

Impact of Demonetisation on Banking - A Conceptual study

M.Geetha Bai, N Anjali

Associate Professor,
Department of Business Management,
Aurora's P.G. College, Hyderabad

Abstract: 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. 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.

Keywords: Demonetisation, Economic Growth, Gross Domestic Product

What is demonetization of currency? (ET)

Demonetization for us means that Reserve Bank of India has withdrawn the old Rs. 500 and Rs. 1000 notes as an official mode of payment.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.

Objectives of Demonetization:

- 1) To tackle black money in the economy.
- 2) To lower the cash circulation in the country which "is directly related to corruption in our country," according to PM Modi.
- 3) To eliminate fake currency and dodgy funds which have been used by terror groups to fund terrorism in India.
- 4) The move is estimated to scoop out more than 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.

Data: Data is collected from RBI website, Economic Times and the like.

Period of study: Period of study has been post monetisation till date.

What has the government done?

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

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.

Chidambaram, Former Union finance minister	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.
2. Chanda Kocchar, MD & CEO, ICICI Bank:	According to chanda kocchar, "this move will definitely bring about a whole amount of transition to no cash or low cash kind of transactions,".
Harish Salve, one of the leading lawyers in taxation laws	"A parallel black economy will collapse,"

Nrayana Murthy , , founder of the Infosys	welcomed the government's move in its fight against corruption. Murthy also added that "the dishonest will have to suffer, absolutely that is the right thing."
Deepak Parekh , HDFC Chairman	anticipated that the Land will become cheaper and "one expects that reate price will come down in medium term."
Arundathi Battacharya, SBI chief	The slowdown in demand that India has seen following the government's demonetisation move is temporary
Shikha Sharm Axis Bank MD and CEO	Bank of Baroda's savings account growth after demonetisation stands at Rs 38,000 crore. Sanctions in the third quarter have been robust with drawdowns on the lower side,

Back Groound-Demonetisation of 1978

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 ₹14.97 trillion (\$220 billion) as of December 30 out of the ₹15.4 trillion that was demonetised. This is against the government's initial estimate that ₹3 trillion would not return to the banking system.

Of the ₹15.4 trillion demonetised in the form of ₹500 and ₹1000 bank notes of the Mahatma Gandhi Series, ₹9.2 trillion in the form of ₹500 and ₹2000 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

Demonetisation: The good, the bad, and the ugly

The good

The year 2016 has overall been "a good year" for India, he notes, 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 I see that as a return to sanity rather than a worrisome contraction,” Hosanagar adds.

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 (\$7.4) 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 Amartya 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.”

Kartik Hosanagar, a professor in Wharton's department of operations, information and decisions, views demonetization against the backdrop of other economic gains. The year 2016 has overall been “a good year” for India, he notes, listing the highlight:

- 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

Money in the banks + Money banks given as loans - Money RBI printed and released into market = Black money.

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.

1. No more black money means all legal transactions.
2. From now Government can easily find out who is holding black money.
3. Banks will galore with deposits so liquidity is easily available at lowest interest.
4. Lowest interest means more investments and more employment.
5. More business means more income thru taxes so no cash crunch for welfare schemes.
6. Use of digital economy
7. Increase in tax payment

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

The Cons.

1. No easy money for people. When 100% white money is there people won't go spending spree. So markets will be dull.
2. When markets are dull business also. So low turnover **means** low taxable income.
3. So far many companies started new businesses or expanded their business by diverting it's black money into new ventures. From now they can't do that some employment opportunities are lost.
4. Deposit rates may be reduced. This will effect people getting deposited income.
5. Huge cash deposits in banks will become burden unless they don't divert them into market in form of loans.
6. An estimated ₹5–10 lakhs crores deposits will be available with Banks for companies and Business entrepreneurs to utilise for their business purposes.
7. 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.
8. There is no such large scale business environment for start ups in India. So employment generation will be difficult and it may leads to collapse of the economy.
9. Hackers focusing India .
10. Banks being dysfunctional.

Conclusion

Banks have gained deposits substantially after demonetisation which they can invest for improving their profitability. There 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, dacoity and misappropriation will be avoided.

Cash is an idle asset and it doesnot 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 ₹2000 and ₹500 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.

Websites

<https://www.rbi.org.in/>

<http://economictimes.indiatimes.com/>

<https://www.quora.com>

<http://www.investopedia.com>

References

1. "97% of scrapped notes deposited with banks as on Dec 30: Report - Times of India".
2. "Demonetisation: Rs 14 lakh crore in old notes are back, only Rs 75,000 crore out". *The Indian Express*. 2017-01-09. Retrieved 2017-01-22.
3. Agnihotri, Amit (2017-01-19). "RBI replaces 60% of banned currency: Rs 9.2 lakh cr remonetised till date". *Business Standard India*. Retrieved 2017-01-27.
4. "Reserve Bank of India - Press Releases".
5. "Reserve Bank of India - Press Releases"
6. "Notes out of circulation". *The Times of India*. 8 November 2016..

