

Effects of Demonetization on Financial Sector of India: A recall overview on Government Initiative

Dr. Brijeshkumar
(Academician & Advocate)

ABSTRACT

The paper discusses about the move of demonetization taken by Central Government of India on 8th November, 2016 with respect to its reasons and effects on financial sectors of India. Central government of India has taken a bold decision on demonetization to tackle with black money and make India a cashless digital economy. Central government of India was a judicious, well-thought out and well-implemented step, and whether it would really eradicate all the existing black money. Demonetization was aimed at addressing corruption, black money, counterfeit currency and terror financing. The current form or forms of money is pulled from circulation and retired, often to be replaced with new notes or coins. Central Government of India completely replaces the old currency with new currency by demonetization decision. The decision was in continuation of a series of measures taken by the Government of India during last two years aimed at eliminating corruption, black money, counterfeit currency and terror funding. The new type of deposits called benami deposits have also come up with demonetization. With the aim of achieving financial inclusion along with making India a cashless and digital economy, efforts are required to make technology reach the bottom of the pyramid. Here I have utilized the opinions of great expert on economics, financial economist and intellectual politicians. This study will help us to know about the positive and negative impact of demonetization decision taken by Central Government of India. This paper is purely based on secondary data, which is collected from newspapers, magazines, websites from internet, some useful books related to topic, ICAI website mentioned in references etc.

Keywords: *Demonetization, Economist and Expert Opinion, Financial Sectors in India, Indian Government, Reasons of Demonetization.*

INTRODUCTION

On the 8th of November, 2016 when the sun had descended below the horizon and the light of day had completely faded, when people were returning back home from a long day at work, a misty light of a new economy was brewing over the country. In an important move, the Indian government has taken a bold step to demonetize (fully ban) the Rs. 500 and Rs. 1000 currency notes of the Mahatma Gandhi series ceased to be legal tender in India from 9 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 Indian Prime Minister Mr. Narendra Modi announced in a broadcast to the nation that Rs. 500 and Rs. 1000 currency notes would no longer be recognized legally as currency. The need for the

government to keep the move a secret because the tax evaders would not be aware before the announcement of demonetization took place. For Modi, this is work in progress. In his speech to the nation, he highlights what his government has done so far. NarandarModi has prompted it will take 50 days for people to adjust to the change.

OBJECTIVES OF STUDY

1. To study the influence of demonetization on banks operations.
2. To find out positive and negative results of post demonetization on bank operations.
3. To know the impact of note ban decision on the financial sector of India.
- 4 To estimate the consequences for future of the note ban decision.
- 5 Aimed at combating corruption.
- 6 To check black money and fake currency note.
- 7 1,000 and 500 were put out of circulation and Effect on parallel economy.
- 8 All the bank accounts are tied up to one PAN (Permanent Account Number).
- 9 This move shows strength of the banking system, retail boost, and increases deposit.
- 10 Remove black money from the economy as they will be blocked since the owners will not be in a position to deposit the same in the banks.
- 11 To check the awareness of online banking among consumers.
- 12 To understand about people's attitude for keeping the money either at home or at bank.

RESEARCH METHODOLOGY

The present study is quantitative in nature and secondary data/information will be used for the purpose of analysis. The secondary data was collected from various published sources like different books, reports, magazines, journals, newspapers, library and relevant government website like etc. have been consulted in order to make the study an effective one. The sources of data include the facts released by Reserve Bank of India (RBI), Exchange, Central statistics office India, and different banks websites. This study is also based on situation specific scenarios, expert's opinions, and use of internet for information search. The study tries to look at the extent of demonetization influence on normal banking operations and all financial sector of India.

CONCEPT OF DEMONETIZATION

Any Government withdraws the legal tender rights of any denomination of currency, it is known as demonetization. Demonetization is the most important and necessary when there is a change of national currency. Demonetization is the act of changing the existing currency in another form. The old units should be retired and replaced by new currency. In other words demonetization means either introducing new notes or coins of the same currency or fully replacing the old currency with new currency. There is a one important thing exist on economics, which is remonetisation, in which forms of payment is restored as legal tender.



REASONS FOR DEMONETIZATION

The government claimed that the demonetisation was an effort to stop counterfeiting of the current banknotes allegedly used for funding terrorism activities, resist tax evasion, resisting inflation as well as a destroy the black money in the country. The move was described as an effort to reduce funding for anti-social elements like smuggling, terrorism, espionage, money laundering schemes, racketeering, drug and people trafficking etc. and to encourage the country towards the cashless economy. This decision taken by government is for welfare of the nation. It is weakening the efforts to remove poverty. Our country is rapidly increasing in terms of growth.



HISTORY OF DEMONETIZATION IN INDIA

The Reserve Bank manages currency in India and derives its role in currency management on the basis of the Reserve Bank of India Act, 1934. The rupee is named after the silver coin, rupiya. The sudden move to demonetize Rs 500 and Rs 1,000 currency notes is not new. Rs 1,000 and higher denomination notes were first demonetized in 12th January, 1946 (Saturday) and in 1954 by RBI headquarter. First time in 12th January 1946, currency notes of 1,000 and 10,000 were totally removed from economy. Both the notes were re-introduced in year 1954. At that time people had given 10 days' time period to exchange the notes. Further that was extended to 15 days more where by people has to give reasons why they had not exchanged it in previous 10 days. It had not created much effect at that time. By the end of 1947 out of Rs.143.97 crores, notes of only Rs. 134.9 crores were exchanged. Thus notes worth Rs. 9.07 were perhaps "Demonetised". The second currency ban was made on 16th January, 1978 (Monday), announced by R. Janaki Raman a senior official of RBI, and at the time of Prime Minister Morarji Desai led Janata party. At that time currency ban was taken 1,000, 5,000 and 10,000 out of circulation. That time the people had given only 3 days to exchange the notes. This time around 73.1 crore was demonetised. Finally the 3rd, the most recent demonetization had been announced as on 8th November, 2016 after 38 years again in India by Prime Minister Narendra Modi. This time the currency of 500 and 1,000 notes are demonetized from economy and replaced it with new designed 500 notes and for the first time Indian government introduced 2,000 value notes. The Government has instructed the hospitals, petrol pumps, airports etc. to accept the old denomination notes till 11th November, 2016. When Last demonetization is done in 1978 where the bank was only way to make all kind transaction but now we are well adapted with technology to support the cash and cashless transaction Government encouraging online banking online shopping is E-wallet, mobile banking, credit and debit cards. The intention behind demonetization was to control the black money under to increase E-transaction in the country.



RECENT DEMONETIZATION IN INDIA

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. These two biggest denominated notes accounted 80% of the currency supply. However, in the days following the demonetisation, banks and ATMs across the country faced severe cash shortages. Also, following Modi's announcement, the BSE SENSEX and NIFTY 50 stock indices crashed for the next two days. November 8, 2016 demonetization announcement involved the task of replacing more than 22 billion pieces of Rs.500 and Rs.1000 notes for 1.3 billion citizens through 1.3 lakh branch outlets was a herculean task. Historically, nowhere in the world has a similar exercise been undertaken at this massive scale. It is a reaping time for the banks that made considerable investments on digitization of banking services. The alternate platforms – cards, internet banking, mobile banking, PoS terminals - have further gained momentum post demonetization announcement. An average daily debit card transaction has almost doubled and demand for PoS machine installations has increased 2-3 times.



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:

1. Citizens deposit old banknotes of Rs. 500 or Rs. 1,000 at any office of the RBI or any bank or any head Post office or sub post office and credit the value into their respective bank accounts with ID Proof.
2. 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.
3. For immediate cash needs, the old banknotes of value up to Rs.4,000 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. The limit for this is Rs. 4,000 upto 24th November.
4. All ATMs will dispense bank notes of only 50 and 100 rupee denominations.
5. No restriction of any kind on non-cash payments by cheques, demand drafts, debit or credit cards and electronic fund transfer.
6. Banks will provide all cash withdrawal transactions at their ATMs free of cost to their customers till 30 December 2016. On 9th November and in some places on 10th November also ATMs will not work. Cash withdrawals from ATMs will be restricted to Rs.2000 per day per card up to 18 November 2016 and the limits will be raised to Rs.4000 per day per card from 19 November 2016.

7. However, exceptions were given to petrol pumps, CNG stations, government hospitals, train and airline booking stations, state-government recognized dairies, ration shops, and crematoriums to accept the 500 and 1000 rupee notes until 14 November. International airports were also instructed to facilitate an exchange of notes amounting to a total value of Rs.5, 000 (US\$74) for foreign tourists and out-bound passengers.

Due to the prevailing economic scenario India witnessed a surge in digital transactions and mobile transactions. This development is to be seen instrumental in achieving complete financial inclusion.

HOW WILL DEMONETIZATION AFFECT FINANCIAL SECTOR?

1. The alternate platforms – cards, internet banking, mobile banking, PoS terminals have further gained momentum post the demonetization announcement.
2. It may cause deflation in the market as people who have earned money through illegal ways would be afraid to declare the money in fear of prosecution due to the illegitimacy of the income.
3. It has already led to reduction of money circulation in the economy and this may result in deflation.
4. A lot of cash which are legally earned will be deposited in the banks and now the banks with more deposits will be able to do more lending and the rate of lending may come down. Accessibility of loans will become easier and as interest rates reduce economic activity will be boosted.

EFFECTS OF DEMONETIZATION FINANCIAL SECTOR OF INDIA

These are the some analyzed financial sectors that which most affected by de-monetization because of the high level of cash spending are as under:

- 1 **Bank Sector as Biggest Beneficiaries:** Yes, the biggest beneficiary from this policy will be the banking sector. The reason behind being called the beneficiary is very obvious because as lot of people are depositing cash in the banks; there will be a lot of liquidity with the banks. As the deposits with the banks will increase so will increase the CASA, which will increase the Net Interest Income and the Net earnings of the banks. CASA is abbreviation of Current Account Savings Account. It is the ratio which indicates how much of the total deposits with the bank are in the current account and savings account. In a simple language, the deposits lying in the savings and current account are CASA. Demonetization disrupted the banks and stressed strongly to carry out bank operations and in long run it helped the banks to pool the deposits without incurring of any cost.
 - **Cash Deposits in Banks:** A lot of cash which are legally earned will be deposited in the banks and now the banks with more deposits will be able to do more lending.
 - **Easy Loans:** Loans will become easier and interest rates may come down. As banks will have more money so more loans will be given out which will increase the money supply in the market and it will create inflation.
 - **Surge in Bank Deposits –** Banks are expected to witness a spike in their deposits from people and businesses who have a lot of legally earned money. As per the new scheme, up to Rs 4,000 will be immediately exchanged by banks and the balance amount would be credited to the account holder. This will increase bank's deposits by a huge margin, increasing the lending activities. This move will also

cause short-term pain for the working class, small businesses and nearly anybody who deals with cash on a daily basis.

- **Increase in liquidity position of 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.
- **Successfully handling demonetization:** Bank has led from the front in successfully reaching out to the customers in their banking transactions, be it waiver of charges or extended business hours into late evenings or to go out of their way in supporting senior citizens and women customers as well as noncustomers.
- **Effect on 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.
- **Mobile Banking Services:** All bank is promoting the mobile banking services which are account information, mini-statements and checking of account history, alerts on account activity or passing of set thresholds, monitoring of term deposits, access to loan statements, access to card statements, mutual funds / equity statements, insurance policy management etc. In transaction facilities funds transfers between the customer's linked accounts and Check Remote Deposit and paying third parties, including bill payments and third party fund transfers etc.

2. **On Indian Financial Market:** After demonetization Indian financial market has been followed just like secular falling trend. Nifty 50 fell approx. 6.3% and S&P BSE Sensex Fell 5.9% from 8 November to 22 November.
3. **On Real Estate Sector:** During November-December 2016, the monthly average housing sales fell about 40% in the top nine cities like Gurgaon, Ahmadabad, Kolkata, Chennai, Hyderabad, Bengaluru, Pune, Mumbai and Noida. Before demonetization the monthly average housesales was 19,000 units in July month and 18,000 units in October month. The monthly average sales were reduced drastically during November-December months by 40% and 49% respectively. The government had announced the demonetization move on November 8, raising hopes of sharp fall in prices in property market, especially secondary or resale segment. Starting of third quarter, October month showing best performance, but November and December both negatively impacted by the demonetisation, 50% of the total sales in the third quarter contributed by October month. The real estate developers were focusing their efforts to attract customers by offering additional free benefits like jewellery, electronic items, automobiles, holiday package and appliances on the purchase of housing units. Builders also offered the price guarantee, rental assurance, and buyback schemes to bring confidence in the sector. In short, demonetization smashed the real estate market and it will result in 40% 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.
4. **Gold Prices:** As investors rushed to invest in safe havens gold futures touched a high of Rs. 31,376 and was

trading at Rs. 30,500 up 2%. Local shops have stopped selling gold in exchange of old notes. It will create havoc for a little while and the economy will also destabilize. But overall it is going to be good for the country.

5. **Micro Finance Institution:** These are the bodies which facilitate with financial assistance to micro businesses and the demonetization led to a very slow disbursement rate. Demonetization resulted in delay in collection of installments from the clients.
6. **Indian Insurance Industry:** The insurance industry in India is on the brink of a digitally enabled transformation. As the use of smart, digital products and services increases, customers' demand for fast, efficient, seamless, and intuitive products and services are increasing. To enable and provide such services and products, all the stakeholders—insurance companies, distribution channels, customers, technology providers, etc. will need to collaborate and network. In other words, an ecosystem of multiple stakeholders' will power the next spurt of growth in the insurance industry, and the role of digital payments in facilitating the growth of such ecosystems is vital.

EXPERTS AND ECONOMISTS VIEWS ABOUT DEMONETIZATION IN INDIA

1. **Amartya Sen (Leading Economist; Noble Laureate; Recipient of the Bharat Ratna):** According to Indian express, Professor Amartya Sen said that millions of innocent people have deprived from their money and being suffered to get their own money back.
2. **Dr. Manmohan Singh (Former Prime Minister; Eminent Economist; Former RBI Governor):** According to Indian express, the former prime minister, RBI governor, and economist Dr. Manmohan Singh said in Rajya Sabha that this demonetization is an organized loot. In his speech he said that, the way the scheme has been implemented will harm the agricultural sector in India, it will also harm the small scale industry and informal sectors of the economy. He also said that India's GDP can falls about 2 percentage point as a result of this note banned policy. Cooperative banks which serves the rural areas are non-functional and has been prevented from cash. Former prime minister also said that this note banned policy is a monumental mismanagement.
3. **Crisil, a Global S&P Company:** Its impact could be even bigger than GST (the Goods and Services Tax which is still running the gauntlet of politicians).
4. **Pronab Sen, Country Director of the India Central Programme of the International Growth Centre, a think Tank:** Demonetization has perhaps -penalized the entire informal sector and damaged it permanently, especially the informal financial sector, which could account for a fourth of bank lending, or 26% of GDP.
5. **Girish Vanvari, Partner and Head (Tax), KPMG in India:** This announcement appears to be the most significant change made by the Modi government to date and we are in No.1 position in terms of growth but we are ranked 76 in Global Corruption Perception ranking. It clearly shows how corruption and black money have spread their tentacles.
6. **Finance Minister Arun Jaitley:** The goal of this is to clean transactions, to clean money.

FINDINGS

The payment industry in itself keeps on evolving with the ever changing consumer sentiments and the needs of the businesses. An innovation in this space is thus a continuous process, while the adoption of each of new development takes its own pace to penetrate. According to RBI Bulletin Cashless Transaction in India increased day by day. From different transaction system E-wallet (PPI) system is going to be more popular. After Demonetization i.e. from NOV-2016, E-wallet payment method is more preferred by customers than any other payment methods.

SUGGESTIONS

In order to ease the burden of demonetization, the Government has introduced numerous measures to ease the burden of demonetization on common man. However, there are various challenges which are being faced by the businesses and people in the nation which needs to be solved at the earliest possible. Few enlisted suggestions are as follows:

1. Set up of digital literacy booths outside banks majorly in rural regions.
2. More printing of smaller currency notes.
3. Cash management in banks & ATMs.
4. Increasing penetration of banks in rural areas.
5. Facility of mobile ATMs.
6. Expanded cash limits for Cash driven sectors.
7. Incentives for RTGS and NEFT.
8. Increase the limit for service tax exemption to Rs. 10,000.
9. Increase in daily cash withdrawal limits from ATMS.

Going ahead, faster implementation of the suggested measures would contribute in the process of remonetization and would play an essential role in increasing the demand thereby rebounding the economy to higher growth trajectory.

CONCLUSION

Demonetization is a tool used by central government to fight against corruption and black money. It is a bold decision taken by government. In the same path, it influenced and brought changes in all the corner of the economy. Banks are major institutions affected by demonetization. Banned denominations were ploughed back and allowed the citizens to exchange with the banks. While exchanging, it disturbed temporarily and influenced its regular operations. Though it affected badly to major extent of bank operations, it helped the economy to find growth and development of the country through financial institutions like Banks. Government of India has become success to some extent. Most of the black money has been crushed. Amount of cash liquidity increased in the bank day by day. And anybody knows if the bank has more deposits then bank become stronger. The country in which bank is strong then that county is more financially strong. On the side of insurance sector, the number of sale of insurance policies and income of some insurance agent fell down during demonetization. Due to bad financial position and personal financial obligation to their family insurance agent started new job during the demonetization. In the research study, E-banking is a buzzword after demonetization. India is now in the list of top countries where major population transactional online. With the introduction of smart phones and mobiles

application the usage rate has increased. But there is a long way to go as rural population of India is still waiting for some program from banks that will facilitate their usage of e-banking services. In future banks will be able to do more and more loans to the individual and to the industrial sectors so that production will grow in our country, employment will be generated, and our country can develop at a very fast rate. But this is only a future perfection; upcoming few months will show the actual economic condition of our country.

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