

# Demonetization: Economic Impact on Different Sectors in India

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**Abstract** - Demonetization refers to change of currency by a government to curb illegal activities and transactions. India initiated its controversial plan of demonetization on 8<sup>th</sup> Nov 2016, by making the Rs 500 / 1000 notes not as legal tender. Through this momentous move the Indian Government tried to tackle four key issues: undesirable upsurge of black money, corruption, fake currency circulation and funding of terrorist activities in the country. With this announcement of Prime Minister Narendra Modi, life of Indian citizens came to a standstill; a person who had many lower denomination notes suddenly became affluent to meet daily needs whereas the urban middle class dependent on e-banking had no cash in hand and spent hours in line outside banks and ATMs to get cash. The rich who had safely hoarded crores in their homes, within a few hours became paupers. Also, this had a phenomenal impact on slowing down the growth rate of the Indian economy. Ten sectors in India were majorly impacted by Demonetization: Agriculture, Real Estate, Construction, Manufacturing, Financial, Aviation, Tourism and Hospitality, Telecom, Healthcare and Automobile. The worst affected sectors being Financial and Real Estate, Construction, Tourism and Hospitality. Through this paper short-term and long-term economic impact of demonetization on various sectors of India are highlighted.

**Keywords** - Demonetization, Agriculture, Real Estate, Financial Services

## I. INTRODUCTION

Demonetization was a move initiated by Indian government to cleanse the formal economic system and discard black money in India. This courageous act nullified around 86% of the Indian currency. It was further implemented in order to keep a check on the illegal activities like smuggling, terrorist activities and espionage.[1] It was declared that existing rupee five hundred and one thousand notes would no longer be used as legal tender. RBI issued guidelines that rupees two thousand notes and new five hundred notes would be in circulation from 10<sup>th</sup> Nov 2016. Although the lower denomination notes i.e. Rupees one hundred, fifty, twenty, ten, two and one rupee note continued as legal tender.[2]

India has witnessed demonetization at two earlier instances i.e. January 1946 and January 1978. During the first demonetization in Jan 1946, Rs. 1000 and Rs. 10000 notes were demonetized.[3] Whereas in January 1978, an ordinance was promulgated in order to phase out the notes of

denomination rupees thousand, two thousand and ten thousand notes.[4] The first demonetization related to conversion whereas the second was termed as cumulating. Hence, it can be said that the change of currency is not new in the economic history of India. It can be understood that all the three instances had a common goal - curb the circulation of black money and keep the illegal activities at bay.

As per RBI estimates 2016, 15 billion notes of 500 denomination [approx. Rs. 7853.75 billion] and 6 billion notes of 1000 denominations [approx. Rs. 6325.68 billion] were in circulation that accounted for 86.4 % of the total value of banknotes in circulation.[5] In regard to counterfeit currency, RBI reported during the year 2015-16 261,695 counterfeit notes of Rs 500 and 143,099 counterfeit notes were discovered.[6] Although the actual number could be much higher. This accumulated money became insignificant from the midnight of 8<sup>th</sup> November 2016 and was considered valuable only if deposited in banks.

### A. Review of Literature

World Bank CEO Kristalina Georgieva said, "Prime Minister Narendra Modi's decision to ban high value banknotes as part of efforts to stamp out corruption will have a profound and positive impacts on the Indian Economy.... Demonetization may have caused some hardship to people living in the cash economy but in the long run the move will help foster a clean and digitized economy." [7]

Getamber Anand, President, Realtors' apex body CREDAI said, "Property sale, in both primary and secondary markets, were affected during November-December due to demonetization as consumers postponed their buying decisions not only in real estate but across all sectors."

YES Securities' recent report on Demonetization says that, 'short-term implications for cash-intensive sectors such as real estate, construction, and consumption were severe. However, in the medium term, benefits through higher government spending, better transmission, greater financial inclusion and movement of household savings from physical to financial would be beneficial' for boosting potential growth of the economy. [8]

According to the report released by Central Statistics Office (CSO), Ministry of Statistics and Programme

Implementation's Second Advance estimates of national income at constant [2011-12] and current prices for the financial year 2016-17 the Gross Domestic Product (GDP) is likely to attain a level of 121.65 lakh Cr., as against the 1<sup>st</sup> Revised Estimate of GDP for the year 2015-16 of 113.58 lakh Cr., released on 31st January 2017. The growth in GDP during 2016-17 is estimated at 7.1 percent as compared to the growth rate of 7.9 percent in 2015-16.[9]

As per CSO report, the sectors likely to register growth rate of over 7.0 % in Fiscal Year 2016-17 are public administration, defence and other services, manufacturing, trade, hotels, transport, communication and services related to broadcasting, 6.5 % in financial, real estate and professional services, 6.6% in electricity, gas, water supply and other utility services and 4.4% in agriculture, forestry and fishing, 1.3% in mining and quarrying and for construction is estimated to be 3.1 % as shown in Table II below.

#### B. Objective of the Study

The major objective of the study is to highlight the key sectors that have been greatly impacted by Demonetization in India.

#### C. Research Methodology

The paper is based on the secondary data collected from various published sources like government reports, magazines, journals, newspapers, websites etc.

#### D. Findings & Analysis

Contradicting grim forecast of 6.4 % growth rate as polled by analysts at Reuters due to the impact of demonetization, a quarterly estimate of GDP is estimated at 30.28 lakh Cr., as against 28.31 lakh Cr. in Q3 of 2015-16, showing a growth rate of 7.0% for the fiscal third quarter [October-December] of 2016-17. As depicted in Table I Growth rates in various sectors in the fiscal third quarter for agriculture, forestry and fishing at 6.0 % is more as compared to the same quarter in the last FY, growth in mining and quarrying was 7.5 % decreased in comparison to the last FY 3<sup>rd</sup> Quarter from 13.3%, manufacturing showed 8.3 % decrease from 12.8%, electricity, gas and water supply and other utility services at 6.8 % grew from 4.1%, construction 2.7 % growth rate fell from 3.2%, Trade, hotels, transport, communication and services related to broadcasting 7.2 % also decreased from 9.6%, financial, real estate and professional services however took a major brunt from 10.4% it fell to 3.1 % but Public administration, defence and other Services grew to 11.9 percent. The comparison of quarter on quarter growth rate in the Fiscal 2016-2017 saw all other sectors grow at a faster pace in the 3<sup>rd</sup> quarter as compared to the preceding quarters in the same year except construction, financial and real estate sectors depicting the demonetization impact on these sectors.

Table I

Quarterly Estimate of GVA at Basic Prices for October-December [Q3] of 2016-17[at 2011-12 prices]

Industry	GVA AT BASIC PRICES [ `Cr.]			PERCENTAGE CHANGE OVER PREVIOUS YEAR/ PREVIOUS QUARTER					
	2016-17			2015-16			2016-17		
	Q1	Q2	Q3	Q1	Q2	Q3	Q1	Q2	Q3
Agriculture, forestry & fishing	378847	317976	541851	2.6	2.3	-2.2	1.9	3.8	<b>6.0</b>
Mining & quarrying	92810	69877	89684	11.2	13.9	<b>13.3</b>	0.3	-1.3	<b>7.5</b>
Manufacturing	501002	494773	475618	8.5	10.3	<b>12.8</b>	9.0	6.9	<b>8.3</b>
Electricity, gas, water supply & other utility services	60647	59323	59435	2.5	5.9	<b>4.1</b>	9.6	3.8	<b>6.8</b>
Construction	220195	209434	218466	4.8	0.0	<b>3.2</b>	1.7	3.4	<b>2.7</b>
Trade, hotels, transport, communication and services related to broadcasting	515079	501864	515009	10.6	8.9	<b>9.6</b>	8.2	6.9	<b>7.2</b>
Financial, real estate & professional services	646730	720369	523081	10.2	13.1	<b>10.4</b>	8.7	7.6	<b>3.1</b>
Public administration, defence and Other Services	323063	371712	378944	6.3	7.2	<b>7.5</b>	9.9	11.0	<b>11.9</b>
GVA at Basic Price	273837 2	274532 8	280208 9	7.8	8.4	7.0	6.9	<b>6.7</b>	<b>6.6</b>

Source-Ministry of Statistics & Programme Implementation, Second Advance Estimates of National Income -2016-17[as on 28 February 2017.

In effect, the overall impact of demonetization was seen in slowed economic growth of India. The pace of growth came down from 7.4 % logged in the 2<sup>nd</sup> quarter in FY 2016-17 to 7% in the 3<sup>rd</sup> quarter as published by CSO. Real Gross Value Added (GVA) at basic prices in 2016-17 is anticipated to be 6.7 % against 7.8 % in 2015-16. However, as shown in Table II, growth of real GVA at basic constant prices [2011-12] is anticipated to increase from Rs 104.70 lakh Cr. in 2015-16 to Rs 111.68 lakh Cr. in 2016-17.

The reported data shown in Table II shows that Agriculture, forestry and fishing have a marked increase in anticipated growth of real GVA at basic prices in 2015-16 from 0.8 % to 4.4 % in 2016-17. GDP in agriculture, forestry and fishing sector is accounted by 60.0% of fruits and vegetables and 40.0% of GVA are livestock products, forestry and fisheries. The Department of Agriculture estimated that production of food grains during Kharif and Rabi seasons in year 2016-17 was 9.9 % and 6.3 % respectively. This is an increase in agricultural output over the previous year of 2.3 % and of 2.0 % respectively.

Coal, iron ore, mica, bauxite, manganese, crude oil and natural gas are some of the key indicators of production in mining sector. Data in Table II indicates the growth in the GVA at basic prices [At 2011-12 prices] for 2016-17 from 'mining and quarrying' sector is estimated to be 1.3 % that is much less as compared to growth of 12.3 % in 2015-16. However, an increase in GVA at basic prices [At current price] is seen from -5.7 percent in 2015-16 to 4.4 percent in 2016-17 that is an increase in growth and could be attributed to changes in the licensing laws and transparency in awarding licenses for mining.

Table II

Second Advance Estimates of GVA at Basic Price by Economic Activity [At 2011-12 prices] [in Cr.s]

Industry	2014-15 [2 <sup>nd</sup> RE]	2015-16 [1 <sup>st</sup> RE]	2016-17 [2 <sup>nd</sup> AE]	Percentage change over previous year	
				2015-16	2016-17
Agriculture, forestry & fishing	1,604,259	1,616,461	1,687,064	0.8	4.4
Mining & quarrying	307,077	344,972	349,351	12.3	1.3
Manufacturing	1,685,844	1,863,835	2,007,564	10.6	7.7
Electricity, gas, water supply & other utility services	213,477	224,323	239,203	5.1	6.6
Construction	829,966	852,821	879,525	2.8	3.1
Trade, hotels, transport, communication and services related to broadcasting	1,796,490	1,988,512	2,133,851	10.7	7.3
Financial, real estate & professional services	2,070,947	2,294,193	2,443,633	10.8	6.5
Public administration, defence and Other Services	1,201,286	1,284,603	1,428,124	6.9	11.2
GVA at Basic Price	9,709,347	10,469,720	11,168,315	7.8	6.7

\*RE: Revised estimates AE: Advance Estimate s

\*\* Source-Ministry of Statistics & Programme Implementation, Second Advance Estimates of National Income 2016-17[as on 28 February 2017]

The key indicator with 71 % contribution to the manufacturing sector GDP is the private corporate sector. There was a decrease in growth of GVA at basic prices for 2016-17 from manufacturing sector estimated at 7.7% as compared to growth of 10.6 % in 2015-16. However, there is an increase in GVA at Basic Price from 9.6 % in 2015-16 to 10.3 % in 2016-17 at current prices due to a reduction in cash dealings with the effect that financial transaction were

accounted and more corporate advanced tax was collected in the 3<sup>rd</sup> quarter.

In the Construction sector key indicators are cement and consumption of finished steel but due to the cash crises, the real estate and infrastructure sector is estimated to grow slow for 2016-17 by 3.1% as compared to growth of 2.8 % in 2015-16. Similarly, for electricity, gas, water supply and other utility services the GVA at basic prices for 2016-17 is estimated to grow by 6.6 % as compared to growth of 5.1 % in 2015-16.

Sales tax growth is the main indicator used for estimating GVA from trade sector. Indicator used for GVA from hotels and restaurant sector is the private corporate growth in this sector. Among the transport sector, the key indicators are railways, passengers handled by the civil aviation, cargo handled by the civil aviation and cargo handled at major sea ports. For trade, hotels, transport, communication and services related to broadcasting, GVA at basic prices for 2016-17 is estimated to grow by 7.3 % as compared to growth of 10.7 % in 2015-16 showing a decrease in growth of the sector.

GVA at basic prices for 2016-17 from financial, real estate and professional services sector is estimated to show decrease in growth at 6.5 % as compared to growth of 10.8 % in 2015-16. Major component of this industry is the banking services, real estate and professional services are corporate sector related to computer activities with a GDP contribution to the sector of 71 %. The following are detailed sector – wise short to medium term analysis of demonetization on various sectors.

1) *Agriculture*: The short term impact of demonetization was feared that sowed acreage would be reduced for want of enough seeds in time and could highly impact production in 2016-17. Cash is the primary transaction mode in the sector and in agricultural dependent states like Uttar Pradesh, Punjab, Madhya Pradesh, Maharashtra, Kerala, Odisha and Gujarat where cooperative banks extend finance to farmers during the sowing season, were debarred to take deposits or exchange the demonetized currency. Credit demand became high as sale, marketing, transport, and distribution of ready produce to wholesale centers or *mandis*, is dominantly cash-dependent. The most affected were the marginalized farmers having negligible landholdings. These strata faced problems from sending the yield to the desired places, to buying seeds, tools, fertilizers with a reduction of circulation of cash in the rural areas. Moreover this is the segment of society that is not socially connected and is completely depend on credit system. Thus, they were the worried lot that their 'kharif crop' would perish for want of buyers without any cash in hand.

2) *Automobile*: Automobile industry especially in states of Gujarat, Punjab, Delhi and Northeast region was much affected with the implementation of demonetization. The generally seen slowdown during the months of November and

December in the automobile sales became a lot more prominent as consumers started delaying purchases due to the liquidity crunch and in anticipation that a rate cut may happen in the near future. The impact in this industry has been more witnessed in the rural areas and semi urban areas where most of the transactions took place in cash. The used car segment and two wheeler customers were largely influenced, as only cash transaction are undertaken while buying and selling them. There is also a slump seen in the sales of luxury cars. So, in totality this industry faced a tremendous slowdown because of demonetization.

3) *Real Estate*: The real estate sector since long considered a safe haven for black money showed poor performance with developers reporting 50% drop in sales in the last three months. Genuine buyers are pinning their hopes on property prices falling and interest rates further being reduced post demonetization. Since buying or selling a property in the secondary market is dependent on liquid cash, it is the hardest hit where sales have virtually dried up. Although agents are optimistic, they say in future the property rates will become more affordable and more customers will be seen in the market as demonetization, along with the new Real Estate Regulatory Act and the Benami Properties Act, would help in eradicating the practice of parking black money in real estate to a great extent and improve the industry's image. The real estate market in long term may see decrease in speculative buying and selling, an increase in transparency, payments through banking systems and price corrections will lead to genuine buyers entering the market. The market will witness an expansion in demand of affordable real estate driving growth in the sector.

4) *Aviation*: According to Economic times, Indian carriers have reported a drop of 7-10% in overall sales after the announcement of Nov 2016. The domestic sector is more impacted as compared to the international sector, due to the previous planning and payments. But the aviation industry showed an immediate surge in the domestic flyers where there were 95.5 lakh domestic flyers, during the month of December 2016. The main reason being the old currency notes could be used to buy airline tickets. According to Domestic Air Traffic Report Jan 2017 around 22.45% passenger growth was recorded by the domestic airlines. Thereby, we can conclude that the demonetization had a minimal effect on the aviation sector.

5) *Travel and Hospitality Industry*: Travel and Hospitality industry faced a tough time since most of the pay-in-cash-only clientele either changed their travel destinations from International to domestic tourism or cancelled their bookings altogether. Most of the hotels showed a drop of 60% in hotel bookings. The wealthy and luxury travelers trimmed their budgets due to cash crunch. Weddings were called off or post phoned, sometimes destinations were changed so leisure segments like hotel banquets and high-end restaurants felt the

pinch on cancellations. Consumers often shifted preferences from fine dining restaurants to fast food eateries. Associated Chambers of Commerce & Industry of India [ASSOCHAM] has reported a 65 percent drop in Christmas and New Year vacation bookings in 2016. International tourism also dropped by 45%. Hence the travel and tourism industry was adversely affected by this initiative.

6) *Banks*: The banking industry benefitted with a surge in deposits allowing banks to lower the cost of funds and better margins. There is no need to borrow funds at high costs as the non-interest income for banks increased due to deposits. Increased focus on cashless transactions, benefitted payment banks and digital wallets in terms of value and volumes. However, NBFC including gold financing companies and micro-financing companies that make disbursements and collections in cash witnessed a negative impact on their business. The fall in property prices may lead to longer period to liquidate properties thus adding to the vows of NBFC lending against property. So, in totality although the banking system became plush with money the financial services sector was at a loss of consumers.

7) *Consumer Durables*: The market for white/brown goods operates 70-80% on cash, thereby affecting volumes due to cash shortage after demonetization. Consumer durables – White Goods, FMCG, etc. had a near-term negative outlook as consumers' cutback on discretionary spending. Significant number of sales that happened through cash in these sectors had a negative impact. The traditional trade wholesalers and *kirana* stores in the unorganized sector suffered losses and had to opt for cashless transactions through digital wallets or card swipe. However, in the organized sector customers shopped where cashless transactions could be made and purchased daily needs and essential products. Demonetization has pushed both companies and customers to the Digital India regime of switching to Cashless platforms. As the demand improves the effect of demonetization will become neutral. Makers of durable goods are also in the process of launching new schemes to tempt consumers to go cashless. Some of them are giving offers and promotions such as waiver of processing fees and installment schemes with delayed start of payments on buying of consumer durable products.

8) *Healthcare*: In the healthcare sector, the worst hit is the medical tourism industry, since patients had come from outside India and were unable to get their treatment done due to financial cash crunch. Even the pharmaceutical industry had been affected due to the transactions which are done on the basis of cash.

## II. CONCLUSION

The cash crunch driven by demonetization could result in the 2016-17 GDP growth rate slowing down for a quarter or two but large scale formalization of the informal economy will ensure a higher GDP growth above 7.1 % as estimated in

the coming fiscal year. The banking system is flooded with cash due to the inflow of money into bank accounts that could reduce interest rates and have a stimulating effect on different sectors giving the much needed impetus for economic growth.

On the whole, the maximum affected segment of the society was the middle class and the rural areas of India. But surprisingly, they welcomed the move with open hands as compared to the affluent. Moreover, there has been an immediate slump in growth rate among the various sectors, but in the long term, demonetization will bear fruitful benefits in context to the growth of the Indian economy. To sum up, this move will lead to sustained economic growth, improved tax compliance, better fiscal balance, lower inflation, control corruption and assist in elimination of fake currency.

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