REVIEW OF RESEARCH
ISSN: 2249-894X
IMPACT FACTOR : 5.2331(UIF)
VOLUME - 7 | ISSUE - 5 | FEBRUARY - 2018

DEMONETISATION AND DIGITAL MONEY: IMPACT ON SOME ECONOMIC INDICATORS

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ABSTRACT

The stratagem ventured by the government to demonetize Rs.500 and Rs.1000 currency notes by replacing them with new Rs.500 and Rs.2000 currency notes, which embodied about 86% of the total currencies in the system, has captivated the country with surprise and held the attention of the nation. The maneuver undertaken by the government is to tackle the menace of black money, corruption, terror funding and fake currency. Demonetization is a memorable experience for generations, it's a liquidity shock which further affects consumption, investment, production, employment and various economic activities. This seclusion of some currencies from the economy is having various short-term effects in conjunction with long-term repercussions. In the last quadrant of the previous year many economic indicators like interest rate, inflation rate, GDP rate, economic growth rate, unemployment rate, balance of trade of India, its foreign exchange reserves etc. have manifested different trends. Some amongst these indicators is balance of trade, inflation rate which has experienced a tremendous blow in last quarter and has affected the growth rate and GDP of the economy and has led to instability. The influx in supply of new money may lead to curbing the black marketing activities and prove to be beneficial in long run and would be beneficial through high government spending and greater financial inclusion. Demonetization has proven to be a trailblazing stanchion to the digital money, e-wallets and e-banking to postulate transparency in the monetary transactions which will further help in constraining the troublemaking perils of corruption, fake currency and black money which has plagued the economy since so many years.

KEY WORDS: *investment, production, employment and various economic activities.*

INTRODUCTION

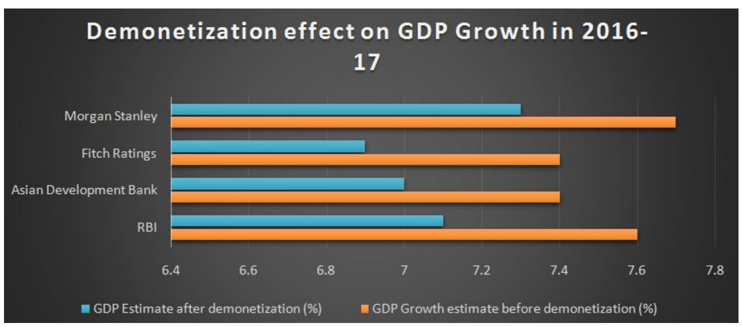
Demonetization, announced on 8 November 2016, has resulted in the withdrawal of the high denomination currency notes of Rs.1000 and Rs.500 as legal tender. This elephantine maneuver was taken to dismantle the black money rotating in the black or underground economy, sabotage the influx of

counterfeit currency in the economy which was pumped in our economy by neighbor country, Pakistan, to finance terroristical activities, to blot out tax evasion, done by black money holders in the economy, by crushing black economy, snuff out corruption and strengthen and intensify the digital or cashless economic transactions which will promote digital payments through e-wallets and online payments. This has suddenly created a shortage of currency which has implications for the economy. Reports suggest that major sectors of the economy face slowdown, be it agriculture, industry, services or the organized and unorganized sectors. The key segments of the economy where cash transactions play a vital role are real estate or construction, gold and jewellery, informal sector and the parallel economy of the country, a sudden demonetization will adversely impact these segments of the economy and these are getting a load of immediate contraction. Due to this currency swap, the Indian economy is suffering. This has led to short-term as well as long-term implications on the economy. Mostly the negative implications are short-term and long-term implications are of positive nature. The manufacturing sector is shrinking, real estate and car sales are down, and farm workers, shopkeepers and other Indians report that a shortage of cash has made life difficult. Demonetization would help wean out counterfeit currency notes and choke terror funding. The economic survey of 2017 forecasted that there will be adverse impact of demonetization on GDP but this will be transitional. Benefits of cash swap include increased digitalization, greater tax compliance and a reduction in real estate prices, which could increase long-run tax revenue collections and GDP growth. (Times, 2017). Note ban has spiked the flow of money into the banks so now banks have money in titanic proportions to lend to the investors and other borrowers.

IMPACTS ON ECONOMIC INDICATORS

1. GDP Growth Rate

The key segments of the economy where cash transactions play a vital role have been affected adversely creating a long run impact on the economy as real estate comprises of 11% of GDP, gold and jewellery comprises of 6-7 % of GDP, consumer goods comprise of 2.5 % of GDP and other activities supporting parallel economy comprised of 100% transactions in black money, though the impact will diminish over time but it has hit trade and consumption very hard, as consumption makes up for around 56% of India's GDP and fall in the same will pull down growth and may lead to behavioral changes in household's savings and consumption pattern. So many of the reputed associations and institutions have professed a dip in the estimated GDP of 2016-17 as shown in the chart below. (economic times , 2017)

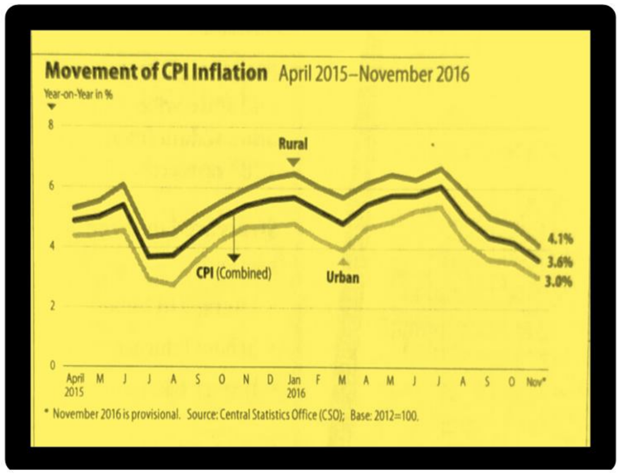


2. Inflation

The trends in inflation seems to be falling down since demonetization as there is a sudden decrease in demand and consumption due to less liquidity in the hands of people. So the inflation rate based on WPI was down to 3.2% in November 2016 and the inflation rate based on CPI was as low as 3.6% in November 2016.

Wholesale price index- inflation rate based on WPI was down to 3.2% in November 2016 against 3.4% in October 2016 and the index for primary articles decreased by 1.3% in November 2016 compared to 2.2% in November 2015.

Consumer price index- the CPI inflation rate eased to a two-year low of 3.6% in November 2016 compared to 5.4% in November 2015. Both rural and urban inflation rates slowed to 4.1% and 3.1%, in November 2016 compared to 6% and 4.7% in the same period last year.



INFLATION: PIVOTAL INDICATOR THE STUDY

Inflation means an increase in general price index which is measured through various tools. For general public inflation is just a continuous price rise. This economic indicator is the paramount focus of our research. Due to the stupendous move of demonetization inflation has shown a sharp decline in its values. As shown in the above charts the inflation in the second last quarter till November has been declined.

Main Causes behind the Dip in Inflation Post-demonetization

One of the preeminent reasons because of which in the post-demonetization inflation witnessed a drop decrease in aggregate demand of the nation. This decline of demand is due to the lack of availability of cash in hand or liquidity in the nation because of demonetization. This less liquidity and low demand has further led to the immediate short-run decrease in the consumption of the country. The sudden decline in money supply and simultaneous increase in bank deposits is adversely affecting consumption demand in the economy in the short term. Money supply is expected to reduce in the short run. Reduction in money supply can also have a deflationary effect in the economy. To the extent that black money (which is not counterfeit) does not re-enter the system, reserve money, and eventually, money supply will decrease permanently. However, gradually as the new notes get circulated in the market and the mismatch gets corrected, money supply will pick up. Government's move to demonetize currency will impact the secondary steel sector as these mills and rolling factories are cash-based. Demonetization will adversely affect steel_demand in rural India. The real estate demand from end users is unlikely to be impacted, since a majority of them are backed by funding from bank loans and also may lead to increase in registered prices of land. Demand from investors for real estate however may come down since in some cases, investors prefer cash transactions.

The impact on high end fashion retail and luxury goods to be more pronounced as discretionary demand in this segment will be curtailed. In case of Quick Service Restaurants, although 60%-70% of the transactions are currently in cash, the impact is likely to be moderate due to the low ticket size of purchases and high likelihood of patrons adapting to plastic money. We expect a limited impact to be caused on the food and grocery retail sub-segment, given the non-discretionary nature of purchases in this segment, since the buying cycle for the current month would have been largely influenced. There has been a 20-40% decrease in the sales of consumable goods like biscuits, toilet soaps, shampoos and washing soaps etc. due to discretionary spending. The small scale grocery stores are caught between the drop in sales on one side and wholesalers stopping visits to these outlets, particularly in small towns in the wake of the liquidity crunch.

The positive macro benefits of this move by the government

This move by the government is likely to have long term benefits for the economy. The extinguishing of the major proportion of unaccounted currency (The World Bank in July, 2010

estimated the size of the shadow economy for India at 20.7% of the Gross Domestic Product (GDP)in 1999 and rising to 23.2% in 2007) would reduce from the liabilities of the government and would add to its finances. This can have very strong implication as the government would get money to spend without borrowing from the market. This would mean that while interest rates can be low, the government spending on large infrastructure (we assume that the government would use large proportion for infra spending) projects would kick start cycle and push economic growth higher in the medium term. The move is also likely to have a habit changing impact in the Indian populous and there could be increased belief of keeping cash in the banks rather than stashed at home and use formal banking channels for their spending needs. Another element of the demonetization would be reduction in cash transactions in real estate. As by coming close to the heels of the real estate, with legislations like RERA, GST and the Benami (ganguli, n.d.) act will further increase transparency in this sector. This will likely reduce real estate prices and make it affordable to some extent. This move is likely to lead to better tax compliance, raise the Tax to GDP ratio and improved tax collection. This could lead to lower borrowing and better fiscal management. Also with lower cash transactions in the near term, inflation may see downtrend in the near term. Also with higher tax to GDP ratio, the government may also get enough headroom to reduce the income tax rates, which can lead to higher disposable income with people and can improve consumption demand in the medium to long term.

DIGITALIZATION: AN EXPLICATION OF DEMONETIZATION

Indian economists have taken a widely divided stance on the efficiency of this move and its impact on the country's black money situation. According to different sources, the country's black money is somewhere between 23-75% of country's GDP. The impact of demonetization hopes to flush out considerable amount of black money as well as to encourage a switch to cashless state within the mainstream economy. Therefore, this new move will definitely have a huge impact on the digital marketing horizon in the country. Some of the obvious beneficiaries of demonetization are banks, micro-financing companies, NBFCs and digital financial operators. Indians are traditionally inclined to use cash transactions and therefore some may feel compelled to object the transition into a cashless economy. Meanwhile, banks also need to gear up for the future. The answer lies in Digitization. According to a Google-BCG report, digital payments industry in India will grow 10 times by 2020 and contribute 15% of GDP. Further, the report predicts that non-cash transactions will surpass cash transactions in the Indian economy by 2023. As online commerce picks up, people's trust and familiarity to card payments and e-wallets is likely to increase. Banks need to market such cashless instruments and modes of payment. This transformation of shift to e-commerce will lead to more transparency in the economic activities.

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