A Study On Economical Changes In India Due To Demonetization

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Abstract: The term conclusion isn't a brand new construct for the Indian economy. The very best denomination note ever written by the bank of Bharat was the Rs 10,000 note in 1938 and once more in 1954. However, to these notes were demonetized in Jan 1946 and once more in Jan 1978, consistent with tally information. once the complete world was anticipating the results of U.S.A. presidential elections, Prime Minister came out together with his them on corruption, counterfeit currency, terrorist act and black cash by asserting "demonetization" and ceasing Rs five hundred and Rs. one thousand notes as a region of tender in Bharat. This paper is a shot to investigate the impact of conclusion on varied sectors, execs and cons of conclusion and also the perception of varied government officers, professionals were and businessmen concerning conclusion. However, this term would work as the tool against black cash? Several industries are attending to be benefitted because of the conclusion policy and plenty of are attending to suffer. However overall the demand goes to or rather has already reduced by 30%-40% because of lack of cash with the shoppers. Because the demand goes down, the profits for the quarter ending December'16 is additionally reduced. The demand can catch the momentum because the mud settles down. The economy can stabilize as presently as there is enough new currency within the hands of demonetization

Keywords : Demonetization, black money, stabilize, new currency, government officers, RBI.

Introduction

Demonetization is the process of devaluing a piece of currency to zero. In other words, changing the value of a particular denomination of currency to nil. Making it a piece of paper with absolutely no value greater than a regular piece of paper. When a currency note of a particular denomination ceases to be a legal tender it is termed as demonetization..India 500rs and 1000rs notes ,which made up to 86% (Of which 500rs notes made up to 46 % and 1000rs notes made up to 40%) of the money supply in India at that time were called invalid from 12 am of Nov 9th 2016. According to Investopedia, demonetization is the act of stripping a currency unit of its status as legal tender. But since our government is replacing the old Rs 500 notes with newer ones and doing away with the Rs 1,000 notes, it would be more appropriate to call the move as `scrapping' or `phasing out' of certain currency notes. The term demonetization has become a household name since the government pulled the old Rs 500 and Rs 1,000 notes out of circulation. In place of 500 and 1000 Rs notes new currency notes of 500 and 2000 were introduced by RBI. Whereas the notes of one hundred, fifty, twenty, ten, five, two and one rupee will remain legal tender and will remain unaffected by this decision. This measure has been taken by the PM in an attempt to address the resolve against corruption, black money and counterfeit notes. This move is expected to cleanse the formal economic system and discard black money from the same.

The reasons of it are as under: 1) To tackle black money in the economy. **2)** To lower the cash circulation in country which is directly related to country corruption **3)** To eliminate fake currency and dodgy funds which have been used by terror groups to fund terrorism in India. **4)** The move is estimated to scoop out more than Rs 5 lakh crore black money from economy. Similar measures have been taken in the past in January 1946, currency notes of 1000 and 10,000 rupees were withdrawn and new notes of 1000, 5000 and 10,000 rupees were introduced in 1954. The Janata Party coalition government had again demonetized notes of 1000, 5000 and 10,000 rupees on 16 January 1978 as a means to curb forgery and black money.

Objectives

- To study the of impact of demonetization on various sectors
- To analyze the immediate impact of demonetization on Indian economy
- To workout the pros and cons of demonetization

Research Methodology

The paper is based on secondary data. The data has been collected from internet.

Impact of on Indian economy: Since our economy is heavily dependent on cash, as only less than half the population uses banking system for monetary transactions, demonetisation has hit trade and consumption hard. With people scrambling for cash to pay for goods and services, the move is likely to take a big toll on the country's growth and output during the current fiscal. Consumption makes up for around 56% of India's GDP , hence, a drop in spending will pull down growth. The current step could also lead to behavioural changes in households' savings and their consumption pattern. Impact of on Indian economy will be huge but the question is it positive or negative. As far as theoretically concerned it will give positive effect on the economy but none of the countries which have implemented demonetization before have been successful in implementing it. The positive impact in economy in the long run. Most the people will come under the structured financial system and the parallel economy and black economy will come an end. If we will look at wealth distribution in future if they are followed by good polices that are they have to reduce supply of 2000rs in the circulation and increase the notes of less denomination to be circulated. Consumers spending will increase if they go for cashless transaction or if they have notes of lesser denomination in hand which will in order bring more business to India and improve the GDP and Employment rate. Stagnation of money will decrease among all people and most people will surely learn to Transact money in internet . So the penetration of internet will also increase and people will get educated in the usage of internet these are all minor effects As far as corruption concern it would probably decrease because of cashless economy. This also raises a question the people can also get corruption in the form of gold. As we have seen several people has opted the option to invest in gold to overcome from demonetisation. GDP will go down for short run but after a year the GDP will increase as Consumers or People spending will increase with that everything needed for a good economy will come into effect. Inflation will increase a little after a year or two to a certain extent. We are now at 3 to 4 percent inflation it may go up to 5 to 6 percent due to increased money flow. Now comes a big question BANKS trust worthiness we as people know that India has a good CRR and SLR ratio in order to prevent the banks from failure With all this takeninto account the BCI index will grow due to huge money supply and demand by the people. So an biggest threat to any economy will reduce that is nothing but unemployment. Due to interest rate cuts it will attract foreign companies to India due reduced interest and as expected if there is a sharp fall in corruption India will become one of the top countries in ease of doing business If country goes towards digital of the great expense of Government will go down that is the money spent for printing money will go down which can be used to improve infrastructure of the country These are the things i expect to happen in the near future due to demonetisation .

- ✓ Demonetization is not a big disaster like global banking sector crisis of 2007; but at the same time, it will act as a liquidity shock that disturbs economic activities.

- ✓ **Liquidity crunch (short term effect):** liquidity shock means people are not able to get sufficient volume of popular denomination especially Rs 500. This currency unit is the favourable denomination in daily life. It constituted to nearly 49% of the previous currency supply in terms of value. Higher the time required to resupply Rs 500 notes, higher will be the duration of the liquidity crunch. Current reports indicate that all security printing press can print only 2000 million units of RS 500 notes by the end of this year. Nearly 16000 mn Rs 500 notes were in circulation as on end March 2016. Some portion of this were filled by the new Rs 2000 notes. Towards end of March approximately 10000 mn units will be printed and replaced. All these indicate that currency crunch will be in our economy for the next four months.
- ✓ **Welfare loss for the currency using population:** Most active segments of the population who constitute the 'base of the pyramid' uses currency to meet their transactions. The daily wage earners, ther labourers, small traders etc. who reside out of the formal economy uses cash frequently. These sections will lose income in the absence of liquid cash. Cash stringency will compel firms to reduce labour cost and thus reduces income to the poor working class. There will be a trickle up effect of the liquidity chaos to the higher income people with time.
- ✓ **Consumption will be hit:** When liquidity shortage strikes, it is consumption that is going to be adversely affected first.
- ✓ **Consumption ḶÍ Production ḶÍ Employment ḶÍ Growth ḶÍ Tax revenue Ḷ**
- ✓ **Loss of Growth momentum-** India risks its position of being the fastest growing largest economy: reduced consumption, income, investment etc. may reduce India's GDP growth as the liquidity impact itself may last three -four months.
- ✓ **Impact on bank deposits and interest rate:** Deposit in the short term may rise, but in the long term, its effect will come down. The savings with the banks are actually liquid cash people stored. It is difficult to assume that such ready cash once stored in their hands will be put into savings for a long term. They saved this money into banks just to convert the old notes into new notes. These are not voluntary savings aimed to get interest. It will be converted into active liquidity by the savers when full-fledged new currency supply take place. This means that new savings with banks is only transitory or short-term deposit. It may be encashed by the savers at the appropriate time. It is not necessary that demonetization will produce big savings in the banking system in the medium term. Most of the savings are obtained by biggie public sector

banks like the SBI. They may reduce interest rate in the short/medium term. But they can't follow it in the long term.

- ✓ **Impact on counterfeit currency:** the real impact will be on counterfeit/fake currency as its circulation will be checked after this exercise.

Impact on black money: Only a small portion of black money is actually stored in the form of cash. Usually, black income is kept in the form of physical assets like gold, land, buildings etc. Hence the amount of black money countered by demonetization depend upon the amount of black money held in the form of cash and it will be smaller than expected. But more than anything else, demonetization has a big propaganda effect. People are now much convinced about the need to fight black income. such a nationwide awareness and urge will encourage government to come out with even strong measures.

- **The Sectoral Impacts** While sectors with linkages to the unorganized economy are likely to be affected, technology and financial services are expected to gain in the medium to long term. On a sectoral basis, the commodities and agricultural sector, including the market for consumer durables and non-durables is expected to feel the heat. In the short to medium term, large denomination purchases will likely be made via electronic purchases rather than through brick and mortar outlets. This will impact the retail sector adversely. The real estate sector is likely to see a significant negative impact in the medium- to long term, particularly in the repurchase market. There are expectations of a revaluation of current real estate transactions across the board representing possible losses to players in the sector. The luxury goods market is also likely to get affected as this move represents an erosionof real wealth to a large Areas of sub-sectoral impact will be felt in luxury cars, SUVs, gems, jewellery, gems, gold and high-end branded products. The real estate sector is likely to see a significant negative impact in the medium- to long-term, particularly in the repurchase market. There are expectations of a revaluation of current real estate transactions across the board representing possible losses to players in the sector. The luxury goods market is also likely to get affected as this move represents an erosion of real wealth to a large number of people. On the positive side, there is likely to a reset of spending patterns as this move represents indirectly a significant push towards a cashless economy. Businesses in the fin-tech sector, including payment banks, mobile wallets, electronic transfer providers, etc., are expected to see gains.

- **The impact of this move will be felt across sectors with differing intensities and across varied time zones.**
- **Effect on parallel economy: Cash Economy to Witness Contraction**
- The currency of the aforementioned denominations constitutes around 86% of the total value of the currency in circulation. It is expected to remove black money from the economy as they will be blocked considering the holders will not be in a position to deposit the same in the banks, temporarily halt the circulation of large volumes of counterfeit currency and curb the funding for anti-social elements like smuggling, terrorism, espionage, etc.
- **Effect on GDP: Downward Bias to GDP Growth** The sudden decline in money supply and simultaneous increase in bank deposits is going to adversely impact consumption demand in the economy in the
- **short term**. This, coupled with the adverse impact on real estate and informal sectors may lead to lowering of GDP growth. The GDP formation could be impacted by this measure, with a reduction in the consumption demand. However, with the recent rise in festivals, demand is expected to offset this fall in an overall impact. Moreover, this expected impact on GDP may not be significant as some of this demand will only be deferred and will re-enter the stream once the cash situation becomes normal.
- **Lower Money Supply has a Deflationary Effect**: With the older 500 and 1000 Rupees notes being scrapped, until the new 500 and 2000 Rupees notes get widely circulated in the market, money supply is expected to be reduced in the short run. Reduction in money supply can also have a deflationary effect in the economy. However, whether the impact of the reduced money supply will lead to deflation or contraction in demand or a mix of both will vary from sector to sector depending on the nature of goods & services. To the extent that black money (which is not counterfeit) does not re-enter the system, reserve money, and eventually, money supply will decrease permanently. However, gradually as the new notes get circulated in the market and the mismatch gets corrected, money supply will pick up speed.
- **Impact on Bond Markets:** Surge in deposits will create more demand for government bonds and other high rated bonds in a situation of tepid demands for credit, leading to lower bond yields especially in the shorter end of the curve. At the same time, a reduction in leakages in systemic liquidity will reduce the scope for open market operation purchases in the coming days. We believe that the RBI will continue

to sterilize excess liquidity from the banking system to keep the short term rates aligned with the policy rate.

- **Credit Impact across Sectors:** Impact of this policy measure will flow to the economy mainly through the Real Estate sector, which has strong linkages with sectors such as cement and steel and which will turn credit negative in the short-run. A significant impact in the short-run will be on the daily/weekly wage employment in the informal sector. The construction sector has one of the highest employment multipliers. The key segments of the economy where cash transactions play a vital role are real estate, gold and the informal sectors, which may face near term contraction. With more money coming into the banking ambit, deposit growth is likely to improve and positively impact the savings rate. The medium- to long-term gains are likely to outweigh the short-term pains.
- **Effect on Banks** As directed by the Government, the 500 and 1000 Rupee notes, which now cease to be legal tender are to be deposited or exchanged in banks (subject to certain limits). This will automatically lead to more amounts being deposited in Savings and Current Accounts of commercial banks. This, in turn, will enhance the liquidity position of the banks, which will be later utilized further for lending purposes. However, to the extent that households have held on to these funds for emergency purposes, there are expected to be withdrawals at the second stage.
- **Effect on Online Transactions and alternative modes of payment:** With cash transactions facing a reduction, alternative forms of payment will see a surge in demand. Digital transaction systems, E wallets and apps, online transactions using E banking, usage of Plastic money (Debit and Credit Cards), etc. will definitely see substantial increases in demand. This should eventually lead to strengthening of such systems and the infrastructures required.
- **Bank Deposit Rates to Soften:** We can expect a large amount of cash in circulation to be brought within the purview of the formal banking system by way of deposits. This is structurally positive for banks, as part of this cash gets deposited as current account and savings account (CASA) deposits, reducing banks dependence on higher cost borrowing. Deposit deployment remains a challenge in the short to medium term due to the current tepid demand for credit, subsequently pushing deposit rates lower. NBFC’s Asset Quality Faces Pressure: We believe in the asset quality of Retail Asset Lenders, especially NBFC’s which have developed expertise in the credit assessment of the informal segment and have built models around it to stay under pressure in the

short term. Within NBFC's, asset quality of lenders with a large dependence on cash collection remain vulnerable in the short term. In the longer term the implications could be a risk profile shift for the NBFCs, as the stronger borrower profile could potentially migrate to banks. Across the medium term, the demand for real estate, especially in the secondary market i.e. Resale Transaction and Tier-II cities where the cash component, as a proportion of transaction is significant, could face a slowdown. This trickle-down effect could encompass the entire real estate sector putting pressure on the demand itself. This could adversely impact NBFC's & housing financers with a large proportion of exposure Mortgage built with a self-employed customer profile. We believe that Micro Finance Institutions and Small Finance Banks (SFB's) may not be significantly impacted in the long term, considering that the cash flows of the borrower segment are usually in the smaller denomination. However, there could be near term disruptions in the collection cycles along with a spike in over dues, which could put their liquidity strengths and the disbursal cycles under pressure.

- **Payment Banks to Benefit:** Payment banks and others entities which are part of the transaction ecosystem are likely to be long term beneficiaries, as more and more cash finds its way into the formal banking channels. We believe the cumulative measures taken to reign in black money will improve banking habits, create financial and transactional history of the informal & cash dependent segments and could, over the long term, make them 'bankable'.
- **Investment in Financial Products**: Investors in the short term will now believe that Cash is not the safest asset and there is little point in hoarding it. This will shift them from physical asset to financial assets where returns are also higher
- **Impact on Consumption Sectors Agreement Cost of Real state May Rise:** We expect that the real estate demand from end users is unlikely to be impacted, since a majority of them are backed by funding from bank loans. Demand from investors for real estate however may come down since in some cases, investors prefer cash transactions. If the proportion of earlier transactions in the real estate sector, which were allegedly done through partial cash payment reduces, the registered prices for real estate will go up. We expect the supply of real estate in the secondary market, which is strongly rumoured to have a large cash component involved, to suffer in the short term, which may in turn improve demand for residential real estate in the primary market. In the medium term, the prices in this sector could regain on many

fronts as developers rebalance their prices (probably charging more on cheque payment).

- **Used car Sales May Fall**: Sales of vehicles in the second hand market for original equipment manufacturers will get impacted, which will cause a ripple effect on New Car sales, as buyers will not be able to dispose of their old vehicles easily.
- **Slowdown in Discretionary Spending to Hurt Consumer Durable Sales**: Sales of White Goods like TV, Refrigerator & Washing Machine could slump as much as 70% as a good portion of the market is driven by Cash. This may continue for next Six Months till the dust settles down and there is adequate circulation of the new currencies. Prices are expected to fall only marginally, due to moderation in demand, as use of cards and cheques could compensate for some purchases.
- **Demand for Gems and Jewellery to Decline:** We can expect the demand for gems and jewellery to decline in the next two to three quarters. This would result in a weakening in the credit profile of industry players due to the high working capital cycles and high operating leverage. The unorganised segment will be hit particularly hard, given the large proportion of unaccounted inventory and high proportion of cash sales. Over the medium-term the organised industry players will benefit at the cost of the unorganised players. Gold imports through the unofficial channels are likely to reduce. There will be no significant impact on jewellery exporters because it is mostly an organised market and sales are against invoices.
- **High End Retail Demand to fall:** We expect the impact on high end fashion retail and luxury goods to be more pronounced as discretionary demand in this segment will be curtailed. In case of Quick Service Restaurants, although 60%-70% of the transactions are currently in cash, the impact is likely to be moderate due to the low ticket size of purchases and high likelihood of patrons adapting to plastic money. We expect a limited impact to be caused on the food and grocery retail sub-segment, given the nondiscretionary nature of purchases in this segment, since the buying cycle for the current month would have been largely influenced.
- **Private Educational Institutions:** Since Private Educational Institutions take huge amounts of donations in Cash which is 40 % to 50%, we expect that this move will impact the Private Education Institutions receipts.
- **Medical Institutions (Both Hospitals & Medical Colleges):** Again, as Medical Institutions like Hospitals and Colleges take huge amounts of donations in Cash

which are more than 100 % of fees, we can keep on expecting that this move will impact not only the admissions but also the receipts.

- **Political Parties:** Elections & Political Parties are major sources of Black Money transactions. Most of the funding of National Political Parties is in Cash which is 40% to 50%, and when it comes to Regional Parties it goes up to 50% to 60%. The sources of more than 90% of such funds are never disclosed. Candidates as well as their donors even the Political Parties will feel cash strapped. An assembly seat candidate spent on an average Rs. 4-5 Crores on Campaigning that is likely to go down drastically. This is going to cause huge craters on their funding and will reduce their funds drastically. It is going to deal a major blow to political parties fattening their coffers with cash contributions in anticipation of high stakes electoral battles in UP, Punjab, Uttarakhand, Goa and Manipur. This stroke is bound to leave big players hamstrung and suddenly resource-poor.
- **Dabba Trading (Bucketing):** It may kill Dabba Trading. Trades done outside bourses, Satta Bazaar & Illegal Betting market may die a natural death as currency gets a new face. Demonetisation was a jolt for Dabba traders, who were thriving in equity markets for many years now.
- **Effect on various economic entities** The key segments of the economy where cash transactions play a vital role are real estate / construction, gold and the informal sectors as such. The role of cash transactions in case of real estate and gold is mostly dubious, however in case of the informal sectors it is the lifeline. For example, small and marginal farmers in the fruits and vegetables category typically require off-loading of their produce in the local Mandi in cash and could see an immediate impact. A sudden demonetization will adversely impact this segment of the economy and it will witness immediate contraction, though this impact will diminish over time. With cash transactions lowering in the short run, until the new notes are naturalized widely into circulation, certain sections of the society could face short term disruptions in facilitation of their transactions. These sections are:
    - Agriculture and related sectors
    - Small traders
    - SME
    - Services Sectors
    - Households
    - Professionals like doctors, carpenters, utility service providers, etc.

- Retail outlets

The nature, frequency and amounts of the commercial transactions involved within these sections of the economy necessitate cash transactions on a more frequent basis. Thus, these segments are expected to have the most significant impact post this demonetization process and the introduction of new notes in circulation.

Conclusion: Demonetization as a cleaning exercise may produce several good things in the economy. At the same time, it creates unavoidable income and welfare losses to 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 activities will be dampened in the short term. But the un-measurable benefits of having more transparency and reduced volume of black money activities can be pointed as long term benefits. If the money disappears, as some hoarders would not like to be seen with their cash pile, the economy will not benefit. On the other hand if the money finds its way in the economy it could have a meaningful impact. However experiences from different countries shows that the move was one of the series that failed to fix a debt-burdened and inflation-ridden economy.

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