



## Impact of demonetization in different sector in Indian economy

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### Abstract

India has amongst the highest level of currencies in circulation at 12.1% of GDP. Cash on hand is an estimated at around 3.2% of household assets, higher than investment in equities, or roughly around \$ 220 billion. Of this cash, 87% is in the form of Rs. 500 and Rs. 1,000 notes or roughly Rs. 14 lakhs cores (\$19 billion). A significant portion of the household cash on hand is generated by economic transactions that are not reported to tax authorities or generated through corruption. On 8th November 2016 night Prime Minister of India Mr. Narendar Modi in his unscheduled television address to the nation announced that the currency notes of 500 and 1000 denomination will not be a legal tender money from midnight. Government took this step of demonetizing the currency as a tool to fight against black money and corruption in Indian Economy. Scrapping the higher denomination money would either result in these being brought into the system or the money just disappearing. So we are presenting this paper to highlights the impact of demonetization in Indian economy.

**Keywords:** demonetization and its impact on Indian economy

### Introduction: What is demonetization?

Demonetization is the process of removing currency from general usage or circulation. In India's case Government completely withdrawn the currency with the denomination of 1000. Along with Rs.1000 currency notes Rs.500 rupee notes were also withdrawn from circulation. For the old 500 currency notes new 500 rupee notes will be issued and a new currency note of 2000 denomination has been introduced in the economy. New currency notes issued to the public through commercial banks and post offices across India by depositing the demonetized currency notes by the people.

### Demonetization in India

This is not for the first time Government Demonetizing the currency. Earlier to this India has witnessed demonetization twice. For the first time demonetization took place in pre independence period. In January 1946, for the first time demonetization took place in India. During this demonetization currency notes of Rs. 1000 and Rs. 10000 rupees were withdrawn from the circulation and new currency notes of 1000, 5000 and 10000 denomination rupees were introduced in the year 1954. On 16th January 1978, Government of India Demonetized the currency notes of 1000, 500 and 10000 rupee notes as a means to counterfeit money and black money. The present demonetization is the third occurrence in Indian Economy and it is the second Demonetization in the post-independence period.

### Objectives of the study

- To analyze the impact of Demonetization on GDP.
- To analyze the impact of Demonetization on different sectors of economy.
- To analyze the future impact of Demonetization on Indian economy.

### Reasons behind demonetization

As per my study Following is the main reasons behind Demonetization.

#### Black Money

A recent study had pegged India's black market economy at over Rs 30 lakh crore or about 20 % of total GDP. This is even bigger than the GDP of countries like Thailand and Argentina. So now after this Decision black money holders are left with just two options – either route this money through banks, declaring it to be their income or burn the stashed file.

#### Fake Currency & Terrorism

Terrorism is a frightening thing. But have you ever thought about how these terrorists get their money? Enemies from across the border have run their operations using fake currency notes. This has been going on for years.¶

#### Economy

The Major impact of this decision is on the economy because it gives highly positive impact on the economic Stability in near future. The coming six to seven months are expected to witness a considerable level of deflation. Sectors like real estate, construction material, Gold, unorganized trade and services will see significant pain in the near time.

#### Election

We all know how much black money is used by political parties. It will be a very tough task to use trucks of money at least for the upcoming five state elections. Now in upcoming UP election which was held in January neither of the parties can purchase the vote of poor people and Some drastic change in the elections going to be seen by everyone.

## **Unorganized Trading**

1. Prices hike in Real estate sectors is mainly because of the involvement of black money, but after taking this decision the prices of property will surely come down to their real value.
2. Unorganized dealing in share market will also be eliminated after this decision and this will gain positive result in the economic condition of the country.
3. The problem of inflation will get solved with this step as the government will get more money in its pocket in form of taxes and undisclosed income.
4. Banking system will also get strengthened as banks will be flooded with huge amount of money. This will also result in more economic development in the nation as the money will be channelized properly through banks.

## **Less Cash Economy**

It is not possible to make India Cash-Less economy, but for the development and making transparency in the economy we can say use of less Cash is possible. So for making people familiar with E-Payment and use of plastic currency.

## **Impact on different segments of economy**

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

### **1. 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. Agricultural growth in India contracted 0.2% in 2014-15 and grew no more than 1.2% in 2015-16, largely because of back-to-back droughts. It was expected to grow at 4% in this year as per CRISIL Report, but due to Demonetization this forecast is proven wrong because Farmers are running out of Cash to buy Seeds, Fertilizer, equipment and Wages payment to workers and Commission to Agents etc. Because of Cash shortage daily supply transport system has also suffered which was result in 25 to 50 % reduction in sales. Following is the main reasons; I. Farmers are not educated and aware about how to work on E-Payment System, Recent study by RBI Says 78% of the population do not use internet in which almost 80 to 85 % are Farmers. II. In most of the Villages Proper Banking system is not Developed yet and Villagers are need to go to the cities for the same because of that Farmer's most of the time is engaged in exchanging the old notes in Banks.

### **2. Automobile Business**

#### **a. 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.*

### **b. 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.

### **c. 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.

## **3. Business sector**

As per the study IPP says Growth in Business sector 0.7% in October 2016 but after 8th Nov.2016 Demonetization shows a different picture because of this decision labour turnover is also increased as lack of Production because of low demand of products people were purchase only if it necessarily required, for this I have studied on following business sector.

### **I. Textile industry**

Most of the Brands and Retailers Report 40 to 60 % drop in sales after Demonetization in first few weeks but from December onwards this drop is slightly decrease, but still we can say the impact of this decision has affect the industry in 2017 also for at least 3 to 4 months.

### **II. Real Estate**

Demonetization smashed the real estate market and it will result in 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.

### **III. FMCG Products**

Consumer expenditures also affected by that decision now only those products are purchased which was necessary for daily consumption and mostly the small traders like 'kirana store', 'small bodies', 'thela wala' etc. they all have done their daily transactions only in cash and because consumer has less cash in his pockets the daily sells of these traders drop down by 20 to 30 %. It is also a short term impact in future things get normal.

### **4. Service Sector**

Service sector is hit very hard 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.

### **5. Impact on Indian economy**

Government of India demonetized the currency as a tool to fight against corruption and black money, which are the major problems of Indian economy. The present demonetization will be having some effects on Indian economy. Some of the major effects of demonetization is as follows.

#### **Effect on Parallel Economy**

One of the major objectives of the demonetization is to fight against the black money. With the demonetization the black money within the economy will be blocked as the owners of the black money in the form of 500 and 1000 rupee notes cannot replace it and deposit it in the banks as it is not having the proper documents. In this way the parallel economy will be affected to a greater extent which is the positive impact of demonetization.

#### **Short run effect on money supply**

Money supply will be reduced in the market due to withdrawal of currency notes from circulation. This effect will be the short run impact of demonetization. The problem of money supply will be solved when the new currency notes widely circulated in the market.

#### **Effect on Consumption**

Decrease in money supply as a result of demonetization is also having an impact on production and consumption. Due to decrease in money supply production decreases and it affect the consumption negatively.

#### **Fall in the prices**

Prices for different goods will fall with demonetization of currency. The prices of consumer goods and the prices of real estate sector are expected to fall.

#### **Increase in bank deposits**

The demonetization increases the deposits in current account and savings bank account. As government announced the demonetization, the money held by the household sector for the emergency purposes will be deposited with the banks, which will increase the deposits in the banks.

#### **Increase in alternative modes of transactions**

Due to demonetization the cash transactions are facing a reduction, which increases the other alternative modes of transactions like use of credit cards, debit cards online payments and transactions etc.

#### **GDP will decrease in the short run**

GDP will be hurt due to the demonetization. GDP of India may fall as a result of demonetization. The extent of fall may

be very less and it exists only for a short duration of time. This fall may not affect the growth of the economy.

#### **Effect on Anti-Social Activities**

Demonetization is a mighty blow on the anti-social activities. Due to the demonetization funding of anti-social activities, smuggling can be curbed. These anti-social activities weaken the economy. It is difficult to the anti-social activists to recover from this. So the anti-social activities can be curbed to a greater extent.

#### **Effect on other units of the economy**

Demonetization will have short run impact on agriculture, small traders, small vendors etc. as agriculturists are dealing with the perishable commodity, not having other mode of payment other than cash transactions and lack of demand will affect the farmers negatively. The same kind of situations faced by the small traders and small vendors. This also a short run effect of demonetization.

#### **Conclusion**

Demonetization in Indian economy is having negative impact on the different sectors of the economy. Majority of the negative effect are short run effects. All these effects are solved when the new currency notes are widely circulated in the economy. On the other hand people are facing some problems in the exchange of currency notes. Even though people are facing such a problem people are ready to bear these problems for its positive effect on the economy. If government successfully clears all the problems, drawbacks associated with the demonetization, this demonetization will become the successful economic revolution in India and we can expect a better tomorrow with corruption free India.

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