Abstract

Demonetization has certainly created a stir in the Indian financial market and the Indian economy at large, in terms of its subsequent impact of reduced lending rates, reduced inflation rates, increase in CASA, affordable Real Estate prices, a move towards a cashless society which also imbibes accountability of transactions thus reducing black money laundering, affordable oil and travel costs and many more. As many economists and industrialists have pointed out, there may be an initial dip in sales, business and hence the seemingly overall growth, but in the long-run, the demonetization drive of 2016 will have a definite positive and a lasting effect.

Introduction

On 08 November 2016, in a surprise move, Rs. 500 and Rs. 1000 notes were declared invalid by the Prime Minister Narendra Modi in a televised address to the nation. He said that the objective behind this move was to curb black money and corruption in the nation. A 50-day window was allowed to deposit and exchange the notes of these denominations. The day following the announcement saw huge crowds lined up in front of banks and ATMs to deposit and exchange their old currency for new notes and currencies of lower denominations. Ever since this announcement, the term ‘Demonetization’ has become a household word.

Investopedia explains Demonetization as an “act of stripping a currency unit of its status as legal tender. It occurs whenever there is a change of national currency: The current form or forms of money is pulled from circulation and retired, often to be replaced with new notes or coins. Sometimes, a country completely replaces the old currency with new currency.” (Investopedia, Definition of ‘Demonetization’).

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In other words, when a currency ceases to be a legal tender it is termed as Demonetization. It is undertaken when an old currency is replaced by a new currency, as was in the case of the European Union (EU) nations adopting Euro as their currency (“Here is everything you want to know about demonetization and different ways of demonetization”, Financial Express, 14 November 2016). In India, Demonetization has been implemented thrice in the past: in 1946, in 1978 and in 2016, to arrest the prevalence of black money and to remove corruption from the country.

**History of Demonetization in India**

The Demonetization drive 2016 was undertaken twice earlier in the years of 1946 and in 1978. The highest denomination note that was printed by RBI (Reserve Bank of India) was the Rs. 10,000 note, in the year 1938 and again in the year 1954. These notes were later demonetized in January 1946 and once again in January 1978.

**Demonetization-1946:** On the 12 January 1946, notes valued Rs 500, Rs 1000 and Rs 10000 ceased to be legal tenders (“Demonetization: Three times India faced the big move”, Indian Express, 18 November 2016). The objective of the drive then, as was mentioned in few newspapers such as Indian Express and Deccan Chronicle, was to curb black money and black marketing.

**Demonetization 1978:** On 16 January 1978, the second Demonetization drive was announced, when notes of Rs 1,000, Rs 5,000 and Rs 10,000 were demonetized. The 1978 demonetization had affected only about 1.8% of the currency notes in circulation in terms of value. The objective of the drive was once again, to prevent illegal transactions in the market and to curb black money. The move enacted under the High Denomination Bank Note (Demonetization) Act 1978 was termed as “An act to provide in the public interest for the demonetization of certain high denomination bank notes and for matters connected therewith or incidental thereto” (“India has demonetised high value currency notes before, in 1978”, Indian Express, 08 November 2016). The people who possessed these notes were given a week to exchange the notes (“Demonetization: Three times India faced the big move”, Indian Express, 18 November 2016).

**Demonetization 2016**

Currency notes valued Rs 1000 and Rs 500 ceased to be legal tenders since 08 November 2016. The objective was again to curb black money and to curtail the shadow economy. The recent demonetization drive has drawn both; a lot of praises as well as a lot of criticism on different counts, be it the impact on the common man, the impact on the industries and the impact on the economy. The recent demonetization affected about 86% of the currency notes in circulation
in terms of value. As can be expected in any decision as large as this, there was a considerable impact on the functioning of the economy. In the first few days after the announcement, many shortcomings in the delivery system and the overall logistics that were needed for the implementation were observed. Jagdish Bhagwati, a renowned economist, supported this recent demonetization, citing that the final beneficiaries of this movement would be the poor who would now also get a share of the black money and would use it for spending, which would in turn increase the money flow in the economy. (Interview of Economist Jagdish Bhagwati on Demonetization, Criticism on PM Modi’s Notes Ban Cockeyed, NDTV.com, 13 December 2016). On the other hand, Nobel laureate Amartya Sen termed the movement authoritarian and a failure. Economist and former PM Manmohan Singh also criticized the drive. He said that this would negatively impact the economy’s growth. He added that it would also adversely impact agriculture, small scale industries as well as those involved in the informal sectors. Few of the economists who supported the drive were Arun Jaitley, Arvind Virmani and Bibek Debroy (Radhika Iyengar, “Both sides of the coin: What top economists think about demonetization”, Indian Express, 28 November 2016).

**Impact of Demonetization on the Economy**

Demonetization 2016 was aimed at reducing black money, corruption and eliminating the shadow or parallel economy. It also aimed at making India a cashless economy or a completely digitized economy. Economists, industrialists and the common man have had varied views on the effect that this drive would have, in the short run and in the long run. While some feel that the decision on demonetization was the need of the hour, few have expressed worry on the negative impact on industry growth rates and the economic growth rates. Many feel that the short-term impact may be negative or stunted but in the long run, it will be positive and sustainable. While the short-term effects have been seen, we are yet to see the impact in the long run, and till then we can only make a forecast or presumptions. Assocham said that the demonetization drive has drastically brought down the economic activity across all the sectors and that growth will remain hampered for at least the third and the fourth quarter of this financial year (PTI, “Demonetisation to impact economy in short term: India Inc”, 26 November 2016). One of the reasons why all activities reduced in the aftermath of this demonetisation move was because most of the households preferred cash purchases to using banking products or digitized modes of payment. The GDP growth in 2017 will take a hit due to the reduction in the economic activity, caused by the liquidity crunch due to Demonetization (DNA, “India’s GDP growth to take a hit on demonetization”, 19 November 2016). Though the Finance Minister, Arun Jaitley, in his Union Budget Speech on 01 February mentioned that the GDP will be bigger and cleaner due to the demonetization drive (NDTV News Desk, “Union Budget 2017: Demonetisation
Will Bring ‘Cleaner, Bigger GDP, Says Finance Minister”, 01 February 2017). “There is greater integration of informal economy taking place with formal economy that leads to larger and cleaner GDP, that was our objective behind the decision on demonetisation”, the Finance Minister told PTI (PTI, “Demonetisation has positive impact, says Arun Jaitley”, Moneycontrol.com, 13 February 2017). Another impact of the drive has been reduced inflation which was due to the reduced liquidity in the market.

The Macro impacts of Demonetization include:

(a) **GDP Growth**: RBI Governor Urjit Patel has said that Demonetization is going to have a short-term impact on the Gross Domestic Product of the country. He also said that the demonetization will have a positive impact in the mid-term and in the long term (DNA, “Demonetization to have a short-term impact on GDP: RBI Guv Urjit Patel to PAC”, 20 January 2017). The International Monetary Fund (IMF) has said that India is likely to grow 6.6% in 2016-17, as against its earlier estimate of 7.6% (Asit Ranjan Misra, “IMF cuts India’s GDP growth forecast to 6.6% on note ban woes”, Livemint, 17 January 2017)

(b) **Declining Inflation Rates**: The Wholesale inflation rate was down from 3.39% to 3.15% from October to November. In December, the retail inflation was recorded at 3.41% (three year low since January 2014) from 3.63% due to the fall in vegetable and pulses prices and due to the liquidity crunch post demonetization (DNA, “Did Cash Crunch keep Wholesale Inflation subdued in December”, 16 January 2017). Retail inflation is down to 3.17% in the month of January, a multi-year low, due to declining prices of food items (Times News Network, “Retail Inflation cools to 5-year low of 3.2% in Jan”, Times of India, 14 February 2017).

(c) **Declining Interest Rates**: The inflow of funds into the Banking system post the announcement has been immense. With increased deposits, the interest rates on deposits have fallen down, which is based on simple economics of demand and supply, wherein with increased supply which in this case is deposits, there would be a decrease in price, which in this case in the interest rates. Most Banks have reduced their interest rates. Increased liquidity has also led to decreased borrowing rates (Kotak Securities, 5 reasons why demonetization affects interest rates).

(d) **Parallel Economy**: As was said by Arun Thukral, MD & CEO, Axis Securities, one of the after effects of Demonetization would be relegation of the parallel economy (Aniruddha Bose, “Demonetisation Has Deferred the Consumption for Couple of Quarters”, Businessworld, 27 January 2017).
(e) **Move towards Digitalised Economy**: Demonetization propelled the usage of digital payment modes within the country. With digitalization, there would be increased transparency in the economy, enhanced foreign investment and improved growth of the economy (Wade Shephard, , “A Cashless Future Is the Real Goal of India’s Demonetization Move”, *Forbes*, 14 December 2016).

Some of the long-term benefits that will be derived from the Demonetisation move of 2016 include:

(a) Transition into a cashless economy, in other words, a digitised economy  
(b) Increased number of Tax Payers  
(c) Increased Financial Savings  
(d) Improved Economy  

A Snapshot of the Short and Long Term Impact of Demonetization on Various Sectors of the Economy

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<thead>
<tr>
<th>Sectors</th>
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<th>Long Term Impact</th>
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<td>Real Estate</td>
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<td>Positive</td>
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<td>Banks</td>
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<td>Consumer Durables</td>
<td>Negative</td>
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<td>Infrastructure</td>
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<td>Pharmaceutical</td>
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<td>Automobiles</td>
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<td>Micro lenders</td>
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*Source: “How demonetisation has impacted key sectors”, Livemint, 09 December 2016.*

**Research Methodology**

**Objective**: The objective of this paper is to study the impact of Demonetization on Key Sectors of the Indian Economy. The sectors under this study are:

(a) The Banking Sector  
(b) The Auto Sector and  
(c) The Real Estate Sector

**Parameters Studied**

(a) Impact on Business  
(b) Impact on the respective Stock Indices and  
(c) The Future Outlook of the Sectors under Study.
**Research Design:** Explanatory. The paper explains the effect of Demonetization on the three sectors under the study.

**Source of Data:** Secondary Data from Print and Online Newspaper and Magazine Articles and Published Interviews, Official sites of BSE India, NDTV Profit and Money Control. Data on Stock indices have been sourced from the official site of BSE.

**Scope of the Study:** The Impact Analysis of Demonetization has been studied for three Key sectors of the economy, them being, the Banking Sector, the Auto Sector and The Real Estate Sector.

Data on Stock indices is quarterly (07 November 2016 to 06 February 2017) for all sectoral analysis.

**Impact Analysis of Demonetization on Key Sectors of the Indian Economy**

(A) Banking Sector

(a) Impact on Business

Right after the announcement, the sector that saw maximum activity in terms of operations, was the Banking sector. With the task of handling cash deposit and disbursement of the anxious public, the banks worked effectively and efficiently through days of November and December 2016. There was a huge influx of cash into the financial system seen in the 50-day window given for depositing and exchanging old notes. There were three distinct areas of banking business that saw a leap, one being the increase in the e payment systems. Transactions on e-wallets had increased from 17-lakh numbers a day to 63-lakh numbers a day and the value of transactions had increased from Rs. 52 crores to Rs. 191 crores. ("400-1000% increase in Digital transactions after Demonetization, says Government", *Times of India*, 09 December 2016).

The other area which saw a growth was the increase in Deposits. As per an article, the growth in deposits this financial year is expected to be much higher than the growth of 9-10 per cent as was seen in the previous year (Radhika Merwin, “With rates on hold, borrowers will get relief only with a lag”, *Business Line*, 07 December 2016).

The advantage derived from the influx of funds is that the banks will see reduced NPAs and will be able to use the funds for further loans, agriculture and infrastructural growth. The adverse side to it, though, is that the quality of the assets may deteriorate especially
for loans against property as the impact on the Real Estate sector has been negative and the prices of the same have come down. The third area that saw a growth was the influx into the Pradhan Mantri Jan Dhan Yojana accounts. Deposits in the same had almost doubled within 45 days post the announcement to 87000 crores (“Jan Dhan Account Deposits Double to 87K Crores Post Demonetization, I-T dissects data”, *Indian Express*, 01 January 2017).

(b) Impact on Banking Stock Index (BSE BANKEX)

![S&P BSE BANKEX Chart](https://www.bseindia.com)

Source: www.bseindia.com

The BSE Bankex closed at 22,374.20 on 09 November 2016, one day after the announcement of demonetization. Post Demonetization, the one-month high of 23,185.59 was seen on 10 November 2016. Initially the index moved up to reach the high on 10 November and then nosedived and remained low throughout the month of December. The index revived in the new year from the 4th of January and has been increasing ever since, with a slight dip between 20th and 23rd of January. As on 6th of February the Index stood at 23354.41, an increase of 4.38% since the close of 09 November 2016. Possible reasons for the initial dip in the index could be the fall in demand loans, a fall in the net interest margin and a slowdown in the economic activity due to demonetization. Few Banking stocks especially PSU Bank stocks showed an increase
in trade post the announcement, which could be due to the expected
effect of curbing black money through demonetization that could
lead to lending rate cuts and an increase in CASA (Rahul Oberoi,
“Demonetization lifts bank stocks, PSU banks soar to fresh 52-
week highs”, Economic Times, 10 November 2016).

(c) Future Outlook

The Banking Sector has been cited as the biggest beneficiary of
demonetization. There has been a surge in deposits which led to a
reduction in deposit rates post demonetization. The demonetization
move is expected to not only increase flow of funds into the
banking system but also encourage need based spending instead of
luxury based spending. It will also encourage increased savings and
investment in financial assets which would finally lead to the
growth of the financial market.

Thus, the transition to a cashless society will definitely have a
positive impact on the financial system as a whole, as cash flow
will increase and the financial intermediaries since digital payment
systems will increase and investment in financial products will also
increase.

In terms of capacity of investments of the sector, analysts have
predicted that banking stocks that are capital adequate and are
fundamentally strong will perform well in the stock market.

Therefore, it can be said that the impact of demonetization on the
Banking Sector, as is being seen at present and as is expected in
future, seems positive.

(B) Auto Sector

(a) Impact on Business

According to an article in Economic Times, Retail sales of cars
(without waiting period) was down by 30-50% while sales of Two-
wheelers and Commercial Vehicles had seen a further slump. The
retail sales of entry level Motorcycles went down by 60-65% right
after Demonetization (ET Bureau, “Demonetization impact on
various sectors: Government needs to inject positive sentiment, led
by tax cuts”, 07 December 2016). Under the Auto segment, passenger
vehicles and tractors are expected to be less impacted as 75-80% of
the purchases are made through financing. Whereas 65% of Tractors’
purchases are via financing, only 35-40% purchases under the Two-
wheeler segment were via financing. The rest is either through

Car sales were at its lowest in the month of December 2016 in 16 years. Not only were the sales down but even the production went down by 22%. While the production of Commercial vehicles went down by 20%, the production of Two-wheelers went down by 25%. This was due to the falling demand as was observed post demonetization. (“Demonetization Impact: Auto Sector in Crisis Sales Log Sharpest dip in 16 years to 12-21 lakh units” in December, Financial Express, 11 January 2017).

(b) Impact on Stock Index (BSE AUTO)

![Stock Index Graph]

Source: www.bseindia.com

The BSE Auto Index closed at 21692.81 on 09 November 2016 the day after the announcement of demonetization. The index saw few ups and downs after it reached its monthly low of 19214.61 on 21 November 2016. Post Demonetization, the one-month high of 20144.62 was seen on 30 November 2016. The index improved in the month of January 2017 and saw a consistent increase with very few hitches in between. The month of February till the 6th saw the index at its highest at 22563.21 as on 1st of February. The close as on 06 February 2017 was 22288.07, an increase of 2.74% since the close of 09 November 2016. A possible reason for
the initial dip in the index could be due to the hit in demand due to Demonetization. The month of December saw low sales and low production throughout. Business got better by January 2017, and so did the index, which rose consistently through the month.

(c) Future Outlook

Though the Auto sector saw a dip in sales after demonetization, industry experts feel that the sector will do well in the future as they could leverage on fall in the consumer lending rates. The Auto Industry has already shrugged off the implications of demonetization as it has seen a 15% increase in passenger car sales in January 2017 as against January 2016, which was the fastest in 4 months though there was a dip in sales in the month of December which could be due to Demonetization (ET Bureau, Auto industry shrugs off demonetization impact, sales grow 15 per cent in 01 February 2017). There has also been recovery in this sector after its setback post demonetization. With a consumer-friendly budget, lowering of interest rates and stable fuel prices, the sector is now set to gaining momentum in the coming quarters. Therefore, it can be safely said that, though the impact of demonetization on the Auto Sector was negative in the first few months after demonetization, it is expected to be much more positive in the near future.

(C) Real Estate Sector

(a) Impact on Business

According to an article in Economic Times, there was more than a 40% fall in the sale enquiries and sale of properties across Mumbai, Bengaluru, Delhi and Pune. There was an expectation of fall in prices of real estate post demonetization, and which is now a reality. The Real Estate sector has seen a slump in prices and sales across markets. The article further states that rate cuts and tax concessions will help improve home purchases (ET Bureau, “Demonetization impact on various sectors: Government needs to inject positive sentiment, led by tax cuts”, 07 December 2016).

According to the Chief Business Officer of 99acres.com, Narasimha Jayakumar “The slowdown owing to this announcement has been more severe in NCR particularly Gurgaon, Mumbai Metropolitan Region (MMR) and certain Tier II markets such as Surat and Vadodara. Minimal impact of demonetization has been felt in markets such as Bangalore, Pune and Chennai, which are primarily end-user driven and rely on bank funding” (Jayakumar Narasimha,
“Demonetization: Dissecting the impact on real estate sector”, *Moneycontrol*. Owing to the announcement, the liquidity in the market went down drastically that led to a dip in the demand for properties, especially in the premium housing and the residential land categories (Narasimha).

Anuj Puri, Chairman and Country Head at Real-Estate consultancy JLL India, expects the sales in the secondary market to dip by around 30-35%. He states that the decision of demonetization has had a greater impact on the secondary market sales than the primary market. (Srishti Sharma, “Resale realty market hit hardest by demonetization”, *Hindustan Times*, 23 December 2017).

Experts opine that the slowdown in the real estate sales, as was seen immediately after the announcement of demonetization, will be short spanned. The situation in the market will improve with the Banks reducing loan interest rates and the Real Estate Regulation and Development Act 2016 (RERA) getting implemented (Vandana Ramnani, “Prediction 2017: Expect transparency in property market; Normalisation after 6 months”, *Hindustan Times*, 17 January 2017). Niranjan Hiranandani, Managing Director of the Hiranandani Group and CMD of Hiranandani Communities, feels that the real estate business will be down till March 2017 and then a turnaround will happen April 2017 onwards (Housing.com/news, *Moneycontrol*, Demonetization to impact real estate market till March 2017: Hiranandani).

(b) Impact on Stock Index (BSE Realty)

![S&P BSE REALTY Chart](www.bseindia.com)

The BSE Realty Index closed at 1324.75 on 09 November 2016, a dip from the previous close, on the day after the announcement of demonetization. The index plummeted further to reach a monthly low of 1180.38 on 22 November 2016. The month of December 2016 saw no extreme increase or decrease till mid-month but remained lower than the index value pre-demonetization reflecting the negative impact of the same on the index. The end of December 2016 and the entire month of January 2017, on the other hand, saw a gradual rise in the Realty index and it also reached its 3-month high post demonetization of 1479.45 on 06 February 2017, an increase of 11.67% since the close of 09 November 2016. The reason for the same could be a fall in liquidity in the market and the slump in the demand for real estate following the demonetization drive.

(c) Future Outlook

Demonization has already brought in a new phase in the Real Estate sector and will further bring more changes that would be transparent and corruption-free and a lot more organized (Narasimha, Moneycontrol). A positive fallout of demonetization for property buyers in the coming year is the reduced prices of properties. The Real estate sector is now subdued due to low availability of cash and the uncertainty in time and extent of price falls. The sector is however expected to pick up once there is enough liquidity in the market.

Narasimha Jayakumar, Chief Business Officer, 99acres.com, is of the view that due to the elimination of black money and because of regulatory changes such as the GST Act, Real Estate (Regulation and Development) Act and amendment of the Benami Transactions (Prohibition) Act, the sector will get cleansed in due course. He also mentioned that fair pricing would facilitate an increase in demand for new projects (Narasimha, Moneycontrol).

According to Brotin Banerjee, MD and CEO Tata Housing, Developers have been offering various schemes to boost sales such as offering home loans at 6% and 7% and schemes where buyers can book now but pay after 3 months. Developers are also assuring property buyers of adjustments in compensation of the prices of the properties if these fall further. These schemes have led to an increase in interest in purchase of ready to move in and nearly completed properties. (Vandana Ramnani, “Prediction 2017: Expect
transparency in property market; Normalisation after 6 months”, *Hindustan Times*, 17 January 2017)

The Real Estate sector will be more transparent, attractive and organised in the year 2017. Reforms such as Demonetization, GST Act, RERA (Real Estate (Regulation and Development)) Act and Benami Transactions (Prohibition) Amendment Act, will all have a positive implication on the sector. Therefore, it can be said that the impact of demonetization on the Real Estate Sector though negative initially, is expected to be positive in the future.

**Epilogue**

Demonetization has certainly created a stir in the Indian Financial Market and the Indian economy at large, in terms of its subsequent impact of reduced lending rates, reduced inflation rates, increase in CASA, affordable Real Estate prices, a move towards a cashless society which also imbibes accountability of transactions thus reducing black money laundering, affordable oil and travel costs and many more. As many economists and industrialists have pointed out, there may be an initial dip in sales, business and hence the seemingly overall growth, but in the long run, the Demonetization drive of 2016 will have a definite positive and a lasting effect. The Union Budget 2017 has reduced the demand and consumption hit faced by sectors due to Demonetization. A cut in the tax rate for lower slabs, higher allocation to agriculture and the rural sector will increase the disposable income and thus the liquidity in the hands of the common man, which would consequently aid consumption, and this in time would lead to sectoral and overall economic growth.

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An Impact Analysis of Demonetization on Key Sectors of the Indian Economy

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