

AFTER EFFECT OF DEMONETIZATION ON INDIAN ECONOMY

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Abstract:

Demonetization meaning is withdrawal of a any currency from circulation or Demonetization in very simple terms means that the currency is no longer legal in the country and it is only a piece of paper with no use. On 8th of November 2016 Indian prime minister announced that the notes of Rs 500 and Rs1000 will not be legal to use from midnight. And that Reserve Bank of India is withdrawing the old currency of Rs 500 and Rs 1000 notes and issuing new note of 500 and a 2000 Rs note which will be in circulation from date 10th November 2016. The decision has taken with the expectation to clean the economic system. The objective was to chase black money and fake currency, to remove corruption, to stop terror funding, to encourage country towards cashless economy. This study is attempted to study the impact of demonetization on the Indian financial market. This study is purely based on secondary data. The data has been collected from the different sources like research papers, published sources like journals reports, newspapers, magazines, and websites.

Keywords: *Demonetization, financial sector, Indian economy*

INTRODUCTION

Money is the fundamental invention of mankind .Money is the life line of any economy. Without money no economy can run. Modern economy is termed as the money economy

With the development of civilization, the requirements of human beings increased. And to fulfil those unlimited needs barter system appeared. But as the time changed,

the creation of money became a strong pillar for any economy.

Monetization is the process of converting or establishing something into legal tender. And the word Demonetization refers to the course of action of pulling out of a specific type of money presently in circulation. “It is banning of any presently circulated currency .Demonetization is when the old currency is banned and substitute with a

new currency”. Demonetize is nothing but “Removal of currency’s capacity as a monetary standard”. It is a Process of removing of any currency from common usage or exchange is termed as demonetization.

From the date of demonetization, all old circulated currencies which are going to demonetized will stop to be a legal tender. Such currency cannot be used as money for any transaction in future, but to replace with the new currency. The money which is pulled back due to demonetization is then replaced with another cash unit.

In year 2016 demonetization happened in India which is the best counter attack on dark cash which the country has ever observed. The currency which was demonetization, i.e. the high value currency note of Rs. 500 and Rs. 1000 (called SBN’S –specified bank notes) were 86.9% of the value of total cash in circulation. The values of such notes were Rs. 15,347 billion or around 11% of GDP of Indian economy. The decision was taken by the Government

- For the promotion of Cashless economy
- To remove Fake currency
- Elimination of black money from market
- To fight corruption
- To fight inflation

- Terror funding and Naxalism

HISTORY OF DEMONETIZATION IN INDIA

This is not the first time that India had experienced demonetization. Demonetization of higher denominations notes in India to wipe out black money which is created due to unrevealed monetary dealings and transactions for evasion of taxes is not for the first time in India. It happened twice before in 1946 and 1978.

1946 demonetization:

The first demonetization took place in 1946 when Rs. 1,000 note, Rs. 5,000 note and Rs 10,000 note were banned from circulation on 12th Jan 1946, about 1 ½ year before India got Independence. The Rs 10,000 note was the highest denomination note ever printed in India by RBI and it was introduced in 1938 for the first time. According to 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 cores” The ban really did not have much impact, as the currency of such higher denomination was not

accessible to the common people. However, all three notes of Rs. 1000, Rs. 5000 and Rs. 10000 were again reintroduced in 1954. In 1946, hundred rupee currency notes were demonetized, a time limit was provided for the exchange of old currency on the basis of declaration and was not allowed if the source of income was not satisfactory. But it did not produce impressive results.

1978 demonetization:

The second time demonetization was done on 16th Jan 1978 when, the then Prime Minister of India Morarji Desai announced the currency ban taking Rs 1000, Rs 5000 and Rs 10,000 out of circulation. The only aim of the ban was to curtail black money making in the country. The value of the banned currency was Rs. 1.46 billion (1.7% of aggregate notes in circulation).

In both prior bans, the main objective was to combat tax evasion by black money held outside the formal economic system. There are several reasons why nations demonetized their local units of currency. Some of them are

- To combat inflation,
- To combat corruption and crime,
- To discourage a cash depended economy

2016 demonetization:

This is the third time when government of India demonetized high value notes. On evening of November 8, 2016, the Indian Prime Minister shree Narendra Modi announced that 500 and 1000 currency notes would no longer be recognized as legal currency from midnight. This is very bold step which was taken by the Indian government for the betterment and transformation of country's economy. It is one of the toughest decision and biggest reform taken by the government.

Methodology

The study is purely based on secondary data. The required data has been extracted from various sources like Research Papers, various bulletins of RBI, various government and non-government publications on demonetization, published sources like Reports, Magazines, Journals, Newspaper articles published electronically or otherwise and the authenticated websites.

This is an investigative study of available data in context with the effect of demonetization in India. Therefore, the opinions written in this paper are of the author's own and the opinions of some presumed authors.

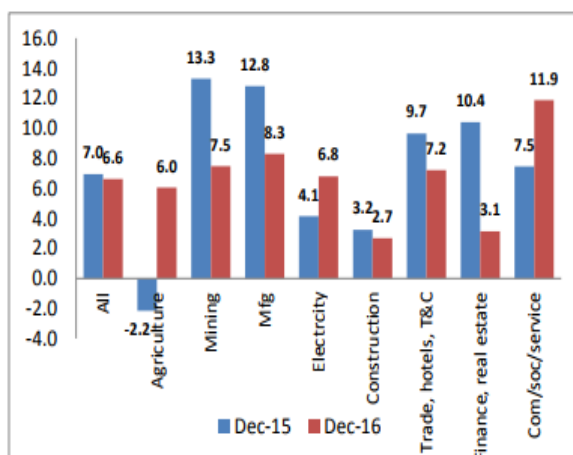
Objectives of the study

The study aims at following

- To give a brief description of demonetization in the year 2016 in India.
- To study the effect of demonetization on financial sector.

After effect of demonetization GDP growth profile

Overall growth in Gross Value Added (GVA) at constant prices did slow down to 6.6% in Quarter 3-FY17 with compared to 7% in Quarter 3-FY16. This is the negative effect of demonetization on different sectors like- manufacturing, trade, construction, transport & communications, real estate and finance, & professional services. The sectors which showed positive GVA growth were social, community services (i.e. government).



Source :care ratings

Industrial growth

Industrial growth after demonetization is a mixed picture. It has been uneven over the period of five months. The impact of demonetization on consumer goods was different in December and January while in November it was relatively optimistic which is opposite to what everybody would have been predicted post demonetization. Basic goods have grown constantly which can be credited to government spending aggressively in infrastructure. Capital goods have seen growth only in single month. Consumer goods growth in September were enormously high with durable goods leading with double digit growth, which was expected to accelerate in October and November on the back of the festival and post-harvest demand.

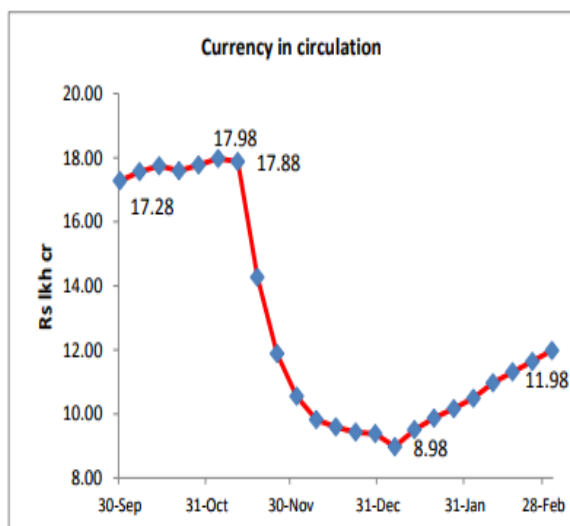
	Basic IIP	Basic goods	Capital goods	Inter goods	Consumer goods	Non-Durable	Durable
Sep-16	0.7	4.0	-21.6	2.2	6.1	13.9	0.3
Oct-16	-1.9	4.2	-27.0	2.6	-1.4	0.6	-3.0
Nov-16	5.7	4.7	15.0	2.6	5.2	9.4	2.5
Dec-16	-0.1	5.5	-3.9	-1.3	-6.0	-8.9	-4.4
Jan-17	2.7	5.3	10.7	-2.3	-1.0	2.9	-3.2

Source: care ratings

Currency in circulation

The Reserve Bank of India has been remonetizing the economy over the time and the currency chart has shown a U

shaped trajectory. It had sharp point just at the time of the demonetization announcement at 17.98 lakh crore and then started declining as people hurried to deposit the currency kept by them. The circulated currency reached a low on January 6th, just after the end date of deposit of old currency notes at Rs 8.98 lakh crore. Subsequently, there has been a rise in the cash availability in the system which was reached Rs 12 lakh crore on March 3rd. As the RBI would be providing ample amount of currency but if any lower quantum could lead to the progressive inclination towards digital modes of payment.

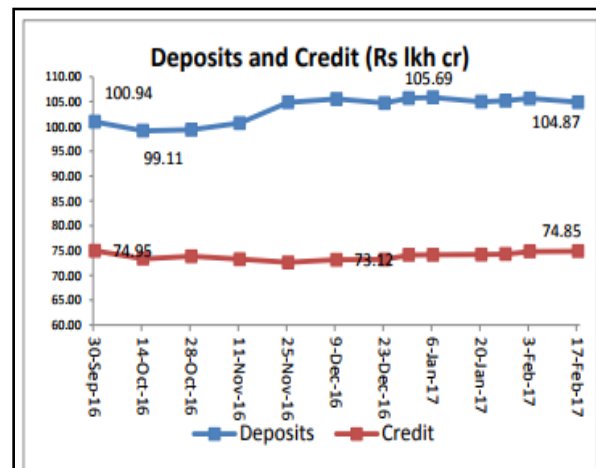


Source: care ratings

Bank deposits and credit

Bank deposits were one of the major recipients of this plan as old notes were deposited in banks. on January 6th these deposits had peaked. Bank credit continues

to delay and on the point to point basis it has witnessed a minor decline from Rs 74.95 lakh core on end September to Rs 74.85 lakh core on end Feb 2017.

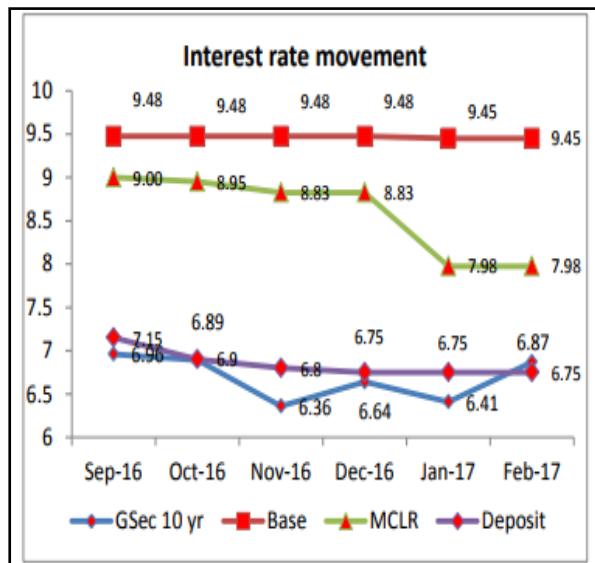


Source: RBI

Interest rates:

The RBI has reserved the repo rate unaffected in the period following to November 8 2016. The 10- GSec yield had drop down in November, but started rising once the MSS bonds were issued and the rate has moved upward ending at 6.87% in February end. Banks on the other hand have lowered the deposits rate due to excess liquidity entering the system even though the repo rate was unchanged by about 15 bps on an average basis. On the lending side, things have been different with the base rate remaining almost unchanged at 9.45% (3 bps fall in the rate) though the MCLR has come down sharply from 8.95% on October to 8.83% in November and to 7.98% in February. Hence, while GSec yields have tightened

due to excess supply of paper, deposit and lending rates have benefited.

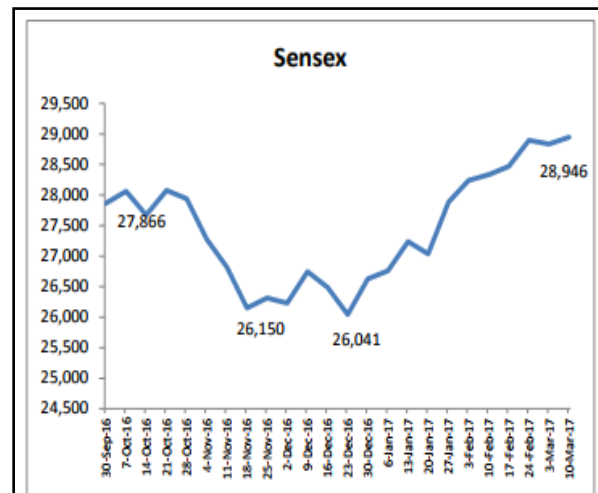


Source: RBI

Stock markets

The movement in stock indices is driven by a number of factors with exact events or announcements leaving their effect. the impact of any positive news or any negative news tends to last for a couple of trading sessions after which it is normally 'business as usual'. The Sensex did drop down when the demonetization was announced however it did also correspond with the US Presidential Elections too which impacted the movements of stock markets worldwide. Subsequently it has been driven by many other factors which have taken the index to all time high of 28946 on 10th March 2017. After the state Elections results were announced it has crossed the 29000 mark. the downward movement of the capital market in November could be affected by many

global factors - with demonetization providing a secondary impact.



Source: BSE

Conclusion

Demonetization in India is a immense step taken by the Indian government to remove black money and corruption. It is a very bold decision of the government.

The main intention of demonetization was to eradicate the black money and eliminate the corruption. Indian govt. has become success to some point. The effect of demonetization appears to be getting weakened over the time. The effect on different sectors has been sharpest in the November and December months. The monetary sector has gone through challenging times and still witnesses low growth in credit. The currency availability in the economic system has been normalized by Reserve bank of India but the amount in circulation is still 2/3 of that in November just before it was announced. Interest rates have shown a varying trend,

with GSec yields rising just at the time when they appeared to be headed southwards. Bank deposit rates have fallen under the force of excess liquidity in the system while banks have lowered their MCLR in a bid to make borrowing easier. However, bank credit growth is still to pick up.

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