

# Impact of Demonetization on Indian Economy

Anjali Ahuja

Assistant Professor

Delhi Institute of Rural Development affiliated to GGSIP  
University, Delhi

Sakshi Anand

Assistant Professor

Delhi Institute of Rural Development affiliated to GGSIP  
University, Delhi

**Abstract** - Demonetization refers to withdrawal of a particular form of currency from circulation. It is necessary whenever there is a change of national currency; the old currency must be removed and substituted with the new currency unit. The currency was demonetized first time in 1946, and second time in 1978. On 8th Nov. 2016 the currency is demonetized third time by present Modi Government. The chaos was created in every strata of the society whether upper, middle or lower. Where some welcomed the move as it was seen for curbing black money, many are suffering by this movement. In this paper analyze the current and immediate impact of demonetization on Indian economy and work out the probable consequences of the demonetization.

## I. OBJECTIVES of Paper

To work out the probable consequences of the Demonetization.

To know the positive and negative impact of Demonetization on India.

## II. METHODOLOGY:

The paper is based on the secondary data. The secondary data was collected from various published sources like reports, magazines, journals, newspapers etc. The dictionary meaning of DEMONETIZE is "To deprive (a metal) of its capacity as a monetary standard" or "To withdraw from use as currency". So, demonetization is the act of stripping a currency unit of its status as legal tender. It is the act or process of removing the legal status of currency unit. A currency on which Governor of RBI on behalf of Central Government guarantees by making statement "I promise to pay the bearer, the sum of money ....." which empowers it a legal status. From the date of demonetization, all old currencies which are demonetized will cease to be a legal tender. Such currency cannot be used as money to do any transaction henceforth, but to replace with a new currency. The Government of India on the 8 November 2016 announced demonetization of high denomination currency notes Rs 500 and Rs 1000. This means that 500 and 1000 rupees notes will be accepted by anyone except the organization declared by the Government. A new redesigned series of Rs 500 and Rs 2000 banknote is in circulation since 10 November 2016.

## III. CAUSES OF DEMONETIZATION

There are many causes of demonetization in any economy some are unclosed black money, corruption, fake currency, and currency storage etc.

## IV. BACKGROUND OF DEMONETIZATION IN INDIA

India had an experience of demonetization of its currency twice before. The first was when Rs. 1000, Rs. 5000 and Rs. 10000 notes were taken out of circulation on 12th January 1946, a 1 ½ year before the Independence. The highest denomination note ever printed by RBI in India was Rs. 10000 note introduced for the first time in the year 1938. However all three of Rs. 1000, Rs. 5000 and Rs. 10000 notes were again reintroduced in 1954. The second phase of demonetization was done on 16th January 1978 when an ordinance was promulgated to phase out notes with denomination of Rs. 1000, Rs. 5000 and Rs. 10000. On 12th January 1946 demonetization was resorted to but the Direct Tax Enquiry Committee in its interim report observed, "Demonetization was not successful then, because only a very small proportion of total notes in circulation were demonetized in 1946 and its worth was Rs. 1,235.93 crores". On 16th January 1978, demonetization of high denomination notes was introduced. The high demonetization notes as on that day amounted to Rs. 146 crore and total notes tendered to RBI amounted to Rs. 125 crore as per data available till August 1981.

**Positive & Negative Impact of Demonetization:-**

**Impact on Black Money and Corruption:** 'Black Money' or 'Dirty Money' is the money on which not tax is paid to the Government and it goes unaccounted in the duration of country tax assessment period which causes revenue loss to the government. It is argued that steps taken by the government of demonetization can help curbing black money in the country. Corruption will also be automatically reduced by removing black money from economy.

1. Source: SBI Research, RBI The Table depicts the public holding of high denomination notes worth Rs. 9926 billion as on March 2016. There are 3 scenarios in table. In scenario 1 and 2 it is assumed that 50% of the notes of higher the denomination do not return to the system. It is also reasonable to expect that 60% of Rs. 500 notes and 40% of Rs. 1000 notes would be exchanged at banks/ post offices and RBI before March 31, 2017. Based on such estimates, roughly round Rs. 4.5 lakh crore of money could disappear from the system.

2. Impact on Counterfeit Currency: The Biggest positive impact of the demonetization will be on the

counterfeit/fake currency as it currently thrown out of the system fully.

3. Impact on GDP: GDP become down because circulation of currency is less because of cash crunch in the country. The GDP formation could be impacted by this measure, with reduction in the consumption demand. Moreover, this expected impact on GDP may not be significant as some of this demand will only be deferred and re-enter the stream once the cash situation becomes normal.

4. Lower Inflation: Inflation arises due to higher liquidity in the market. Because of demonetization there is less liquidity and less cash flow in the market that's why inflation becomes down. As the black money goes out of the system the money supply will shrink to some degree. This will reduce inflation rate in the Lower absence of any open market interventions by the Reserve Bank of India. Inflation is of four types.

Creeping Inflation (2% - 4%)

Walking Inflation (5% - 10%)

Galloping Imflation (10% - 20%)

Hyper Inflation (more than 20%)

5. Impact on Purchasing Power: The move of demonetization has affected the purchasing power. This is mainly affect those assets that are used as long term investments like Real Estate, Vehicles and core sectors of cement and steel. The stock prices of the companies of these sectors will have a negative impact. Purchasing power of consumer is also affected due to the shortage of cash because 90% transactions taking place in cash in the Indian economy.

6. Impact on Real Estate Sector:

Demonetization smashed the real estate market and it will result in more than 50% drop down and it will remain for further 5 to 6 months. While the short-term impact is negative, Experts hoping that rate cuts in the coming months would boost home sales.

7. Impact on Banks and Financial Institutions:

The demonetization effects on banks will be both on the positive side and the negative side. However, In the long run it will be more on the positive side. As per directions of Government people have to deposit their money with the banks which will increase the liquidity of the banks for short term. This liquidity can be used by banks for lending purpose for long run.

As the liquidity of banks increases, they are expected to enhance the borrowing cycle by the lending money at lower rate of interest. However, the negative impact also as the earning of the banks will also take a hit for the next 2-3 quarters. We may not see loan book

growing as the banks will be busy in facilitating the demonetization process.

8. Impact on Lending Rate: Lending rate become down because of Banks getting money at Repo Rate and banks lending money at Base Rate. In this situation Repo Rate become less and automatically Base Rate will become down and banks having sufficient money to lend so lending rate become down.

9. Impact on Ecommerce: Impact of demonetization on Ecommerce mostly bad, some good. For the online retail market, gross merchandise value (GMV) of players fell by 40-50% in first few weeks after demonetization, in the middle of their biggest quarter for sales. Things may remain bleak till March. Even high-value items like expensive smart phones are selling less. Products returned are up by 50%. And experts feel consumer sentiment won't improve quickly. But the boost to digital payments (100% jump in transactions) has led industry to hope for a bright medium term. Also, grocery and food delivery set-ups are doing better since they sell essential items. Some saw new customer orders jump to 25%, from the usual 15-16%

10. Impact on Tourism:

Cash Crunch badly hits the tourism sector. It is very difficult for people for getting the money from the banks and ATMs. The travel and hospitality industries are facing a tough time.

Peak tourism period of November-December badly hit. For tourist destinations beyond metros, business may be down by as much as 40%. Tourism business in metros may go down by 10%. Cash shortage at airports and hotels are a big problem. And many national monuments entry points don't have card payments facilities. Western countries have issued advisories on cash Liquidity in India

11. Online Transactions and others modes of payment: The Government wants to go cashless, Demonetization will have positive impact on digital transactions and other mode of payment.

With cash transactions facing a reduction, alternative forms of payment will see a surge in demand. Digital transaction systems, E wallets, online transactions using E banking, usage of Plastic money (Debit and Credit Cards), UPI, EFTPOS, Net Banking Aadhar card, etc. will definitely see substantial increases in demand. This should eventually lead to strengthening of such systems and the infrastructures required

## CONCLUSION

In long run, there are some positive and some negative impact of demonetization but negative impact does not outweigh the positive impact of it. After the demonetization some sectors not affected like Pharma, FMCG, Education, Agriculture, Hospitals, Energy and Telecommunication From an equity market perspective, this move would be positive for Banking and Infrastructure sector in the medium to long term. This

would be negative for Real Estates, Customer durables, Luxury items in the near to medium term.

Demonetization can lead to elimination of fake currency and corruption, it can be said that this is a historical step by the Modi Government and should be supported by all. This decision of Government will definitely fetch results in the long term this is the stepping stone towards/ for sustained economic growth in long run.

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