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Impact of Demonetization

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ABSTRACT
The French coined the term Demonetize in 1850–1855, and many countries have used the demonetization policy with restriction and discomfort as it disrupts both the economy and population present study is an event study. Demonetization in India was an historical decision and present paper is analysis of immediate change in important macro variables due to demonetization. Paper calls for further study on effect of demonetization too which will be depending upon long term changes due to the event. The aim of the action was to curb corruption, counterfeiting use of high denomination notes for terrorist activities and especially the accumulation of "black money", generated by income that has not been declared to the tax authorities. Slowdown in economy, failure in checking on black money and inconvenience to the mass had been hot news for last some months. Here is an analysis based on data to test the authenticity. In different sections of the paper we will discuss various issues related to the event.

Keywords: demonetization, digital payments, GDP, money supply

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INTRODUCTION

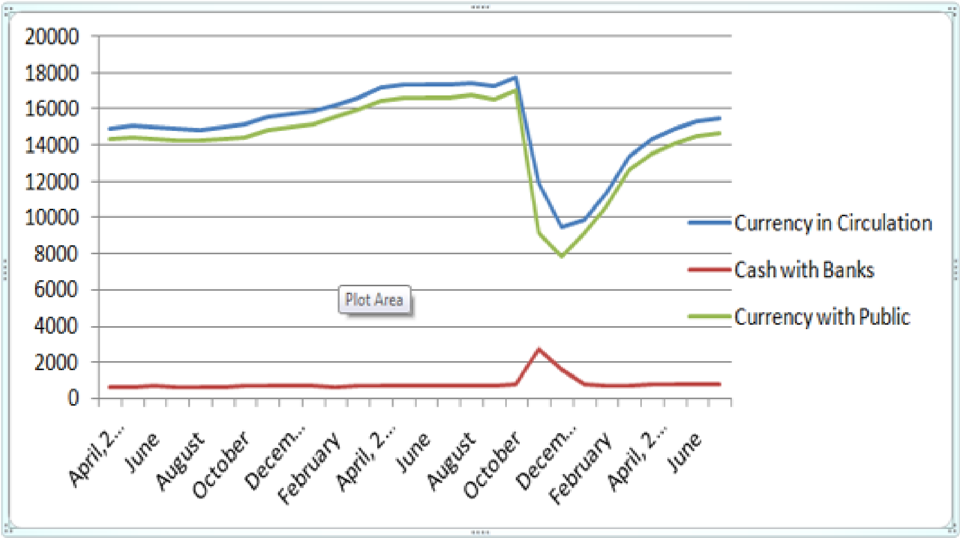
Decrease in money supply was an obvious and immediate result of demonetization. The demonetization, by removing 86 per cent of the currency in circulation and was very severe contraction in money supply in the economy [1].

As we can see in Figure 1 that currency which has been a major medium of transaction is continuously and moderately increasing over time. But suddenly due to demonetization public has to submit currency notes of Rs.500 and Rs.1000 which are not legal tender now. Public could exchange old notes with new one so currency with public dipped and with banks it is surged. Situation is severed till February 2017 due to improper management to mitigate the woes. From February to June there is speedy recovery but yet not reached.

A sudden attack on cash with public was aimed at nullify the black money which was stored in the form of big dimensioned notes. But a big dip in currency available with public could also affect the level of demand in economy because currency is widely used for transaction in India. In Figure 2, slight increase in demand deposits and a substantial increase in time deposit is exhibited. Fixed deposits may be a better option for people who deposited all their cash with banks instead of going for another investment option due to short term uncertainty created in economy. Factor of indignity makes the money supply unique, though immediately after demonetization bank credit was stagnant but after December we can see increasing trends and could be expected to be compensating the supply of in economy.

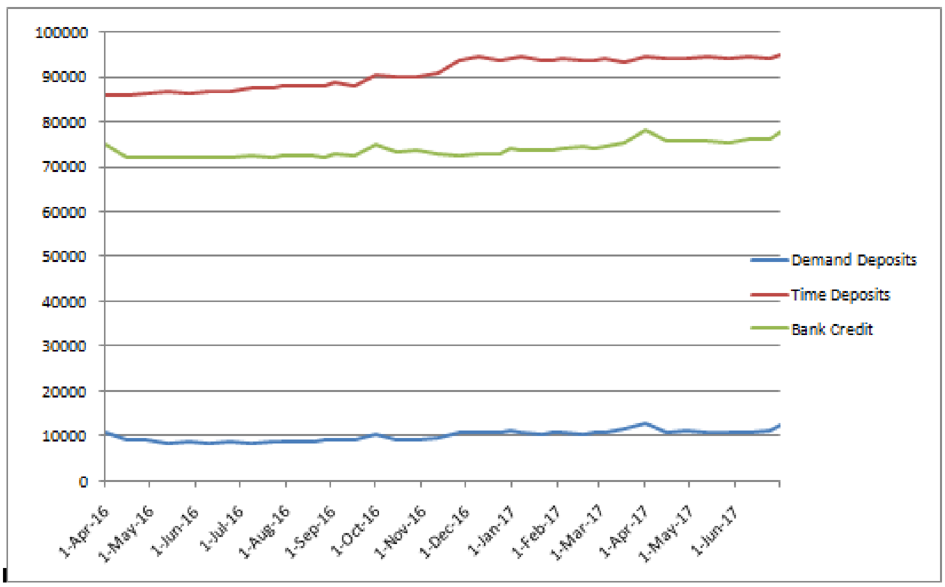
Money supply is an important variable affecting economy [2] and composition of money is also equally important. Demonetization affected availability of currency which is an important part of overall money supply. Currency is important component of narrow money as well broad money. Currency ratio depicts the banking habits of people in any country (Punam). Currency ratio is high in developing countries due to more use of currency than demand deposits.

People in India also use more currency than demand deposit and high currency ratio is expressed by Table 1 and Figure 3. Immediately after the announcement demand deposit are more than currency and currency ratio has been less than one till April. There was a sharp increase in demand deposit in March and currency ratio was again above one in April. Here a decrease in currency is not an indicator of improved banking habits of people as all it happened due to sharp decrease in currency due to the event. But difference between currency and demand deposits is narrowed after the event.



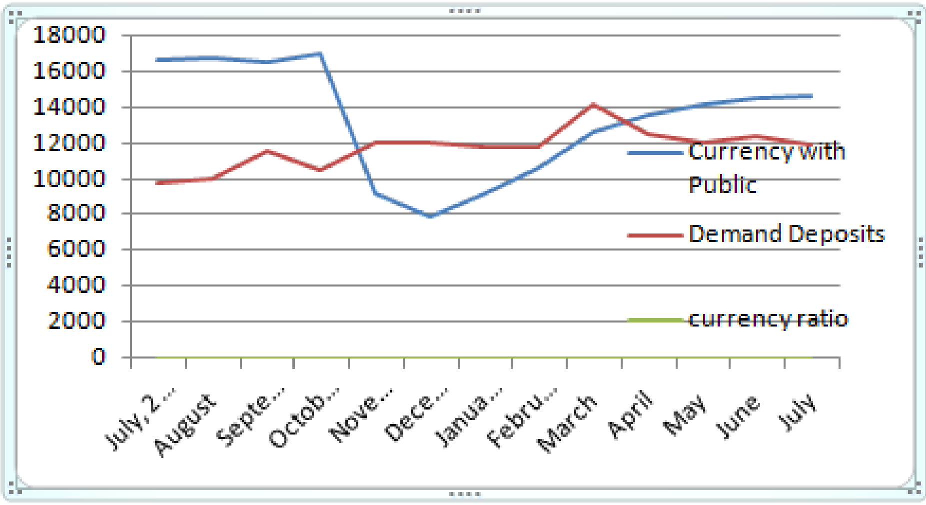
Source: Handbook of statistics on Indian economy

Fig. 1. *Currency as medium of transaction increasing over time.*



Source : Handbook of statistics on Indian economy

Fig. 2. *Increase in demand deposits and a substantial increase in time deposit.*



Source : Handbook of statistics on Indian economy

Fig. 3. *Graph of the uses of more currency than demand deposit and high currency ratio in India.*

Table 1. *Uses of more currency than demand deposit and high currency ratio in India.*

	Currency with public	Demand deposits	Currency ratio
July (2016)	16621.65	9730.24	1.7082467
August	16738.79	9954.11	1.6815958
September	16564.78	11534.71	1.4360812
October	17022.1	10405.35	1.6358988
November	9128.78	11958.59	0.7633659
December	7843.12	12008.91	0.6531084
January (2017)	9128.73	11778.09	0.7750603
February	10638.57	11798.73	0.9016708
March	12637.1	14106.3	0.895848
April	13524.49	12394.53	1.091166
May	14130.19	12006.17	1.1769107
June	14521.49	12376.82	1.1732812
July	14691.77	11905.67	1.2340145

GROWTH OF ECONOMY

Demonetization of 86% of currency in circulation was expected in result in a big squeeze in cash-in-hand for the next some months, the government had set limits on daily exchange of old notes for new ones, and the new currency printing felled short of demand. Monetary policy is widely used as an important tool to boost the economic growth and also has been a cure in financial crisis. Negative interest rate many times considered as "helicopter drops" of money. But what happened in India was just opposite of it "helicopter Hoover". There had been a strong co relationship between currency in circulation and GDP in India. Currency is major lubricant for commerce [3]. Reported a very high degree co relation between growth rate of currency in circulation and growth rate of GDP.

GDP growth rate shaded from 7.3% in 3rd quarter to 7% in 4th quarter due to Demonetization. But according to [4] it was not as sharp as many analysts had expected and this deceleration in the Indian economy reflects the economic disruption that demonetization caused at the end of last year. We can see some encouraging signs in Figure 4 that the disruption is beginning to wane, and we look for growth to eventually return to its pre-demonetization run rate. Strong population growth and robust investment spending should underpin Indian economic growth for years to come.

We can see signs of optimism in Figure 5, private consumption and gross capital formation shows an upwards trend even after the demonetization, though rate of growth of private final consumption expenditure is slower and curve is less steep after the Q3 of 2016–2017. Increasing investment is depicted by increasing gross fixed capital formation.

Increase in stock in economy (Table 2) is also a positive signs of revival. Slowdown in economy is expected to over soon. Not only in domestic market but even in externally we are doing well even after the demonetization. Our exports as well imports are growing. Growing trends in net exports (Table 3) is also a positive sign as it is also an important contributor in national income.

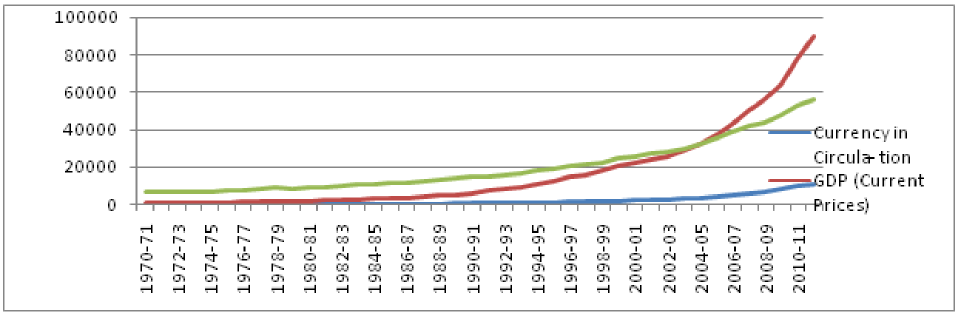


Fig. 4. *Signs of disruption in pre-demonetization run rate.*

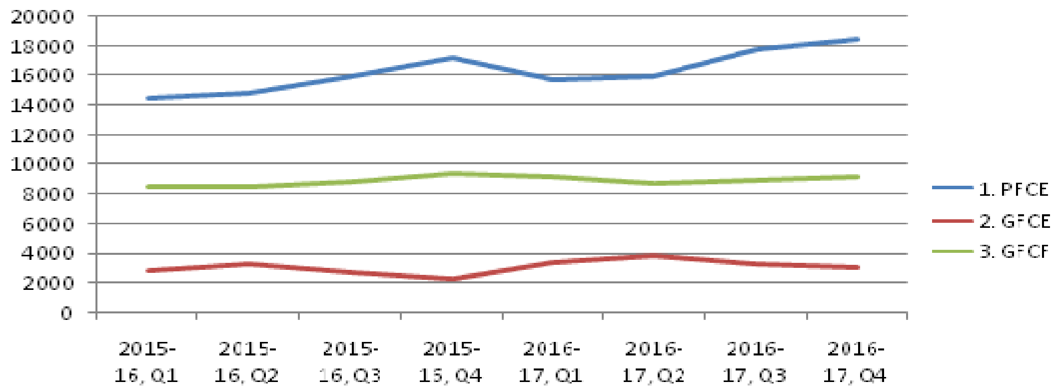


Fig. 5. *Signs of private consumption and gross capital formation. Source: Handbook of statistics on Indian Economy, RBI Publication. PFCE: private final consumption expenditure, GFCE: Government final consumption expenditure, GFCF: gross fixed capital formation.*

Table 2. *Increase in stock in economy.*

Quarterly Estimates of Gross Domestic Product At Market Prices (At Constant Prices) New Series (Base: 2011-12)								
Item /	2015-16				2016-17			
Year	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Change in Stock	672	681	649	743	731	722	690	769

Source: Handbook of statistics on Indian Economy, RBI Publication.

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Table 3. *Growing trends in net exports.*

Quarterly Estimates of Gross Domestic Product At Market Prices (At Constant Prices) New Series (Base: 2011-12)								
	2015-16				2016-17			
Item / Year	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Export of goods & Service	5834	5991	5813	6150	5949	6083	6045	6783
Import of goods & Service	6240	6570	6147	6155	6206	6319	6273	6888
Net Export of goods & Service	-405	-579	-330	-6	-257	-236	-228	-106

Source: Handbook of statistics on Indian.

Economy, RBI Publication

We can see increasing trends in exports and imports in Figure 6, narrowing difference between exports and imports exhibiting positive sign in external sector. Here, we can conclude that external sector is not affected by the event.

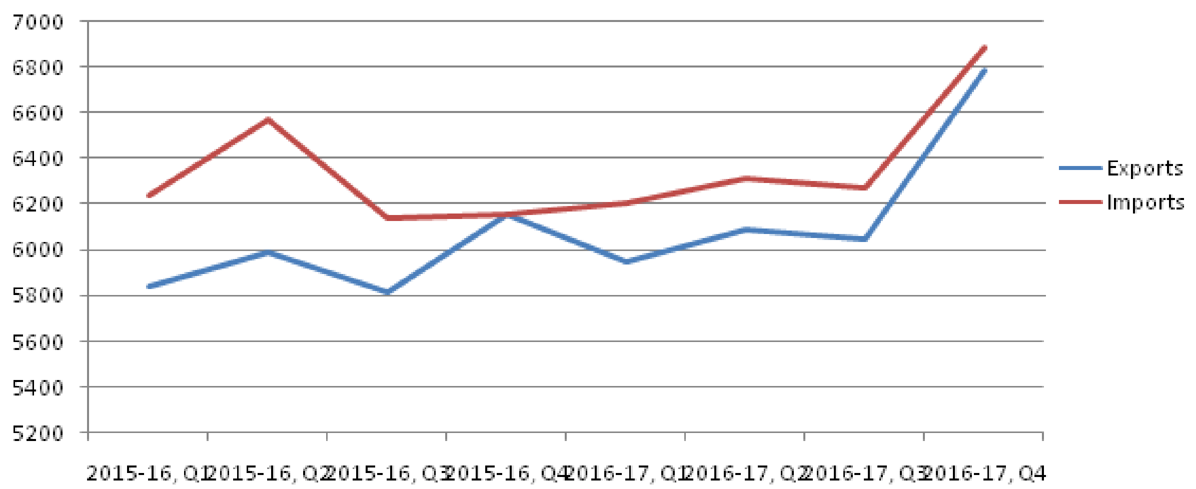

Fig. 6. *Increasing trends in exports and imports.*

DIGITAL PAYMENT

According to the Payments Council of India (Established in 2009), the growth rate of the digital payments industry, which was earlier in the range of 20–50 per cent, has accelerated post demonetization to 40–70 per cent. The Hindu reported that "Reserve Bank of

India (RBI) has urged citizens to switch to alternative modes of payments such as pre-paid cards, credit and debit cards, mobile banking, and Internet banking."2 In a press conference on November 12, the Union Finance Minister too said that "Those in businesses should start using digital payment gateways, cards and banking system. The value of digital transactions swelled more than 40 percent by December 2016, according to the Reserve Bank of India. The Committee on Digital Payments constituted by the Ministry of Finance, Department of Economic Affairs under the Chairmanship of Shri. Ratan P. Watal, Principal Advisor, NITI Aayog. The Committee had been constituted in August 2016 with a term of 1 year to review the payments system in the country and to recommend appropriate measures for encouraging digital payments. According to Watal in April 2017, there has been a significant growth in digital payments as compared to April 2016 6. Watal's comment comes amidst doubts raised by some commentators on the real growth rate of digital payments. He was speaking during the launch of a book, 'Measurement of Digital Payments – Trends, Issues and Challenges' prepared by Niti Aayog. The book was launched at a seminar, 'Digital Payments - Trends, Issues; Challenges' organized by industry lobby group Ficci in collaboration with Niti Aayog.

The picks above mentioned shows trends of various methods of payments. ECS refers to the Electronic Clearing System. ECS enables quick transfer of funds from one bank to another through electronic mandates. RTGS is Real Time Gross Settlement, which is the facility for paying for transactions in the debt market, on a real time basis, transferring funds and securities from one account to another electronically. NEFT refers to National Electronic Fund Transfer. This is the new and improvised version of ECS which enables clearing across the country, electronically, twice a day. Pre-Paid Instruments (PPIs) facilitates purchasing of goods and services by making payments in advance. National Automated Clearing House (NACH) is useful for corporate and financial institutions that make payments in bulk like dividends distributions, salaries, interests, pensions, etc.

Data released by the book shows that there is clearly positive impact on digital payment. Most fluctuating instrument is debit card. Retail options are more affected by demonetization. But after December there is a sudden dip in growth rate of use of debit card, in volume it is stable in February and March. All digital payment methods are exhibiting decreasing trends after some time. It is due to forceful use of digital payment methods due to less availability of cash and later on avoided due to availability of cash. But it is better in comparison of pre-demonetization scenario [5]. Presented Black Swan Effect of Demonetization on Digital Mode of Payment, A black swan is an event or occurrence that deviates beyond what is normally expected of a situation and is extremely difficult to predict.

CONCLUSION

A big squeeze of money from the economy affected the growth of economy and the decision had been criticized widely. But it was not a sharp decline and various positive signs such as increasing consumption expenditure and capital formation made economy optimistic. The demand from segments which have access to digital medium of exchange would remain unaffected, but that from the rest of the economy would get compressed. Increase in growth of GDP in Q2 over Q1 (2017–2018) is remarkable achievement of economy. Digital payment was to have during the phase of shortage. Payment through digital methods surged as well as shaded immediately as cash was made available to public but situation is still better than what it was before the demonetization.

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