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Demonetisation of 500 And 1000 Rs Notes: Impact on the Indian Economy

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ABSTRACT

On 8th November 2016, the Prime Minister Narender Modi announced the demonetization of all 500 and 1000 Rs banknotes of Mahatma Gandhi Series. The reason for this move was simple: India‟s Ministry of Finance claimed that 500 and 1,000 rupee notes are being used to finance terrorism, fund illegal drug sales, fuel the black market, drive counterfeiting, and pay bribes. This so-called "black money" had reputedly built up to such epic proportions that Prime Minister Modi declared that enough was enough, that he would take it upon himself to wash his country‟s currency supply in one fell swoop. Demonetization can be said as a „Surgical Strike‟ on Black Money, Terrorism, Fake Currency, Unorganized trading, Real Estate, Share market etc. on the other hand if we talk about the Indian industry on a broader way it can be categories in three parts Manufacturing sector, Service sector and Agriculture sector. After demonetization only Agriculture sector shows some positive improvement while if we talk about the manufacturing and service sector both were crashed down and these will affect the whole Indian market in 2017 also. As of December 28, official sources said that the Income Tax department detected over 4,172 crore of un-disclosed income and seized new notes worth 105 crore as part of its country-wide operations. The department carried out a total of 983 search, survey and enquiry operations under the provisions of the Income Tax Act and has issued 5,027 notices to various entities on charges of tax evasion and hawala-like dealings. The department also seized cash and jewellery worth over 549 crore out of which the new currency seized (majority of them 2000 notes) is valued at about 105 crore. The department also referred a total of 477 cases to other agencies like the CBI and the Enforcement Directorate (ED) to probe other financial crimes like money laundering, disproportionate assets and corruption.

Keywords: Demonitaisation, GDP, Indian Economy, Black Money.

INTRODUCTION

Demonetization for us means that Reserve Bank of India has withdrawn the old Rs 500 and Rs 1000 notes as an official mode of payment.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. On 28 October 2016, the total currency in circulation in India was Rs. 17.77 lakh crore (US$260 billion). In terms of value, the annual report of Reserve Bank of India of 31 March 2016 stated that total bank notes in circulation valued to Rs.16.42 lakh crore (US$240 billion) of which nearly 86% (i.e. Rs. 14.18 lakh crore (US$210 billion)) was 500 and 1000 rupee notes. In terms of volume, the report stated that 24% (i.e. 2,203 crore) of the total 9,026.6 crore banknotes were in circulation.

In an important move, the Government of India declared that the five hundred and one thousand rupee notes will no longer be legal tender from midnight, 8th November 2016. The RBI will issue Two thousand rupee notes and new notes of Five hundred rupees which will be placed in circulation from 10th November 2016. 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. Also, RBI data showed that as of March 2016, 632,926 currency notes were counterfeit—known as an FICN (Fake Indian Currency Note). As a proportion of NIC (Notes in Circulation), the 1,000 rupee and 500 rupee notes were the highest. Nullifying these FICNs was also part of the demonetization move. Now we talk about the impact of Demonetization on Indian Economy Sector. First economy can be bifurcated in three broad segments Agriculture Sector, Manufacturing Sector and Service sector all these three sectors contributed in Indian GDP. Agriculture Sector Contribute 17% in GDP Manufacturing Sector Contribute 30% in GDP Service Sector Contribute 53% in GDP After Demonetization all the three sectors faces negative impacts.

OBJECTIVES OF PAPER

- To study the experience of impact of demonetization in various countries in past years;
- To analyze the current the immediate impact of demonetization on Indian economy;
- To workout the probable consequences of the demonetization.

RESEARCH METHODOLOGY

The paper is based on secondary data. The data has been collected from internet. Graph and percentile method has been used to analyze the data.

Procedure for Exchange Old Notes

The Reserve Bank of India laid down a detailed procedure for the exchange of the demonetized banknotes with new Rs.500 and Rs.2000 banknotes of the Mahatma Gandhi New Series and Rs.100 banknotes of the preceding Mahatma Gandhi Series. Following are the key points:

- Citizens will have until 30 December 2016 to tender their old banknotes at any office of the RBI or any bank branch and credit the value into their respective bank accounts.
- Cash withdrawals from bank accounts will be restricted to Rs.10, 000 per day and Rs.20,000 per week from 9 November 2016 till 24 November 2016.
- For immediate cash needs, the old banknotes of value up to Rs.4000 per person can be exchanged for the new Rs.500 and Rs.2000 banknotes as well as Rs.100 banknotes over the counter of bank branches from 10 November 2016 by filling up a requisition form along with a valid ID proof.
- All ATMs will dispense bank notes of only 50 and 100 rupee denominations.

IMPACT ON DIFFERENT SEGMENTS OF ECONOMY

There is short-term and long-term impact of Demonetization on different sectors of economy.

Agriculture: The sector typically sees high cash transactions and therefore near-term impact could be seen till liquidity is infused in the rural areas. As farmers face a temporary shortage of cash in hand, it could lead to a delay in payment which in turn would hurt the related companies in the short term. As liquidity eases and cashless transactions gain acceptance, the fundamentals would be driven by the longer term drivers of normal monsoons and positive traction in acreage.

Manufacture: Automobile- Two Wheelers: Clampdown on cash transactions and temporary cash crunch could hurt purchases particularly in the economy segment of the two wheeler space where the percentage of cash transactions have been high. However, as companies learn to work around it, demand may pick up by overall growth in consumption on the rural as well as the urban side. Passenger Vehicles: The seasonal slowdown seen during November and December months could get more pronounced as consumers delay purchases due to temporary liquidity crunch and expectations of rate cuts. However, as most passenger vehicles are financed through loans, the blip would be temporary and demand may recover on the back of growth in demand in rural and urban areas as well as trickle down benefit of the 7th Pay Commission Payouts. Commercial Vehicles: Slackness in the economy on account of demonetization could have a negative impact on the commercial vehicle volumes which have been under pressure in recent times. However, this slowdown may be short lived and demand may pick up, led by pre-buying in response to the changes in emission norms as well as a pickup in overall economic activity. Consumption-related sectors like consumer durables, FMCG, etc: The outlook is near-term negative as cash sales account for a significant chunk of sales for companies in these sectors. As customers and companies migrate to the cashless platforms, demand should come back making demonetization near term neutral. In the long term, demand may shift from the unorganized players to the organized players.

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 Account of commercial banks. This in turn will enhance the liquidity position of the banks, which can be utilized further for lending purposes. However, to the extent that households have held on to these funds for emergency purposes, there would be withdrawals at the second stage.

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 increase in demand. This should eventually lead to strengthening of such systems and the infrastructure required. CARE's View In spite of the initial hiccups and disruptions in the system, eventually this change will be well assimilated and will prove positive for the economy in the long run

Service sector:- Service sector is hit very heard by Demonetization decision in November 2016 worst Slump in nearly three year is noted. The Nikkei India Services Purchasing Managers' Index (PMI), which tracks services sector companies on a monthly basis, stood at 46.7 in November, down from 54.5 in October. The Index slipped into contraction territory for the first time since June 2015 and pointed to the sharpest reduction in output for almost three years. On other hand if we talk about Banking Sector this is the only sector which was benefited by that decision in many aspects, this move will pull a large chunk of first time users to banks, who will have to use the system at least once to exchange their old notes for new ones. According to a study conducted by Moody's, people tend to continue using banking services once they have crossed the 'first-time user' mark. This development will increase bank deposits by 1 to 2 percent compared to what they were before the demonetization scheme.

GDP: According to the government's latest growth estimates, the pace of growth will be impacted by slowing growth in the manufacturing and mining sectors and also construction activity. This estimate is in line with the forecast of India's central bank, Reserve Bank of India, which in its last monetary policy had forecast GDP growth to be at 7.1 percent for the twelve months ending March. But this latest estimate does not consider the impact demonetization on the economy, "in the absence of sufficient information." While releasing the data, Chief Statistician T C A Anant said the figures for November were available and examined but "it was felt in view of the policy of demonetization of notes there is a high degree of volatility in these figures and conscious decision was taken not make projection using the November figure".

This latest government estimate has been released almost a month before the standard release date of February 7. According to the data released Friday January 6th: "the Gross Value Added (GVA) at basic prices for 2016-17 from the mining and quarrying sector is estimated to decline by 1.8 percent, as compared to growth of 7.4 percent in 2015-16," a statement from the Central Statistics Office of the government said Friday evening. The GVA at basic prices for 2016-17 from the manufacturing sector is estimated to grow by 7.4 percent, compared to growth of 9.3 percent in 2015-16, the data showed. The private corporate sector has a share of around 72 percent in the manufacturing sector.

CONCLUSION

The present study shows the impact of Demonetization on Indian economy's different sectors. GDP of Country slightly decreases as compare with the previous year but we cannot say it will be same in future also. ―This intervention is a one-time draining of this current stock of black money but unless the root causes of corruption are removed, corruption will continue. It is sort of like a dialysis, more of a short term cleaning up than a solution of the problem. 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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