

Impact of Demonetisation on Construction Industry

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Abstract

Demonetisation of Rs. 500 and Rs. 1,000 notes by the Government of India is a very bold act and welcoming one. The hoarding of money by unscrupulous people led to double pronged impact on the economy.

First the prices of commodities have gone up quite steeply due to free flowing of high value currencies by a handful of few and second the purchasing power of money in real terms has slid badly to common people who are the majority and in whose possession the savings is very reasonable.

To say succinctly, the high value currencies were stored only in the form of Black Money. Pumping of this was used for activities which are antisocial and on things which would shoot up prices of essential commodities. Right from vegetables to gold, prices went sky high.

A majority of black money or hoarded currencies was spent or invested in Real Estate Sector. In fact, this sector is more commonly known as the platform for safe spending of hoarded high value denominations.

Rightly, the bold act of the Government has brought in very positive results in the Economy.

I. INTRODUCTION

It is a commonly known fact that the Real Estate Sector is the one where cash transactions play a pre dominant role. Even the educated people, prefer to do it more with liquid cash than by going in for explicit bank loans. The underlying reason is the actual value of the property can be undermined to the extent of cash payment and for loan purposes; some other value or the balance of the property can be given.

The stamp duty can be avoided for the cash given and the governmental charges are only for the value spelt out on the document. Moreover, real estate was considered to be the safe outlet for pumping out the hoarded money.

The article spells out the impact of demonetization on the construction industry.

II. CLASSIFICATION OF REAL ESTATE SECTOR

The Real Estate Sector can be basically divided into two viz, Residential real estate and Commercial real estate. The Residential Real Estate is the one which is dealt with by more number of genuine purchasers and a handful of black money holders who use it more for the sake of converting the black into white. This holds the major share in the Real Estate Sector.

The Commercial Real Estate on the other hand, is less in share and is handled only by a few who really need it for the sake of commercial business. In other words, the acquisition on this is rather small compared to the huge and more concentrated residential real estate sector.

III. CONTRACTION OF CASH IN THE ECONOMY

The demonetization has resulted in a spell bound impact on the economy. Liquid cash became dearer. The constrictions slapped on withdrawal of cash from bank as also from ATMs, plainly speaking, forced us on disciplined spending.

The demonetized currencies constitute nearly 85% of the total value of the money in circulation. More of the high value money was spent on real estate business. Hence, more than a general contraction of cash circulation in the economy, it drove a major blow to the Real Estate Sector.

IV. IMPACT FELT BOTH IN PRIMARY AND SECONDARY SECTORS OF REAL ESTATE

The construction industry alone accounts for about 8 – 10% of the GDP and offers employment both direct and indirect to about 40 million people.

The demonetization has caused abrupt stoppage of work in many projects. The payments, especially to workers, were only by liquid cash. The sudden restriction on withdrawals led the contractor unable to cope with the labour pressure.

Work at SARE Homes' residential projects, spanning six cities, has slowed dramatically as migrant workers, who are out of cash and have no bank

accounts to draw from, have little choice than to return to their home villages.

Property enquiries also slumped by nearly 80%, according to Property Portal 99 acres.

According to Getamber Anand, President of Indian Builders' Association CREDAI, all the projects nationwide had been hit and estimated that roughly half of the migrant workforce, numbering in the low millions, had left for home.

Besides this, Road Developers have also reported a slow down as they struggle to find sufficient labour.

V. TWO SIDED IMPACT

The first and foremost is fleeing of labour force from the sites. They were not paid money for the days they worked. They could not prolong in a new place without liquid cash. The local people were also reluctant to extend credit facility to migrant workers, as they themselves were badly hit by poor cash sales. Consequently, the labourers were returning to their villages. Many of the ongoing projects came to a standstill.

Majority of workers do not have bank account at all. As they are the floating population seeking job, it is literally impossible for them to open bank accounts from place to place.

The Contractors, though they had sufficient balance, could not draw from bank in view of the restrictions on the amount and number of transactions per week. They were only silent spectators to the fleeing of workers from the site.

The new bookings were virtually nil. The Builders who made a massive investment are in troubled waters. India's decade long construction boom created one in three new jobs as tens of millions of people made journey from rural areas to towns seeking livelihood, came to a grinding halt.

This sparked a blow also on the Cement and Steel makers who faced a sudden slump in demand.

According to Ashwinder Raj Singh, CEO, Residential Services, JLL India, "poor sales leading to almost flat prices, heavy liquidity challenges and high unsold inventory have all colluded to keep real estate sector away from fulfilling its potential and provide necessary residential stability to average citizens".

VI. HOW WAS THE IMPACT SPREAD

The Real Estate Sector is severely hit by the demonetization, as it is controlled by a high involvement of black money and cash transactions. Analytically, while new purchases are backed by bank

loans, the resale secondary market is always controlled by cash transactions. Goes without saying that cash transactions means hoarded and unaccounted money.

Besides this, the high end luxury segments of real estate are also facing major tremors since this is another area where payments are made largely by cash. Many Developers have announced a price dipping by about 25%, to tide over the liquidity crunch.

The majority of cash transaction is in secondary market and luxury market. The demonetization has literally devastated these.

VII. MASSIVE LAYOFFS AND FLEEING OF WORKERS

Multiple reports from Chennai, which has the maximum share in the state's construction sector, Coimbatore, Trichy and other areas warn of a disastrous situation if the situation is not immediately resolved.

According to N Nandakumar of the Confederation of Real Estates Developers' Association of India (CREDAI), Tamil Nadu, the members of the organisation have been asked to arrange rations for workers at their shelters.

On an average, there will be anywhere around 100 – 200 workers at a single project. CREDAI alone has 130 members (who are all leading builders) in Chennai.

According to Labour Department Official, there are 500 – 600 unorganized builders in Chennai who are not members of CREDAI or other Builders's Associations.

It is also said that more than 1000 major projects in Chennai and Kancheepuram districts have been badly hit.

According to S Janakarajan, an Economist teaching at the Madras Institute of Development Studies (MIDS), a large number of construction labourers are facing layoffs. Contractors who pay weekly wages are also helpless. The total work force in our country is roughly 64 crore, out of which 90% belongs to the informal sector, whose contribution to GDP is roughly 50%. In this, while farm sector has a 50% share, about 30% share belongs to construction workers.

VIII. WILL PRIMARY SALES REVIVE FASTER THAN SECONDARY SALES

According to Jaxay Shah, President Elect for the Confederation of Real Estate Developers Associations' of India (CREDAI), the Primary market in comparison to the Secondary market has been stable

because the transactions are through financial institutions and banks. The Secondary market, on the other hand, has virtually come to a standstill.

According to Samantak Das, Chief Economist and National Director at Knight Frank India, the Developers and Consumers are still trying to read the situation and the actual manifestation of demonetization will probably come in two to three months. For now, low availability of cash and uncertainty about price trends is likely to keep the real estate market subdued.

IX. WHAT DOES PE ANALYTICS SAY

PE Analytics owns and operates Prop Equity which is an online subscription based real estate data and analytics platform covering over 83650 projects of 22,202 developers across over 42 cities in India.

According to Prop Equity Research, residential real estate valuation in the top 42 cities in India, sold and unsold, will take a tumble and fall up to 30% from Rs. 39,55,044 crore by approx. Rs. 8,02,874 crore to Rs. 31,52,170 crore.

Maximum fall on total market valuation will be in Mumbai Rs. 2,00,330 crore followed by Bangalore by Rs.99,983 crore and Gurgaon Rs. 79,059 crore.

Indian realty is now bracing for sub prime level crisis, which is expected to deeply impact the core of unorganized real estate and black money, Prop Equity said.

We expect lot of secondary market transactions (resales) coming down in volume. For every five buyers, there is only one buyer willing to pay all cheque. And usually, people want to take at least 20 – 30 percent of the amount in cash, but this will now go away for the time being, Samir Jasuja, CEO and Founder of Prop Equity.

He further said that we can expect more formal and organized developers to weather this storm and will relatively be in a better position in the next 9 – 12 months.

Prop Equity observed correctly that while there will be acute pain in the short term, in the mid to long run, it will be hugely beneficial for Indian realty as it will create lot of transparency.

X. CONCLUSION

The demonetization has caused a huge shock in the realty sector as it is eminently a cash involved one. Not only in secondary sector, but also in the Primary sector, most of the buyers and sellers prefer to

have a major chunk in cash, restricting to only a lesser amount on transparent payments – by way of cheques and DDs. As such, this is the sector where hoarded money finds its place.

Black money takes the colour of white in realty sector.

In our country, presently, except organized big institutions, most of the small companies encourage only cash transactions. This only gives rise room for investment of black money. The peculiar truth is that most of the small constructions are handled only by small companies where money only has a say in the matter.

The demonetization has just shaken the real estate sector totally. It is absolutely true. Prices are coming down to as much as 25 – 30% to tide over the crisis.

In the long run, this will definitely help the real estate sector fully. Not only large institutions, even small companies will be forced to undertake only open transparent financing. Black money investment will be ridden of it, in the near future.

XI. RECOMMENDATIONS

Government must enact a rule that irrespective of the value of the deal, all transactions should be done only by way of Cheques or DDs. This will ensure total transparency and will eliminate cash dealings.

Once this is strictly ensured, automatically the corruption and illicit elements will go off at all stages.

Offenders should be sternly dealt with without any dispensation.

Interest Rates must be brought down substantially to give a solid thrust for boosting purchases.

As the demonetization will bring in stability, the financial institutions should also have only Fixed Rate and no more Floating Rates. Definitely, housing loans with Fixed Rates will prove beneficial to both buyers and institutions. The buyers are worry free and fully protected from volatilities with Fixed Interests. Their planning will be more precise and comfortable.

The Government should take a bold decision that all housing loans should only be on Fixed Rates and floating interest rates should be abolished forthwith.

The Government's guideline value should be more realistic and reasonable. Even in the same locality, value differs hugely from place to place. This only leads to malpractice.

Corruption at all levels – from planning to registering should be avoided. Sternest action should be enforced on the errant. Corruption and Malpractices are wide present in realty sector. Hence, sternest action is the pre-requisite.

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