



## Impact of Demonetization on Different Sectors of Indian Economy: An Exploratory Study

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### Abstract

The 'demon' in demonetization is in the beginning. Any Government withdraws the legal tender rights of any denomination of currency, it is called demonetization. Demonetization announced on 8<sup>th</sup> November 2016 was aimed at addressing black money, corruption, counterfeit currency and terror financing. The initial effects of demonetization on common people was terrible. According to Fisher's Quantity Theory of Money in the short run, money supply will fall, demand will be sluggish and people will lose jobs. The latest Central Statistical Organization (CSO) estimates suggest that the impact of demonetization on Gross value added (GVA) growth was modest. Food inflation declined significantly. Demonetization has made impact on some segments of the export sector such as readymade garments, gems and jewellery. There has been a significant improvement in the use of digital modes of payments post demonetization. This paper articulates the impact of demonetization on various sectors of the Indian economy.

**Key Words:** Demonetization, Digitalisation, Cash Crunch, Cashless Transaction CSO, GVA.

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## 1. INTRODUCTION

Demonetization referred to the act of stripping a currency unit of its status as legal tender. Indian Government has taken a bold decision on note ban on 8<sup>th</sup> Nov, 2016. RBI has withdrawn the old Rs 500 and Rs 1000 notes as an official mode of payment. Such notes valued at Rs 15.4 trillion, constituted 86 percent of the value of total currency in circulation. The process of demonetization involves either introducing new notes of the same currency or completely replacing the old currency with new currency. The reasons of taking the decision of banning note are as follows-

- To tackle black money in the economy.
- To lower the cash circulation in the country which is directly related to corruption in our country.
- To eliminate fake currency.
- To destroy terrorist financing activities.
- The move is estimated to scoop out more than Rs 5 lakh crore black money from the economy.
- To resist tax evasion.
- To reduce corruption.

However, in the days following demonetization, banks and ATMs across the country faced severe cash shortages. Also following the announcement of banning note, SENSEX and NIFTY 50 stock indices crashed for next two days. ATMs across the country faced severe cash shortages.

Note ban decision taken by government was for welfare of the nation, but was it really beneficial for our nation? Would note ban decision actually eradicate the black money, if does then at what extent black money will come out? What should be the impact of this decision on Indian economy? Would Indian economy be prosperous or would be poor. This paper articulates the impact of demonetization on common people and also various sectors such as agricultural sector, auto mobile sector, manufacturing sector, inflation, stock market, non-banking financial intermediaries etc.

## 2. LITERATURE REVIEW

**Singh P. et al. (2016)** stated that Demonetization for us means that Reserve Bank of India has withdrawn the old Rs. 500 and Rs. 1000 notes as an official mode of payment. Demonetization is the act of stripping a currency unit of its status as legal tender.

**Lahiri A. (2016)** stated that the cash shortage may have already affected the prices of perishable goods and services. Prices of vegetables in wholesale markets, according to newspaper reports, have fallen significantly. Overall inflation may come down because people have less to transact, but this decline in inflation will be for a short period.

**Deodhar R. (2016)** highlighted the fact that Demonetization is the mechanism by which the government states to withdraw the money which is current legal tender. The government being sovereign can take such decision. The effect of this announcement is that the currency notes in circulation will now cease to be valid tender and can only be exchanged at the banks. Demonetization of higher denomination notes as an idea has been around.

**Kalyani P.(2016)** stated that there was acute shortage of money in market and daily transaction was severely affected 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 is expected to reduce in the short run.

**Rao k. (2016)**, stated that demonetization, by removing 86 per cent of the currency in circulation, has resulted in a very serve contraction in money supply in the economy. This effect would be more severe on individuals who earn incomes in cash and spend it in cash.

**Ramdurg A. et al. (2016)** stated that, Demonetization is not new to India or to the outside world. Various Governments across the world have decided to ban currency note in circulation, rendering huge amount of cash useless overnights, due to plethora of reasons. Demonetization, entire amounting circulation was not reached back to Government. It means certain amount of money certain which was in circulation is lost. Therefore it leads to deflationary conditions.

**Sinha A. et al. (2016)** highlighted that Demonetisation of 86 per cent of currency notes as illegal tender in just a blink of time on eve of 8<sup>th</sup> Nov, 2016 mandated the creation of immediate interruption in daily lives. The chaos was created in every strata of the society whether upper, middle or lower.

### **3. OBJECTIVES OF THE STUDY**

- To understand the concept of demonetization.
- To know about actual present outcomes of the note banned decision.
- To know the potential of the note ban decision.
- To analyze the impact of demonetization on Indian economy.
- To work out the probable consequences of the demonetization.

### **4. SCOPE OF THE STUDY**

This study will be helpful for the citizens of India. Indian citizens would be able to know the present and future condition of the economy and they can take rational decision on their income and expenditure. Any businessman can also take the wise decision so that he will be able to generate more revenue. Finally everybody would be able to know the impact of note banned decision on Indian economy as well as Indian markets.

### **5. RESEARCH METHODOLOGY**

The present work is a blend of descriptive and exploratory research work. The data is purely secondary in nature and has been collected through various journals, articles and news papers and useful websites.

### **6. IMPACT OF DEMONETIZATION IN INDIA**

#### ***On common people:***

- Initially there was a huge hue and cry about the idea, people had to wait in long queues just to withdraw the necessary money they needed.
- There was a limit to the per capita withdrawal and that was a huge issue for many people because of their personal requirements which included health, marriage etc.
- Those families who had wedding and other special occasions were depressed due to shortage of money. Thousands of wedding have been cancelled which impacted the vendors who supply for those weddings.
- Many daily wage workers were unable to find work.

- Demonetization has a direct impact on sectors dealing with cash vendors, auto rickshaw owners, taxi drivers, daily wage earners and small traders.
- As the time passed the things slowed down a bit. The queues in the banks shortened, ATMs were filled with money, new currency circulated and all these normalized the situation.

The demonetization of Indian currency has created numerous hardships to common person but in long way it has lot of benefits-

- Unaccounted unproductive cash will become productive as it enters the legal system.
- Counterfeit money will cease to exist with immediate effect.
- Penalties imposed by the Income Tax department on the illegal conversion of black money into white money, the revenue to the government will be increased.
- Black money held by the political parties is flushed out.
- With huge cash at the disposal of the banks, the borrowing of money will get cheaper.
- Government can avail finance at lower rates and speed up the infrastructural spending creating huge job opportunities.

## **7. IMPACT OF DEMONETIZATION ON VARIOUS SECTORS**

### ***Agricultural Sector:***

- Agriculture in India accounts for 50 percent of the workforce. Farmers were severely affected. Agriculture is impacted through the input-output channels as well as price and output feedback effects,
- Farmers were not able to purchase inputs like seeds from the last year harvest and also failed to purchase new quality seeds from market.
- The problem of demonetization is largely associated with the rural areas of the country having lesser number of banks and ATMs compared to the urban areas and semi-urban areas. The problem was not the inaccessibility of the banks and ATMs, but the limit on cash which can be withdrawn. A farmer can take a day out from his busy schedule and manage to go to bank and get the cash back, however the limit on the amount withdrawal forces him to do it again and again and the banks in rural areas can make it look 50 kms.

Though there are so many negative effects of demonetization on agricultural sector, there are some positive effects also, those are as follows-

- The interest rates of banks started falling which could reduce the capital cost and farmers can now go for farm mechanization.
- Government can build cold storage chain thereby minimize the wastage which are 80000 crore annually.
- The intermediaries and commission agents will be minimized and farmers can directly deal with consumers and they can credit instant payments to their bank account.
- The national portal made for farmers of the country will be more effective as the farmers will have wider market instead of local and district mandies. They will get more prices for their production with payment directly in their bank accounts.

***Electricity Industry:*** Electricity generation was expected to have been impacted the least, with the share of the unorganized sector being very low and the share of informal employment close to zero. Weak demand for electricity was already a challenge before demonetization, with power

generation in excess relative to demand. In November and December, 2016, however, electricity generation increased by 8.9 per cent and 6.3 per cent respectively, which was higher than the average growth of 4.5 per cent recorded during April-October. In January 2017, however, it decreased to 3.9 per cent.

**Coal Industry:** Coal production also increased by 6.4 percent in November, 2016, 4.4 per cent in December and 4.8 per cent in Jan, 2017.

**Automobiles Industry:** Automobile sector is impacted majorly by demonetization. The major decline is seen in the demand of two wheelers than luxury cars/ four wheelers since cash is the primary mode of transaction in the purchase of two wheeler vehicles.

**Manufacturing Industry:** It was impacted adversely as evident from-

- The decline in the sales of fast moving consumer good in all the months from November, 2016 to January, 2017.
- Contraction in the manufacturing purchasing managers' index (PMI) in December for the first time in 2016
- Decrease in export growth during November, 2016.
- Manufacturer also cut production due to rising inventories.

**Real Estate Industry:** Demonetization move created a real dent in the residential real estate sector. After demonetization, expectations of downward correction in house prices seemed to have impacted registrations in some of the cities in November, 2016. In December, 2016, however, registrations appeared to have bounced back, though they were lower than in October, 2016.

**Transportation Industry:** Domestic air passenger traffic growth was robust at 22 per cent in November, 2016 and 23.9 per cent in December, 2016 and 25.6 per cent in January 2017. Domestic air cargo traffic contracted by 0.6 per cent in November, 2016 but revised to 7.5 per cent in December, 2016 and 10.1 per cent in January, 2017, Growth in international air cargo traffic (at 15.4 per cent) and international passenger traffic (at 7.7 per cent) remained strong in November, 2016.

**Impact of Demonetisation on Financial Sector:** This section sets out the impact of demonetization on banks, liquidity conditions and transmission of monetary policy, non-banking financial intermediaries and Jan Dhan accounts.

**A. Commercial Banks:** Demonetisation has had a significant impact on the balance sheet of Scheduled Commercial Banks (SCBs), both in terms of size and composition. Decline in currency in circulation on account of demonetization led to a surge in bank deposits. The demonetized notes were accepted at bank counters till December 30, 2016. Between October 28, 2016 and Jan 6, 2017 (i.e, days immediately prior to and after demonetization for which fortnightly banking system data are available), total currency in circulation declined by about INR 8,800 billion, This, in turn, was largely reflected in sharp increase of about INR 6720 billion in aggregate deposits of the banking system even after outflows in NRI deposits during the period.

**B. Non-banking Financial Intermediaries:** Demonetization has impacted various financial intermediaries differently-

**Mutual Funds:** Reduction in` deposit interest rates by banks after demonetization enhanced the relative attractiveness of debt oriented mutual funds. As a result, there were net inflows in income/debt schemes during November 2016 to January 2017 in contrast to net outflows during

November 2015 to January 2016. This was reflected in a sharp increase in the overall resources mobilized by mutual funds during November 2016 to January 2017 as compared to outflow in the same period of the last year.

**Net Inflows/Outflows In Mutual Funds (Rs in billion)**

Category	Nov 2015- Jan 2016	Nov 2016- Nov 2017	April to January		
			2015-16	2016-17	Year of Year growth percentage
Income/Debt-Schemes	-535.5	520.4	880.2	2673.1	203.7
Equity Schemes	129.4	240.6	728.7	556.9	-23.6
Balanced schemes	63.8	108.0	187.2	261.0	39.4
Exchange Traded Fund	31.2	138.0	50.1	188.8	276.6
Fund to Funds Investing Overseas	-0.9	-0.2	-3.6	-3.1	-
Total	-311.9	1007.6	1842.7	3676.6	99.5

Source: SEBI

**Life Insurance Companies:** Premiums collected by life insurance companies more than doubled in November 2016. Premiums collected by Life Insurance Corporation of India (LIC) increased by more than 140 per cent (y-o-y) in November, 2016 as compared with less than 50 per cent by private sector life insurance companies.

**Life Insurance Premiums (Rs in billion)**

Category	Oct-15	Oct-16	Nov-15	Nov-16	Dec-15	Dec-16	Jan-16	Jan-17
Private Insurance Companies	28	35	24	35	37	48	36	44
y-o-y growth percentage		28.3		48.9		28.4		23.8
LIC	80	76	52	125	73	83	67	87
y-o-y growth percentage		-4.8		141.9		12.8		29.8
Grand Total	107	111	76	161	110	130	13	131
y-o-y growth percentage		3.7		112.7		18.1		27.8

Source: IRDAI

**NON-BANKING FINANCIAL COMPANIES (NBFCs):** Loan disbursements by all categories of NBFCs declined significantly in November 2016 with the monthly average disbursements during April-October 2016, especially for micro finance companies whose business is more cash intensive. In contrast with loan growth, collections (i.e, repayments of loans due) of loan companies during both November and December 2016 increased over the monthly average collections during April-October 2016.

The growth of credit extended by banks to NBFCs also appeared to have been impacted due to demonetization. Bank credit growth to NBFCs decelerated from 5.1 per cent on y-o-y basis in

October 2016 to 1.3 per cent in November 2016, which further declined by 0.6 per cent in January 2017.

**Jan Dhan Accounts:** Post-demonetization, 23.3 million new accounts were opened under the Pradhan Mantri Jan Dhan Yojana (PMJDY), bulk of which (80 per cent) were public sector banks. Out of the new Jan Dhan accounts opened, 53.6 per cent were in urban areas and 46.4 per cent in rural areas. Deposits under PMJDY accounts increased significantly post demonetization. The total balance in PMJDY deposit accounts peaked at Rs 746 billion as on December 7, 2016 from Rs 456 billion as on November, 2016. As there were reports regarding the use of these accounts to convert black money into white, the Government issued a warning against the misuse of such accounts.

**Monetary Policy Transmission to Lending Rates:** Surplus liquidity conditions have helped in facilitating the transmission of monetary policy to market interest rates. Post demonetization, several banks lowered their domestic term deposit rates and lending rates.

## 8. IMPACT OF DEMONETIZATION ON INFLATION

The impact of demonetization on inflation in the near-term stemmed mainly from moderation in food inflation, especially perishables, as inflation excluding food and fuel remained broadly unaffected.

**Food Inflation:** Food inflation declined from 3.7 per cent in October 2016 to 2.6 per cent in November, 2016 to 2.0 per cent in December 2016 and further to 1.3 per cent in January, 2017. This was mainly on account of vegetables and pulses. Vegetable prices declined by 6.2 per cent on a month-on-month basis in November 2016 and further by 11.7 per cent in December, 2016. The vegetable price decline continued in January 2017 albeit at a lower rate of 4.7 per cent. Pulses prices declined by 7.4 per cent between October 2016 and January 2017. The sharp decline in prices of pulses and vegetables was due to a number of factors.

**Inflation Excluding Food and Fuel:** Prices of housing, health, transport and communication, pan, tobacco and intoxicants and education- together accounting for 31 per cent of the CPI basket-also remained unaffected. Although the real estate sector remained in stress, no correction was seen in rentals. Barring new rental agreements, existing contracts have pre-set annual rental increase clauses of a fixed percentage. Thus, on the whole, inflation excluding food and fuel during November, 2016-January, 2017 was not impacted due to demonetization.

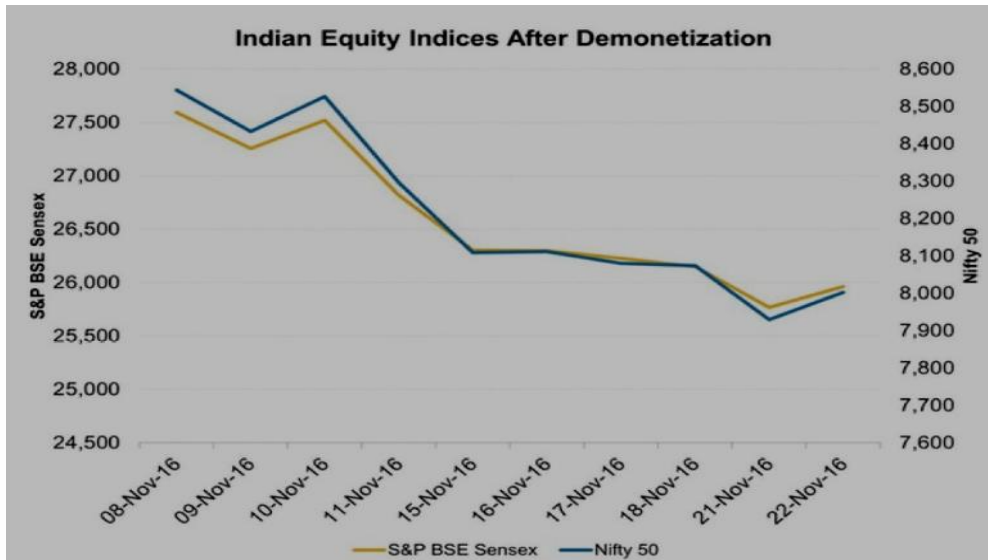
*CPI Inflation in Selected Groups (Year-of-Year in per cent)*

Category	Nov-15	Dec-15	Jan-16	Oct-16	Nov-16	Dec-16	Jan-17
Fuel & light	5.3	5.4	5.3	2.9	2.8	3.8	3.4
Clothing & Footwear	5.8	5.7	5.7	5.2	5.0	5.0	4.7
Housing	5.0	5.1	5.2	5.1	5.0	5.0	5.0
Miscellaneous*	3.8	4.0	3.9	4.7	4.8	4.7	5.1
CPI excluding Food-Fuel	4.7	4.9	4.7	4.9	4.9	4.9	5.1

\*Includes household goods and services, health, transport and communication, recreation and amusement, education and personal care and effects.

### 9. IMPACT OF DEMONETIZATION ON FINANCIAL MARKET

After demonetization Indian financial market has been followed just like secular falling trend. Nifty 50 fell approx 6.3 per cent and S & P BSE Sensex fell 5.9 per cent from Nov 8,2016 to Nov 22,2016.



There are many other factors besides demonetization that have affected the markets such as Donald Trump's election as President of the US and the subsequent rise in US bond yields and the strengthening of the dollar. That has led to funds flowing out from emerging markets and India too has been affected.

### 10. IMPACT OF DEMONETISATION ON EXTERNAL SECTOR

Demonetisation impacted India's external sector only moderately, but which was already facing a challenging external environment due to slow down in global trade because of rising support for protectionism in the US. Gold imports, which rose sharply in November 2016, moderated thereafter.

#### Balance of Payments

- i. **Merchandise Exports:** India's export growth, after having accelerated in Sept-October 2016, slowed in November 2016 (2.4 per cent in US\$ terms on a y-o-y basis) as shipment, especially from some labour-intensive sectors, were adversely affected by demonetization. Export growth recovered in December 2016 and January 2017 to 5.5 per cent and 4.3 per cent respectively.
- ii. **Merchandise Imports:** After a spurt in November, 2016, gold imports moderated in December 2016 and January 2017. As regards non-gold imports, demand for edible oil was expected to slow down as domestic consumption and off take have weakened following demonetization.
- iii. **Capital Flow:** Foreign Direct Investment (FDI) flows remained buoyant in November and December 2016. Portfolio flows (debt & equity) declined sharply from November 2016 to mid-January 2017, reflecting largely global factors. However, they turned positive since the last week of January 2017.



iv. **Demand for Gold:** After demonetization, domestic demand for gold or gold items increased suddenly, with buyers reportedly willing to pay huge premiums to dispose of old currency notes with jewelers.

#### 11. SUGGESTIVE MEASURES

In order to ease the burden of demonetization, the Government has introduced numerous measures to ease the burden of demonetization on common people. Those are as follows-

- Set up of digital literacy booths outside banks specifically in rural regions
- More printing of smaller currency notes
- Subsidy scheme for smart phones
- Cash management in banks and ATMs
- Increasing penetration of banks in rural areas
- Facility of mobile ATMs
- Expanded cash limits for cash driven sectors
- Incentives for Real Time Gross Settlement (RTGS) and National Electronic Funds Transfer (NEFT)
- Increase the limit for service tax exemption
- Increase in daily cash withdrawal limits from ATMs.

#### 12. CONCLUSION

Demonetisation is a one step of many steps in fighting corruption, black marketing and financing insurgency. However preparation for demonetization was lop-sided and its impacts was terrible on Indian public. The people, who were targeted, did not come on streets but common people are out from their work places as well as homes. The overall impact of demonetization on the real economy has been transient. The analysis in this paper suggests that demonetization impacted various sectors of the economy, however, the adverse impact in general, was short-lived as it was felt mainly in November and December 2016. The impact moderated significantly in January 2017 and dissipated by mid February 2017, reflecting an accelerated pace of demonetisation. Demonetisation will have major impact on parallel economy but sudden announcement and failure to prepare in advance has created temporary chaos and discomfort among the general public. Demonetisation is expected to have a positive impact over the medium to long-term. In particular, there is expected to be greater formalization of the economy with increased use of digital payments. The reduced use of cash will also lead to greater intermediation by the formal financial sector of the economy, which should, inter alia, help to improve monetary transmission.

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