



A CONCEPTUAL STUDY OF IMPACT OF DEMONETIZATION ON INDIAN BANKING SECTOR

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Abstract

Demonetization is the process where government declares the currently running currency notes illegal to be tender after the declaration is made. The old unit of currency replaced with new currency. There are both pros and cons of demonetization in the Indian economy. The main objectives of the study are to describe the demonetization concept in India and impact of demonetization on different components of banking sector along with problems and issues due to demonetization. This paper is based on descriptive design with the involvement of secondary data which has been compiled from newspapers, reports, research papers and websites as well.

Keywords: *Black Money, Cashless Transaction, CASA Deposits, E-Transactions.*

Introduction

Cash is the preferred mode of transaction in India and only less than half the population uses banking system for monetary transactions. Indians are a resilient lot. By nature, we Indians, maybe have it in our blood to bounce back from shocks-natural and man-made and get on with things. On 9th of November, when the citizens of India- were told that the 500 and 1000 INR currency notes in their pockets will no longer continue to be legal tender, the entire country was in stun. The next few days that followed were long queues outside ATM's (banks were suddenly the most 'in demand' commodity); wage earners requested their bosses for short leave to tend to the same. With demonetization effort 86% of India's currency was nullified that aimed to wash the stock of 'black market's cash supply' and counterfeit notes out of the economy and convert it into the licit, banked and taxable, part of the economy. According to recently released data, only about 1% of Indians paid taxes on their earnings in 2013. When the policy change was announced, people were given until December 30, 2016, to return 500- and 1,000-rupee notes to banks, or else risk losing the value of them. Demonetization is the most important and necessary when there is a change of national currency. The old unit of currency replaced with new currency. Demonetization is the process where government declares the currently running currency notes illegal to be tender after the declaration is made. There are both pros and cons of demonetization in the Indian economy. The reasons for demonetization are to control counterfeit notes that could be contributing to terrorism, and to undermine or eliminate the "black economy".

Reasons behind Demonetization

As per the, study following are 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. 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- 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. 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. The in its pocket in form of taxes and undisclosed income. 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 cashless 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.

Literature Review

According to a Bloomberg report (2017), banks were estimated to have received 14.97 trillion rupees (around \$220 billion) by the December 30 deadline, or 97% of the 15.4 trillion rupees' worth of currency demonetized. While the actual value of the currency deposited is still to be formally accounted for, there is little doubt that most of the invalidated currency was returned. Sorting through the money deposited and figuring out its legitimacy will take time. These rates of deposits defied expectations that vast troves of undeclared wealth would not find their way back to the banks and that black marketers would lose this money since they would not be able to deposit their undeclared cash without being found out. This didn't happen, presumably in part because of people's ingenuity: They found many ways to get their money back into banks, whether it was legitimate or not.

A study highlights an important point related to banking sector. For short run deposits with banks were hiked as people deposited their money to convert their old currency into new one but once when the new currency supply in the economy was full-fledged once again people had withdrawn their money from the banks because it was the money they deposited to convert in to new currency. This was the amount deposited by people which they were using for liquidity not for investment. Interest rates were predicted to be reduced only for short to medium run but not for long run. (Sachin Abda, 2017).

Mukhrjee et al.(2016) studied about the impact of the present government move for demonetization on the credit availability, government finance, spending and levels of various activities. The researchers stated that in a very short period there would be more serious effect on persons earning income in cash as well as spending in cash while impact will be up to a lesser extent on those earnings in non-cash form but spending in cash. Each sector backing demand by cash along with the real sector especially the unorganized one will much adversely effected in very short run time. In case of short term effect having complete replacement, an immense strengthening of informal sector credit market would be seen in the



rural market and there would be adverse effect on construction sector. The medium term impact would produce results in terms of enhancements in deposits in the economy.

Demonetization effect will be positive in coming time for Indian Economy. Indian consumers will strive to learn new ways of cashless transactions. By adopting the cashless means certainly there will be a check on black money. (Geeta Rani, 2016).

Sukanta Sarkar (2010) conducted a study on the parallel economy in India: Causes, impacts & government initiatives in which the researcher focused on the existence of causes and impacts of black money in India. According to the study, the main reason behind the generation of black money is the Indian Political System i.e. Indian govt. just focused on making committees rather than to implement it. The study concludes that laws should be implemented properly to control black money in our economy.

Sunil in his study mentions about the problems and issues due to demonetization. He points out on the following issues like formation of long winding queues in front of each bank as well as ATM's from morning to evening. A considerable hue and cry from the public for getting their money exchanged. Little violation at some places by public was also seen. A few deaths were accounted resulted from stress of not getting money, ultimately due to demonetization of currency. And the most important issue was that bank employees had to work for longer hours. (2017).

Arpit Guru and Shruti Kahani (2010) researcher analysed the black money income? Need for amendment in DTAA & ITEA and analysed that black money is spread everywhere in India up to a large extent which continuously stashed towards abroad in a very large amount. The researcher also identified how black money had caused menaces in our economy and in what ways it is used.

Tax Research Team (2016) in their working paper stated in favor of demonetization. Its main objective is to analyze the impact of demonetization on Indian economy. This paper shows the impact of such a move on the availability of credit, spending, level of activity and government finances.

According to Indian express, Mr. Kaushik Basu (2016) said that government of India made policy that any person who deposits money beyond the limit of 250000, have to pay huge penalty. This policy created a new black market, in which large amount of illicit cash broken in to smaller parts and deposited by the members of team; which is a legal way of illegal activity. Mr. Basu said this move is hurting innocent people who has no illegal money but they have built cash reserve over a long period of time.

Objectives

1. To describe the demonetization concept in India.
2. To study the impact of demonetization on different components of banking sector. To describe Problems/Issues due to demonetization.

Research Methodology

This paper is based on descriptive design with the involvement of secondary data which has been compiled from newspapers, reports, research papers and websites as well. As this is a conceptual study so no statistical tools/techniques has been adopted. Since this paper is based on secondary data, use of articles, websites and research papers, newspapers, speeches has been done.



Analysis and Interpretation

Impact of Demonetization on Various Components of Banking System

Banking sector finds demonetization as a great move. There will be a boost in the financial assets savings as India is moving towards being a cashless economy. Margins are being impacted as there are a lot of deposits and limited access to lend. The credit deposit ratio is seen to be in an unfavorable state. There is expected to be positive margins only if capital adequacy spikes up.

The best and available source to deploy huge flow of deposits is by G-Secs. However, this will create a temporary dip on the bond values. Banks have to be ready to compromise on the lending rates to attract customers for credit purposes and as part of these banks such as SBI, PNB and other banks have slashed their lending rates on housing loans. In the near future, a dip in lending rates is expected to be seen on all types of loans. This will make it easier for individuals to get loans at affordable rates. Banks are said to be making profits with the help of demonetization. Irrespective of the different available sources of e-wallets, the banking sector is still being involved in many online transactions. This helps in making the financial transaction controlled and thus the retail payment system is a great way of adding an additional source to the banks. As part of demonetization, many have turned to be 'first time users of banks'. Once the first time user is cleared, people are continuing to use banks for future transactions. This has helped the banks to have increased deposits of up to 1-2%. As RBI has stabilized and controlled outflow of money from banks, the inflow is helping in having a formal economy as compared to having an informal economy. "Bank 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 a 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.

Bank employees- Bank employees entrusted with duties of front door banking mentioned the following problems:-

1. Insufficient number of scanner machines to detect forged/fake notes.
2. Short supply of Rs100 denomination notes.
3. Non-supply of new Rs 500 denomination notes.
4. Paucity of work force as well as machines to open sufficient number of counters to tackle the crowd.
5. Reasonable requirement of special counters to serve senior citizens, handicap persons as well as woman customers.
6. Non-availability of relieving hands to enable them to attend nature's call as well as have their tiffin.
7. Even female employees are asked to perform the duties by sitting late in the night without following the norms laid under Shop and Establishment Act where they are supposed to be escorted to their destination if they perform their duties beyond 8pm.

Bank customers-The scarcity of cash due to demonetization led to chaos, and most people holding old banknotes faced difficulties exchanging them due to endless lines outside banks and ATMs across India, which became a daily routine for millions of people waiting to deposit or exchange the 500 and 1000 banknotes since 9 November.

Several people were reported to have died from standing in queues for hours to exchange their old banknotes. People, who were in village, remote areas would not be that much aware of demonetization, were not able to exchange their money. Farmers who don't have an account in banks won't be able to



change their whole cash into new currency as there are limits imposed. If somebody and couple who's has left his family was against their marriage without any Identity proof won't be able to change their money, and will be left with nothing but paper in their hand. Poor people who work on daily wages won't be able to get their wages as there is shortage of cash.

Cashless Transaction With The Aid of Modern Banking Instruments- 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. CARE's View In spite of the initial hiccups and disruptions in the system, eventually this change will be well assimilated and will prove positive for the economy in the long run.

Increase In CASA Deposits For Most 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. The biggest beneficiary from this policy will be the banking sector. This is mainly due to the queues of people depositing cash in the banks – which will result in substantial 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. However, this will not be abnormally high since the RBI has increased the CRR in the short term to mop up some of this liquidity. As stated above higher CASA means large amount of deposits are in current and savings account. This way the banks get funds at no or very low cost (interest). Banks do not pay interest on the current account deposits and pays a very low % of interest on savings account deposits. Hence, it is a good measure to get deposits at no or very low cost. As the banks get a lot of liquidity in their hands, they are expected to enhance the borrowing cycle by lending the money at a lower rate of interest. Hence, the interest rate on borrowing will lower down.

Bank Deposits And Interest Rate- For short run deposits with banks were hiked as people deposited their money to convert their old currency into new one but once when the new currency supply in the economy was full-fledged once again people had withdrawn their money from the banks because it was the money they deposited to convert in to new currency. This was the amount deposited by people which they were using for liquidity not for investment. Interest rates were predicted to be reduced only for short to medium run but not for long run.

Jan Dhan Accounts- Post-demonetisation, 2.33 crores new accounts were opened under the Pradhan Mantri Jan Dhan Yojana (PMJDY), bulk of which (80 per cent) were with public sector banks. The total balance in PMJDY deposit accounts peaked at 746 billion as on December 7, 2016 from 456 billion as on November 9, 2016 – an increase of 63.6 per cent.

Profitability of Banks- Banks' net profits essentially reflect the difference between interest earned on loans and advances and investments, and interest paid on deposits and borrowings, adjusted for operating costs and provisions. Loans and advances and investments, which are the main sources of interest income, together constitute more than 85 per cent (61 per cent accounted for by loans and advances and 25 per cent by investments). The sharp increase of 4.1 percentage points in the share of CASA deposits in aggregate deposits to 39.3 per cent (up to February 17, 2017) resulted in a reduction in the cost of aggregate deposits. Banks have also lowered their term deposit rates; the median term deposit rate declined by 38 bps during November 2016-February 2017. The decline in the cost of



funding resulted in decline in the 1-year median marginal cost of funds based lending rate (MCLR) by as much as 70 bps post-demonetisation (November 2016-February 2017). Banks earned return of around 6.23-6.33 per cent under reverse repos and market stabilisation scheme (MSS) as against the cost of CASA deposits of around 3.2 per cent. Accordingly, for an average deployment of about 6 trillion in a quarter under reverse repos and MSS securities, banks' net interest income from increased deposits is estimated at about 45 billion in a quarter after demonetisation. Banks continue to enjoy the increased share of low cost CASA deposits, although it is gradually declining with the increase in currency in circulation. The increase in net interest income would need to be adjusted for the cost of managing withdrawal of SBNs and injection of new bank notes (such as calibration of ATM machines, staff overtime, security arrangements, lower fees/waiver of fees on digital modes of payments), the exact details of which are not available at this stage.

Problems/Issues Due To Demonetization

The most serious issue is that the massive decline of the cash economy has had a tremendous impact on the access to essential commodities since trucks and other goods vehicles have stopped because of insufficient money to buy diesel and the fact that employers have been forced to retrench labour because of cash. The informal economy - the largest employer of labour and a very large producer of goods, usually cheaper than those in urban markets - has been very badly hit. Most economists, in India and abroad, believe that our GDP growth will fall to at least 5.6%, if not 4.6%. The rupee which is Rs 68.12 to \$1, will fall to Rs 110 to \$1. About \$5 billion have already left India. Such a major crisis is called recession.

1. Formation of long winding queues in front of each bank as well as ATM's from morning to evening.
2. A considerable hue and cry from the public for getting their money exchanged.
3. Little violation at some places by public.
4. A few deaths were accounted resulted from stress of not getting money, ultimately due to demonetization of currency.
5. Bank employees have to work for longer hours.
6. People are unable to withdraw huge amount for the big occasions at their home.
7. Swipe machines found to be not working properly at many places whatever may be the issue (i.e. personally observed in trade fair).
8. Illiterate or less educated people are not so much aware about the cashless transactions.
9. Lack of ATM's especially in rural areas creates big problem.
10. In present time, there are still villages/areas which are unbanked even today resulting their routine work disturbed as they have to go to nearby villages or cities to get exchange their notes.
11. Most of the cashless transactions are connected through internet which demand proper network that is still inadequate in some parts of India.
12. Many illegal agents (Dalals) are emerged who are indulged in exchange of notes with a huge commission resulting in moral degradation.
13. As some newspapers as well as news channels reported that back door policy on its way at some places in some banks with the involvement of some bank officials.
14. Even some bank employees are found to be guilt indulging in conversion of 'black money' to 'white money'.
15. Less educated or illiterate people may have to face security issues in case of providing information relevant to their financial instruments to get transactions done through others.



Challenges Faced by the Common Man due to Demonetisation

The bold decision taken by our respected PM Mr. Modi Ji by declaring the demonetization of Rs 500 & Rs 1000 note had definitely affected the people holding black money. Some people are against this and some are looking forward with hope that something good will happen to our country and to common man's life. Lets see what kind of challenges a common man is facing irrespective of his/her profession.

1. Lack of Money in ATMs- Many people depend on ATM service as it's easy to withdraw money and it also saves a lot of time and hassle. Due to demone, there are long queues and inspite of people patiently waiting for hours, they are unable to get cash. Also many don't have the time to go stand in queues due to several issues like old age or bad health etc.
2. Currency Change not Available- Many people who are getting Rs 2000 note from banks or ATM are not able to get the change as none of the shopkeeper is ready to give change of Rs 1800 on purchase of Rs 200 so change is a big worry now a days to common person.
3. Usage of E Wallets- Usage of E Wallets is one of the best solution but challenge is that many people who are of old generation don't use smart phone and if they use then also big ratio among them is of people who don't feel secure on transferring the money through E Wallets.
4. Banks unable to feed their Customers- You can still find long queues of people waiting outside banks for their number and some of the times it happens that after long hours of waiting they come to know that cash is finished and now they have to come again after some hours or need to be in queues tomorrow again. It all shows that banks are not prepared enough to feed their customers.
5. Old and poor people losing lives- It's been in several news channels that some of the people who are not well or are very weak have lost their lives due to standing in queues for long hours. But sad part is no one is ready to take responsibility of such activities.

Conclusion

The move taken by the present central government as announced by our Honourable PM is the biggest move towards demonetization in Indian history in itself. No doubt, Indian citizens have suffered a lot and suffering to some extent even today. Unorganized sector is facing much trouble due to lack of cash with people. Most of the sector has its impact but all the issue mentioned above stand for very short period to short period only. The real picture of India will definitely change and Indian economy will emerge as one of the strongest economy in the word in medium to long period only as forecasted by our PM. So, the Indian citizens will have to wait more for the good days and need to strongly support the PM great move of demonetization. Banks are said to be making profits with the help of demonetization. Irrespective of the different available sources of e-wallets, the banking sector is still being involved into many online transactions. As the banks get a lot of liquidity in their hands, they will lend the money to the people at a lower rate of interest. Hence, the interest rate on borrowing will lower down. The scarcity of cash due to demonetisation led to chaos, and most people holding old banknotes faced difficulties exchanging them due to endless lines outside banks and ATMs across India, which became a daily routine for millions of people waiting to deposit or exchange the 500 and 1000 banknotes since 9 November. People in villages and semi-urban areas are worst hit as majority of the transactions are done through cash. The government's constant flip-flops on withdrawal and deposit limits at bank branches and ATMs have put people in complete disarray. With one month past the note ban move, the problem doesn't seem to be fully resolved as banks continue to face cash crunch. Every person has their own and different take on this big move. The government and many other believe it will bring about many long-term benefits for the Indian economy, whereas, opposition parties try to emphasize the bad that has come from the demonetisation in the short-term.



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