ISSN: XXXX XXXX
PRAGYANA – Peer Reviewed International Journal of Multidisciplinary Research
Vol.-1 (1), Jan.-Jun. 2023, pp. 47-52

IMPACT OF DEMONETIZATION ON INDIAN ECONOMY

Geetika Shukla[1], Devesh Gupta[2]

[1]Assistant Professor
Dewan Institute of Management Studies,
Meerut
[2]Assistant Professor
IIMT University,
Meerut

ABSTRACT

The world is watching India with high expectations as India is poised to become economic leader of the region. It is an imperative that India becomes shock proof to the financial crisis and other threats. In this backdrop India has taken seriously the cause of financial inclusion years ago. However, the results were not encouraging. However, the current times are more pressing. This need of the hour has to be dealt with a serious action towards financial inclusion. To become the strong economy, India needs to eradicate black money, corruption and financial crimes. In this technological era and with largest youth population, this is the best time to strike the chord of second financial reforms. The hurdles are lack of financial inclusion and financial illiteracy. It is very ironical that, though we have largest tech savvy youth population and growing literacy, many are still financially excluded. This paper will take up the issues related to demonetization and its linkage to complete financial inclusion. The paper also discusses the economic imperatives of demonetization old high denomination currency notes in India and its aftermath.

1. INTRODUCTION

Demonetization is a radical monetary step in which a currency unit's status as a legal tender is declared invalid. This is usually done whenever there is a change of national currency, replacing the old unit with a new one. Such a step, for example, was taken when the European Monetary Union nations decided to adopt Euro as their currency. However, the old currencies were allowed to convert into Euros for a period of time in order to ensure a smooth transition through demonetization. Zimbabwe, Fiji, Singapore and Philippines were other countries to have opted for currency demonetization.

In India's case, the move has been taken to curb the menace of black money and fake notes by reducing the amount of cash available in the system. It is also interesting to note that this was not the first time the Government of India has gone for the demonetization of high-value currency. It was first implemented in 1946 when the Reserve Bank of India demonetized the then circulated Rs 1,000 and Rs 10,000 notes. The government then introduced higher denomination banknotes in Rs 1000, Rs 5000 and Rs 10000 in a fresh avatar eight years later in 1954 before the Morarji Desai government demonetized these notes in 1978.

2. DEMONETIZATION IN INDIA

In a surprise television address to the nation on November 8 Prime Minister Narendra Modi declared that notes of Rs. 500 and Rs. 1000 will cease to be legal tender from midnight. This means that the government has to bring all 500 and 1000 rupee notes out of circulation. On November 8 these denominations made 86 % of Indian currency in circulation. The government came up with the following justifications for this move:

- Disrupting proliferation of counterfeit notes.
- Making cash hoarded from undeclared sources of income (black money) worthless.
- Disrupting drug trade or terrorism activities which are mainly funded by black money.
- Encouraging cashless transactions.

3. IMPACT OF DEMONETIZATION ON BANKING SECTOR

The government's decision on November 8th, 2016 to immediately demonetize the currency notes of Rs. 500 and Rs. 1,000 in circulation, which account for 86% of all currency notes in circulation, has impacted a raft of sectors. Consumers have turned frugal, causing a sharp drop in demand for goods and services. While farmers and small industries will bear the brunt and sectors like transport and real estate will visibly be in pain, several other industrial sectors will have to scale back services or production.

The biggest beneficiary from this policy will be the banking sector. This is mainly due to the queues of people depositing cash in the banks – which will result in substantial liquidity with the banks. As the deposits with the banks will increase so will increase the CASA, which will increase the Net Interest Income and the Net earnings of the banks. However, this will not be abnormally high since the RBI has increased the CRR in the short term to mop up some of this liquidity.

As stated above higher CASA means large amount of deposits are in current and savings account. By this way the banks get funds at no or very low cost (interest). Banks do not pay interest on the current account deposits and pays a very low % of interest on savings account deposits. Hence, it is a good measure to get deposits at no or very low cost. As the banks get a lot of liquidity in their hands, they are expected to enhance the borrowing cycle by lending the money at a lower rate of interest. Hence, the interest rate on borrowing will lower down.

NBFCs and microfinance institutions (MFIs) are under severe stress as their collection cycles (mostly in cash) have gone awry post November 8. Most NBFCs and MFIs have announced 'collection holidays' till such time there's sufficient money in the system. The government's demonetization drive may puncture the earnings of most banks this quarter. With most staffers handling the Rs 500 and Rs 1000 note deposits, exchange and withdrawals, "revenue- yielding" operations such as vending loans and crossselling investment products have taken a backseat in most banks.

The earnings of banks may take a hit in the third and fourth quarter. We may not see loan book growth as most banks are busy facilitating the demonetization process. They're not aggressively selling a lot of credit products now. That apart the SME and real estate sectors, to which most banks lend a significant part of their book – are in a state of major flux.

4. IMPACT OF DEMONETIZATION ON REAL ESTATE SECTOR

With the present demonetization move by the Government, the much talked about industry today is real estate industry and the much-talked topic is real estate prices. The advent of series of transformational reforms Viz. Demonetization, Real estate regulator (RERA), GST, Benami Transactions (Prohibition) Amendment Act, IFRS, all in a row and in quick succession has created lot of ripples, expectations and predictions about India's real estate sector as to how it is going to react and respond in bringing home buyers confidence back into the markets. The housing segment of the Indian real estate can be broadly classified into three luxury or upper segment, mid segment and low end /affordable housing segments. To put it bluntly, Demonetization is not going to have much direct impact on mid market housing and affordable Housing segments. It may be relevant here to remember that the housing shortage in India is characterized by the fact that more than 90 percent of housing shortage (appxly 20 million units) relates to EWS/LIG Housing. The luxury real estate is less than 5% of the overall demand in almost all the cities.

With demonetization, it is widely anticipated that land price will come down. Approximate estimations say, post demonetization, southern states may witness 20% fall in land prices while Mumbai and NCR may witness a fall of 30% and 50% respectively corroborated with the cash components involved in the transactions hitherto. In an affordable housing apartment project with unit price at Rs 3000/ per square feet plus stamp duty and Registration fees, the fall in land prices by 20 percent to 30% will have only a negligible impact of say 2 % to 3 % on the overall price. In other words, a fall of less than Rs 100 per square feet will not alter the situation significantly. It is apprehended even Rs 100 will also be eaten away by unexplainable incidental expenses and uncertainties.

But there could be some impact on the land prices which may affect the luxury real estate market directly as the land cost is directly proportional to the end price of the unit / apartment / home. In other words, the estimated fall in land prices is not going to impact the mid income and affordable housing projects. This is because the component of the land cost in the mid income and affordable housing projects is around 10% of the overall price of the unit, fall of even 30% on the land prices, will impact only to the tune of 3% or so and as said, it is apprehended even this small 3% may get adjusted in the unforeseen incidentals and expenditures.

5. IMPACT OF DEMONETIZATION ON AUTOMOBILE SECTOR

The scrappage of notes of denominations INR 1,000 and INR 500 has taken the nation by storm. The sudden announcement made by Prime Minister Narendra Modi on 8th Nov, 2016 threw citizens into a quandary and even though this would be a short-term impact, its ramifications would be felt throughout various sectors. In the automobile sector, the scrapping of INR 1,000 and INR 500 notes has had a huge effect. In the month of November itself the bookings were down 50%. The results for December 2016 have come out and they are even more shocking for the auto makers. Vehicles sales in India are down to a 16 year's low.

For December 2016, vehicle sales declined to 1,221,929 units. This is a 18.66% decline. India last reported these kind of vehicle sales back in December 2000. Dealerships across the country have reported a drastic dip in walk-ins and inquiries, in both urban and more particularly in rural areas. Business in Gujarat, Punjab and NCR has been more affected with buyers in these regions preferring to make payments by cash.

Customers opting for finance options also make down payments in cash which has hence brought down sales considerably. This drastic dip in demand is even more pronounced in the luxury car market. In rural areas, sales of automobiles have dipped by around 40% and are expected to go down 60% as the cash crunch continues and as most farmers prefer to make payments by cash.

To boost sales, auto dealerships have been introducing various schemes. On the spot discounts to customers and hefty incentives to company sales teams who convert inquires to sales have also been offered. The dip in sales has also prompted auto manufacturers to bring down production. Honda Motorcycle and Scooter India have stated that production is being rationalized to control inventories while Honda Cars India is also said to align production to contend with slower sales. Maruti Suzuki and Hyundai India have also cited notable dip in demand but have yet to confirm whether they will be putting brakes where production is concerned. Besides automakers, component suppliers too have been hit by demonetization and have been adjusting production to tackle the situation while the situation is worse for the secondhand car market and service stations.

Earlier it was thought that demonetization will affect largely the expensive cars. But that is not the case. From affordable two wheelers to expensive cars, the entire segment has been affected. At the same time, it is to be noted that this is a welcomed move by the government and a bold step in weeding out black money. It will have adverse effects in the short term due to inconvenience caused to citizens but will be a major leap in cashless economy and Digital India and will bring about more transparency into the system in the future.

6. IMPACT OF DEMONETIZATION ON AGRICULTURE SECTOR

Reports of stress in agriculture have begun to appear because of demonetization. Cash is the primary mode of transaction in agriculture sector which contributes 15% to India's total output. Formal financing in many parts, especially Punjab, Uttar Pradesh, Odisha, Maharashtra, Gujarat and Kerala is significantly from cooperative banks, which are barred from exchange-deposit of demonetized currency. Notably, this is a time of kharif harvest and start of rabi sowing, partly explaining why this period is dubbed the 'busy season' from a standpoint of credit demand, the other being bunching of festivals and weddings. Agriculture is impacted through the input-output channels as well as price and output feedback effects. Sale, transport, marketing and distribution of ready produce to wholesale centres or mandis, is dominantly cash-dependent. Disruptions breaks in the supply chains feedback to farmers as sales fall, increased wastage of perishables, lower revenues that show up as trade dues instead of cash in hand and when credited into bank accounts with limited access affect the sector.

Currently, many of these networks are operating sub-optimally or altogether at a standstill, depending upon location, market links and other item-specific factors. The input side is equally affected as many payments/purchases, such as seeds, fertilizers, implements and tools, are outright in cash. Borrowing-financing operations of larger farmers and organized producers are also cut off or severely clipped.

The impact is visible in different sub-segments. Winter crops such as wheat, mustard, chickpeas are due for sowing in a fortnight. Wheat prices were already up due to low stocks and anticipated shortfall in 2015-16 output and have firmed up further as demonetization fallout pushes traders to build more inventories. Production in 2016-17 could drop if sowed acreage (rabi) reduces for want of enough seeds on time to exploit the adequate soil moisture. Yields could fall from late sowing and subsequent exposure to rough spring weather, the lack of sufficient or timely application of fertilizers, pesticides, etc. Farm labour, vital for this period, is reported to be unpaid as farmers have no cash. Many of them are reported to be returning from some northern parts to homes in UP and Bihar. Labour shortages and wage- spikes may follow with a lag.

Plantation crops, such as, rubber, tea, jute, cardamom are seeing no wages paid to workers. Small-medium tea growers have few buyers now (a third of the tea was unsold in recent auction in the south). Raw jute trade is halted as paucity of funds affects procurement- delivery by traders. Projections of scarcity have appeared with appeals for official procurement support. Cotton is witnessing havoc: daily arrivals have plunged to 30,000- 40,000 bales against the usual 1.5-2 lakh bales at this time (harvest) as per reports and prices have soared 9% in a week, pushing up global prices in turn.

7. CONCLUSION

The demonetization of the highest denomination notes undertaken by the government is a big shock to the Indian. The demonetization is taken for several measures such as tax evasion, counterfeit currency and funding of illegal activities. Some people are depositing currency notes in excess of specified limits directly into bank accounts has showed the unaccounted income, subject to higher tax and other penalties. Alternative payment methods, such as e-wallets, online transactions using e-banking, debit and credit card usage have been increased and this will shift an efficient cashless infrastructure.

REFERNCES

Official and Government Publications

1. Annual Report —Ministry of Commerce, Government of India, Various Issues

Books, Journals & Periodicals

1. Business Today India 2016 Commerce & Trade

References and Articles

1. Clarke S. The Financial System and Demonetization of the Economy. Warwick: University of Warwick, Centre for Comparative Labour Studies, 1998.
2. Cost of demonetisation for India Inc: Stranded trucks, unpaid workers, cancelled bills. Retrieved from http://www.business-standard.com/article/economy-policy/cost-of- demonetisation-for-india- inc-stranded-trucks-unpaid-workers-cancelled-bills- 116112100058_1.html
3. Pratap Singh. 2013.Depreciation of Rupee in Indian Economy: An Analysis, "International Journal of Innovations in Engineering and Technology (IJIET)", Vol. 2 Issue 4 August 2013 332, (ISSN: 2319 – 1058).
4. Speech by Raghuram Rajan at NIRD. Retrieved from https://rbidocs.rbi.org.in/rdocs/Speeches/PDFs/CPFI1807162A1AEF2408344A3CB4F48A5C5 30C2E05.PDF