

Impact of Demonetisation on Banking- A Conceptual Study

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Abstract:

The term Demonetisation has become a household name since the government pulled the old ₹500 and ₹1,000 notes out of circulation. While as per dictionary demonetisation means "ending something (e.g. gold or silver) that is no longer the legal tender of a country On 8 November 2016, the Government of India announced the demonetisation of all ₹500 (US\$7.40) and ₹1,000 (US\$15) banknotes of the Mahatma Gandhi Series. In this paper an attempt is made to bring in the insights of Demonetisation and its impact on Banks. How far Governments objectives have been fulfilled, whether it has served the purpose with which it has been implemented. Opinion of many Banks' higher officials has been included to understand whether this move yields positive responses and its impact on economic growth.

Key Words : Demonetisation, Economic Growth, Gross Domestic Product,

Introduction

Demonetization is a process by which a series of currency will not be legal tender. Then the series of Currency will not acceptable as a valid currency. The announcement done by our Prime Minister Sri Narendra Damodardas Modi on 8th November 2016 regarding the demonetization of Rs. 500 & Rs. 1000 notes is a bold decision relating to economic policy of the nation. The basic reason behind the decision is curbing all black money in India. Secondary sources of data have been used for study which is collected from various journals, news bulletins, periodicals, and online sources. Hence it can be concluded that apart from disrupting daily lives of common citizen, there are even bigger implication for the economy as a whole. The rural areas in particular, which don't have formal sources of banking, also deal largely in cash from unorganized sector like land lords, private money lender and Chites. The present paper is an attempt to study the impact of demonetization on Indian economy particularly on business environment. It was found that as an impact of demonetization the interest rate may go down, increases the employability opportunity, decrease the price of the commodity and other product.

Keywords: Demonetization, Indian Economy, Banking, Currency

What is demonetization of currency? (ET)
Demonetization, means that Reserve Bank of India has withdrawn the old Rs 500 and Rs 1000 notes as a official mode of payment. Demonetization is the act of stripping a currency unit of its status as legal tender.

Objective of the Study:

1. To high light on the Demonitization in India and after effects of it.
2. To present the scenario of deposits and growth in Banks, post Demonetization.
3. To study impact of Demonetization on Indian Economy..

Data: Data is secondary data, from various publication, through internet.

It is pure conceptual paper. The effects may vary according to dimension of study.

Period of study : period of study has been post Demonetisation till date.

Review of Literature:

Ashima in her article has stated Demonetization in India¹ can be an excellent example of change management principals. This article tries to draw an analysis of steps that have been taken and steps that could have been taken to make the process more effective. Abhinav Singh et al² their paper elucidate the implication of demonetization in developing economies like India. . Dr. Tandon Deepak et al³ have critically examined the process of demonetization, boons and banes of demonetization, key impacts on various sectors and have concluded that necessary to put the economy on a high growth path that would generate more jobs and make housing in the urban area more affordable to the poor. For over a month, discussion all over India is going as to whether the move is good, with great execution or the move is bad and could have been better executed. However, one can safely conclude that the intentions are very good. Kulkarni, Kishore G et al⁴ believed that on the demonetization decision was taken to tackle the rampant corruption, unrecorded (or black

money), and control the fake currency that often finances terror activities. The paper⁵ by Kulkarni, Kishore on current world economy notes that the current economic scenario is not in bright side. In 2016 when the world economy was in mess, the commodity market was crashing. Stagnant global trade, subdued investment and heightened policy uncertainty marked another difficult year for the world economy. Gupta, Dinesh Kumar in his article expressed⁶ that demonetisation step of 2016 was somehow different from to earlier steps because of its sudden declaration taking aback the general public, bankers who were to deal mainly with the situation as it was feared that if the black market caught any whisper of what the government was planning, they would find ways to get rid of their illicit cash, and the initiative would flop on one of its initially-stated goals. The step worked as a trigger point for the general public to adopt the alternate banking delivery channels, as momentarily, it was a no cash situation. Government has come out with a number of incentives on cashless transactions like waiver of surcharge on transactions in cashless mode. S.K.Govil⁷ in his research opined that demonetisation would be positive for sectors like banking and infrastructure in the medium to long term and could be negative for sectors like consumer durables, luxury items, jewellery, real estate and allied sectors, in the near to medium term. It can also lead to improved tax compliance, fiscal balance, lower inflation, lower corruption, complete elimination of fake currency, a step for sustained economic growth in the longer term. Dr. Kaithil Ashok Kumar⁸ expressed a view that demonetization in Indian economy seems to be very harsh as, common man of the rural and urban area, small shopkeepers, small traders, artisans, daily wage workers, small households, small traders, small scale manufacturers have suffered more and will suffer till circulation of currency notes resumes to normal in four to five upcoming months. The rural economy mainly the agriculturists have suffered with dual impact as, their sale of Kharif crop could not get them profit and the sowing of Rabi crop has got affected. The effect on rural economy will affect the overall productivity of the agriculture sector in the coming year. The cashless transaction has been promoted by the government but, it will take years to develop this skill in rural population and in semi-urban and in common commuter of the urban areas. The condition will improve in near future with the gradual transformation of Indian economy from cash transaction to cashless transaction. This transformation of the economy will increase liquidity with the banks, feasible tax system, increased revenue collection, more transparency in economy, increased public expenditure, more welfare of the society, lower rate of interest, more

capital available for funding, enhanced rate of investment by the government and by the industrialists. In long term this will improve the economy bring, more transparency, less regional disparity, higher rate of growth of the economy. The argument of K.Bharati⁹ posited in favour of demonetization a —Surgical Strike on Black Money, i.e., the cash that would be extinguished would be —black money and hence, should be rightfully extinguished to set right the perverse incentive structure in the economy. While the facts are not available to anybody, it would be foolhardy to argue that this is the only possibility. Therefore, it is imperative to evaluate the short run and medium-term impacts that such a shock is expected to have on the economy. Further, the impact of such a move would vary depending on the extent to which the government decides to remonetise. This paper elucidates the impact of such a move on the availability of credit, spending, level of activity and government finances. Mr. Brijesh Singh¹⁰ in his research felt that there are multiple reasons why nations demonetize their local units of currency. Some reasons include combating inflation, to combat corruption, and to discourage a cash system. The process of demonetization involves either introducing new notes or coins of the same currency or completely replacing the old currency with new currency. The objective of this research paper is to understand the impact of Demonetization in the economy, to understand the effect of cashless transaction in different industry and to understand the impact effect and aftermath of demonetization.

Conclusion

Review of literature critically examined the process of demonetization, boons and banes of demonetization. Demonetization in Indian economy seems to be very harsh as, common man of the rural and urban area, small shopkeepers, small traders, artisans, daily wage workers, small households, small traders, small scale manufacturers have suffered more and will suffer till circulation of currency notes resumes to normal. However, one can safely conclude that the intentions are very good, a step for sustained economic growth in the longer term.

Objectives of Demonetization from the Government point of view:

To tackle black money in the economy.

To lower the cash circulation in the country which "is directly related to corruption in our country," according to PM Modi.

To eliminate fake currency and dodgy funds which have been used by terror groups to fund terrorism in India.

The move is estimated to scoop out more than Rs 5 lakh crore black money from the economy, The surprise move by government is a disaster for people who have accumulated lakhs and crores of unaccounted cash under their pillows and mattresses. The winter is coming and these worthless pieces of paper can provide the corrupt some ephemeral warmth.

created a shortage of cash in the system, leading to a lot of discomfort for the general public and businesses. Also, since there is a shortage of newly printed Rs 500 and Rs 2,000 notes, the situation has worsened. The move has also led to a shortage of lower denomination notes such as Rs 100 and Rs 50 that are still legal tender, as people have taken .

Opinion of few experts from banking and other sectors on Demonitisation:

What has the government done?

Prime Minister Narendra Modi's decision to scrap high value notes of Rs 500 and Rs 1,000 has

Almost all the stalwarts of the banking sector including Deepak Parekh, Chanda Kocchar think that the move will help curb black money in the economy.

<p>1.Chidambaram ,Former Union finance minister</p>	<p>It will take at least 2 years for the economy to recover from the ill-conceived decision of the Prime Minister, “The decision with horrendous consequences is likely to limit the GDP growth rate to 6% to 6.5% during 2017-18 and 2018-19,” he estimated.</p>
<p>2.Chanda Kochar, MD & CEO, ICICI Bank:</p>	<p>According to chanda kocchar, "this move will definitely bring about a whole amount of transition to no cash or low cash kind of transactions,".</p>
<p>3.Harish Salve , one of the leading lawyers in taxation laws</p>	<p>"A parallel black economy will collapse,"</p>
<p>5.Deepak Parekh, HDFC Chairman</p>	<p>anticipated that the Land will become cheaper and "one expects that reate price will come down in medium term."</p>
<p>6.Arundathi Battacharya, SBI chief</p>	<p>The slowdown in demand that India has seen following the government’s demonitisation move is temporary</p>

<p>7. Shikha Sharm Axis Bank MD and CEO</p>	<p>Bank of Baroda’s savings account growth after demonetisation stands at Rs 38,000 crores. Sanctions in the third quarter have been robust with draw downs on the lower side,</p>
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Back Ground-Demonetisation - 1978 to 2010:

Year	country
1978	India
1982	Ghana
1984	Nigeria
1987	Myanmar
1991	Soviet Union
2010	North Korea
	Zimbabwe
2016	India

Prior to announcement by Prime Minister Narendra Modi that high denomination notes would stop being legal tender from 9th November, 2016, there were two similar instances in India.

The first instance was in 1946 and the second in 1978 when an ordinance was promulgated to phase out notes with denomination of Rs 1,000, Rs 5,000 and Rs 10,000.

The government’s move to demonetise, even then, was to tackle the issue of black money economy, which was quite substantial at that point of time. In January 1978, the Indian government demonetised Rs 1,000, Rs 5,000 and Rs 10,000 notes which was quite substantial at that point of time. The move was enacted under the High Denomination Bank Note (Demonetisation) Act, 1978. Under the law all “high denomination bank notes” ceased to be legal tender after January 16, 1978. People who possessed these notes were given till January 24 the same year — a week’s time — to exchange any high denomination bank notes. The main difference between then and now is that currency of higher denomination was barely in circulation, unlike the Rs 500 and Rs 1000 note today.

Facts in numbers

Up to 97% of the demonetised bank notes have been deposited into banks which have received a total of Rs 14.97 trillion (\$220 billion) as of December 30 out of the Rs15.4 trillion that was demonetised. This is against the government's initial estimate that Rs3 trillion would not return to the banking system.

Of the Rs15.4 trillion demonetised in the form of 500 and 1000 bank notes of the Mahatma Gandhi Series, Rs9.2 trillion in the form of Rs500 and Rs2000 bank notes of the Mahatma Gandhi New Series has been recirculated as of 10 January 2017, two months after the demonetisation.

Demonetization: Key developments

- New currency notes
- Limits on ATM cash withdrawals to cease 1st February onwards
- No cash withdrawal limits from March 13: RBI

IT Dept expands list of transactions under scanner

Benami property holders under scanner

Taxman cracks down

Demonetisation affect on banks in today's India:

The negative impacts are because of regulation, costs of demonetisation, loss of opportunity and short-term damage to economy.

1. The 100% cash reserve requirement (CRR) on incremental deposits meant that banks did not earn any interest on Rs 3 lakhs crores of deposits for nearly a fortnight.
2. The waiver of ATM charges would result in banks losing Rs 20 in every transaction.
3. The waiver of merchant discount rate on cards would result in banks losing 1% in every card transaction.
4. Banks use third parties like cash logistics companies for cash transportation. Moving out Rs 15 lakh crore of currency notes and moving in Rs 7 lakh crore plus from currency chests would have cost several thousand crore.
5. As banks have been focused on exchanging currency notes, they have not been able to sell any loan products.
6. Some SME businesses have seen their sales drop 50–80% and could default in their instalments. They wont immediately be classified as NPAs because of some relaxations, but if the delay persists bank NPAs might worsen.
7. Uncertainty has resulted in drop in spending on high value items from credit cards. These are the transactions which are converted into EMIs and banks earn from them.

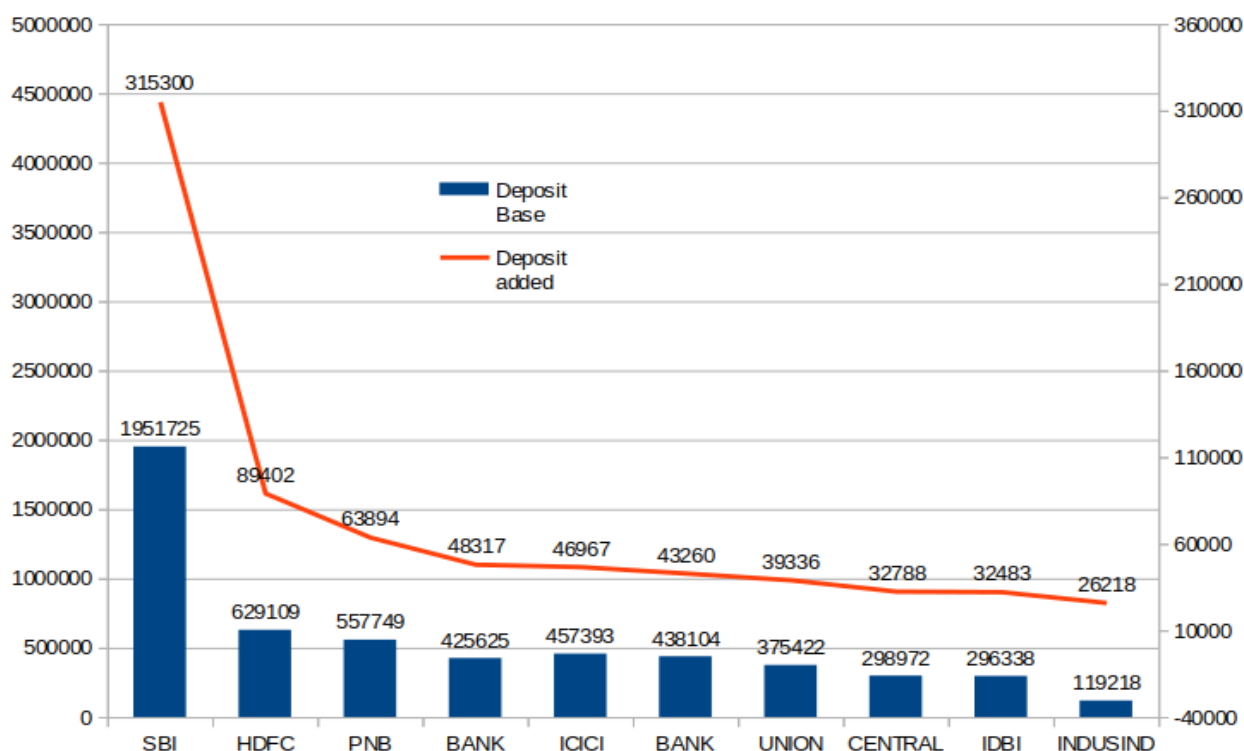
The Positive Impact on Top ten Banks.

Post demonetisation Deposit Growth of Banks in India

State Bank of India and HDFC Bank were the most successful in attracting and retaining deposits in the wake of demonetization of currency, according to an analysis of their deposits growth so far this financial year. The highest growth was reported by State Bank of India, which added a massive Rs 3.15 lakh cr of deposits as of Dec 31 when compared to Apr 1, the first day of the financial year. The growth in deposits at SBI was a massive 19.3% in the nine months. As of Dec 31, the total deposits at the bank had risen to 19.52 lakh cr, which was about 26% of the total money held by all public sector banks in India at the time. The number does not include the share of associates such as State Bank of Travancore, which are in the process of being merged with SBI. The second biggest beneficiary of demonetization was HDFC Bank, which saw its deposits jump 16.6% as of Dec 31, when compared with the corresponding number of April 1. Against the Rs 3.15 lakh cr added by SBI, HDFC Bank added a more modest Rs 89,402 cr. Its total deposits at the end of 2016 stood at Rs 6.29 lakh cr, or about a third of SBI's. HDFC Bank too accounted for 26% of the total deposits in all private sector banks in India at the time.

With almost 64,000 cr, Punjab National Bank was the only one to report deposit additions of over Rs 50,000 cr in the three quarters of the financial year. Bank of India added 48,317 cr, growing 12.8%, while ICICI Bank added 46,967 cr, growing 11.4%. Axis Bank had a relatively poor performance, and added just 13,666 cr and reported a growth of only 3.9%. The highest growth rate among established banks was reported by IndusInd bank, a part of the Hinduja Group. It added Rs 26,218 cr and reported a growth of 28%. The worst performer was Indian Overseas Bank, which saw a decline of Rs 14,312 cr — 6.6% — during the nine months.

Deposit Growth of Banks, Apr 1 - Dec 31, 2016



Demonetisation: The good, the bad, and the ugly

The good

The year 2016 has overall been “a good year” for India, listing the highlights:

The GDP growth rate has held up at more than 7%. Foreign direct investment went up significantly during the year. (It rose 30% on a year-on-year basis to \$21.6 billion between April and September 2016, according to public data published by the India Brand Equity Foundation, a government-sponsored trust.)

Initiatives such as the ‘Make in India’ program “have borne early fruits.” Many MNCs including Panasonic and Pepsi set up manufacturing facilities in India during the year.

“The start-up world has seen a drop in investment activity, but It is that, as a return to sanity rather than a worrisome contraction,”

The bad

The claimed objective of the exercise has apparently changed from rooting out black money to promoting cashless transactions. Several measures have been introduced, among them a 0.75% discount on digital payments made for buying petrol and diesel and a 0.5% cut in the price of railway season tickets bought using digital technology.

In another twist, the government appears to be no longer pushing demonetization as a “cashless” plan. It has now become a “less-cash” strategy.

In India, Bloomberg data shows the share of cash in the volume of consumer transactions is 98% (against 55% in the U.S. and 48% in the U.K.). It is

90% in China and 86% in Japan. Much of the cash transactions are in rural India. So, expectedly, life came to a near standstill and much misery ensued when people found themselves unable to use their own money. Even when the money was in a bank account, limits on ATM withdrawals compounded the problem further.

But India is also a country where finding novel, workable solution to problems – commonly known as jugaad — is par for the course.

By December 31, the visible impact was a Parliament at near paralysis as politicians took pot shots at each other, a plethora of banking riches coming back into the system (some 90% of the Rs500 and Rs1,000 notes were returned), and a host of new scams to convert black money into white with the connivance of bankers and politicians.

The Ugly

The term demonetisation has become a household name since the government pulled the old Rs 500 and Rs 1,000 notes out of circulation. While as per dictionary demonetisation means “ending something (e.g. gold or silver) that is no longer the legal tender of a country. Since our economy is heavily dependent on cash, as only less than half the population uses banking system for monetary transactions, demonetisation has hit trade and consumption hard. With people scrambling for cash to pay for goods and services, the move is likely to take a big toll on the country's growth and output during the current fiscal. Consumption makes up for around 56% of India's GDP, hence, a drop in

spending will pull down growth. The current step could also lead to behavioural changes in households' savings and their consumption pattern, say economists.

Nobody is denying a short-term setback. The Reserve Bank of India (RBI) has reduced the GDP growth rate forecast for 2016-17 from 7.6% to 7.1%, the Asian Development Bank from 7.4% to 7%, Fitch from 7.4% to 6.9% and Bank of America-Merrill Lynch from 7.7% to 7.4% (for calendar 2016). All believe, however, that growth will recover the next year.

It's work in progress. Three events dominated India's economic landscape last year, but whether they can be described as "progress" is debatable.

"The timing is not right for implementation," says West Bengal finance minister Amit Mitra, who is also chairman of the empowered committee of state finance ministers. He lays the blame squarely on the center's move to demonetize Rs500 and Rs1,000 notes. "

According to Wharton emeritus professor of management Jitendra Singh, while it is too early to assess the impact of demonetization, the move raises long-term questions. **"What will have been gained from this step, and at what cost and mostly borne by whom?"** Demonetization represents much more than destabilization; **critics argue that it has struck a body blow on economic activity in India.** The decision – which was entirely unsuspected – was announced on 8 November 2016. While the pros and cons of the measure still continue to be debated, the consensus of opinion appears to be that while the proponents of demonetization may have had good intentions, the suffering it has caused to millions of Indians is unwarranted. Since Rs500 and Rs1000 notes make up some 86% of the total currency in circulation in India, especially in the vast rural areas, one economist compared the pain to what individuals might experience if 86% of their blood was removed from their bodies.

To be sure, demonetization has its supporters. While industrialists and corporate chiefs (Ratan Tata, Mukesh Ambani, K.V. Kamath and Deepak Parekh, to mention a few) favor the move, economists (including Nobel laureates Amaryta Sen and Paul Krugman, among others) are critical. "The clan of economists has spoiled the party [with] their estimates of how output will be affected as spending has stopped, manufacturing hit and several workers laid off. The net result can be a fall of between 0.5% and 2% in GDP,"

"The debate still goes on."

According to Singh, Modi took "a bold, even visionary, step" with demonetization in attempting to combat the black economy and counterfeiting, and cutting financial support to terrorism. "What was always key, however, was how well the implementation process would unfold," he notes.

"Even supporters of the decision would say that the implementation was far from perfect."

Demonetization against the backdrop of other economic gains:

The year 2016 has overall been "a good year" for India:

The GDP growth rate has held up at more than 7%. Foreign direct investment went up significantly during the year. (It rose 30% on a year-on-year basis to \$21.6 billion between April and September 2016, according to public data published by the India Brand Equity Foundation, a government-sponsored trust.)

Initiatives such as the 'Make in India' program "have borne early fruits."

Many MNCs including Panasonic and Pepsi set up manufacturing facilities in India during the year.

"The startup world has seen a drop in investment activity, but I see that as a return to sanity rather than a worrisome contraction

"The biggest wild card in all of this, of course, is demonetization,"

Pros & cons of Demonetization

There is no other decision that effected 1 billion people from rich to poor alike since independence like the present demonetisation. Surely there will be pros and cons with this decision. The decision taken by Modi is to know how much black money is there with people. RBI will have data about how much currency it printed and released into market. Now with demonetisation move the money with people will come to the banks in the form of deposits. So the

The Government will now have an approximate figure about black money. Now it will fill up that black money with new currency to ensure that all that money which is in circulation is white. Now the Government can track the movement of money. Any suspicious transaction can easily be track down. So zero black money.

The Pros.

No more black money means all legal transactions. From now Government can easily find out who is holding black money.

Banks will galore with deposits so liquidity is easily available at lowest interest.

Lowest interest means more investments and more employment.

More business means more income thru taxes so no cash crunch for welfare schemes.

Use of digital economy

Increase in tax payment

These are the PROS the Government is talking about. But there is danger lie also in this.

The Cons.

No easy money for people. When 100% white money is there people won't go spending spree. So markets will be dull.

When markets are dull business also. So low turnover **means** low taxable income.

So far many companies started new businesses or expanded their business by diverting their black money into new ventures. From now they can't do that some employment opportunities are lost.

Deposit rates may be reduced. This will affect people getting deposited income.

Huge cash deposits in banks will become burden unless they don't divert them into market in form of loans.

An estimated 5–10 lakhs crores deposits will be available with Banks for companies and Business entrepreneurs to utilise for their business purposes.

The companies which are already availed loans from banks and the companies which have no any new plans to expand their business will not take loans.

There is no such large scale business environment for start ups in India. So employment generation will be difficult and it may lead to collapse of the economy.

Hackers focusing India .

Banks being dysfunctional.

Conclusion:

Demonetisation would be positive for sectors like banking and infrastructure in the medium to long term and could be negative for sectors like consumer durables, luxury items, jewellery, real estate and allied sectors, in the near to medium term. It can also lead to improved tax compliance, fiscal balance, lower inflation, lower corruption, complete elimination of fake currency, a step for sustained economic growth in the longer term.

Banks have gained deposits substantially after demonetisation which they can invest for improving their profitability. Their non-performing advances have also come down.

Besides as banks will reduce their cash holdings due to more digital interface it will add to their long term profitability and cash loss for various reasons like theft, dacoit and misappropriation will be avoided.

Cash is an idle asset and it does not yield any income unless kept in a bank. So people will keep their surplus cash in banks instead of at home.

However, during November and December bank work was largely centered on accepting and exchanging specified bank notes. As a result other activities like lending during busy season is affected which will reduce their earning for the next quarter and profitability.

Further as all ATMs are to be recalibrated for issue of new denomination notes like Rs2000 and Rs500 it will add substantially to their operational

expenses. It will reduce their income during the next quarter.

As people are not very much versatile with digital operations, they may face various operational risks like cyber fraud.

Thus, demonetisation is not an unmixed blessing but merits are more than demerits and the economy will move forward with less cash holdings by banks.

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