government which is a Large shock for the economy. The impact of the shock is in many sectors of the economy. From market perspective, this move would be positive for banking and infrastructure sectors in the medium to long term. For sectors like consumer Durables, Gems and Jewelers, Real Estate it may be negative in the near to medium term. The step of demonetization was effective for the tax department. A Lot of tax was collected during that period. Like-Madurai City Corporation collected a record Rs. 5.20 crore in taxes on after the announcement that the civic body was ready to accept the demonetized Rs. 500 & 1,000 currency notes. So, lastly we estimate that this move could be beneficial in reducing corruption, eliminating black money and the step leads to economic growth in Long run.

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