

DEMONETIZATION

DEMONETIZATION OF HIGHER CURRENCY NOTES IN INDIA

In a surprise television address to the nation on November 8 Prime Minister Narendra Modi declared that 500 and 1000 rupee notes will cease to be legal tender from midnight. This means that the government has to bring all 500 and 1000 rupee notes out of circulation. On November 8 these denominations made 86 % of Indian currency in circulation.

The government came up with the following justifications for this move:-

1. Disrupting proliferation of counterfeit notes
2. Making cash hoarded from undeclared sources of income (black money) worthless.
3. Disrupting drug trade or terrorism activities which are mainly funded by black money.
4. Encouraging cashless transactions.

DEMONETIZATION IN THE PAST

1946

According to RBI'S history volume:

"Sir Chintaman Deshmukh (governor) felt that we may not get even as much as Rs. 10 crores as additional tax revenue from tax evasion and that the contemplated measure, if designed to achieve such a purpose, has no precedent or parallel anywhere. If value is going to be paid for value (no matter whether such value is in lower denomination notes), it is not going to obliterate black markets. His advice is that we should think very seriously if for the object in view (to be deduced from the declaration form) whether this is an opportune time to proceed with the scheme. Provided Government are satisfied on the points of

- (i) sparing harassment to the unoffending holders and
- (ii) A worthwhile minimum of results in the shape of extra tax revenue, he does not wish to express any objection to the scheme as drafted, if Government wish to proceed with it, the only being the administrative difficulties involved."

1978

In January 1978 an ordinance passed by the Janta Party coalition scrapped the 1000, 500 and 100 rupee notes.

One thing which is important to note is that the then governor of RBI IG Patil was very critical of the move. Here is what he said –

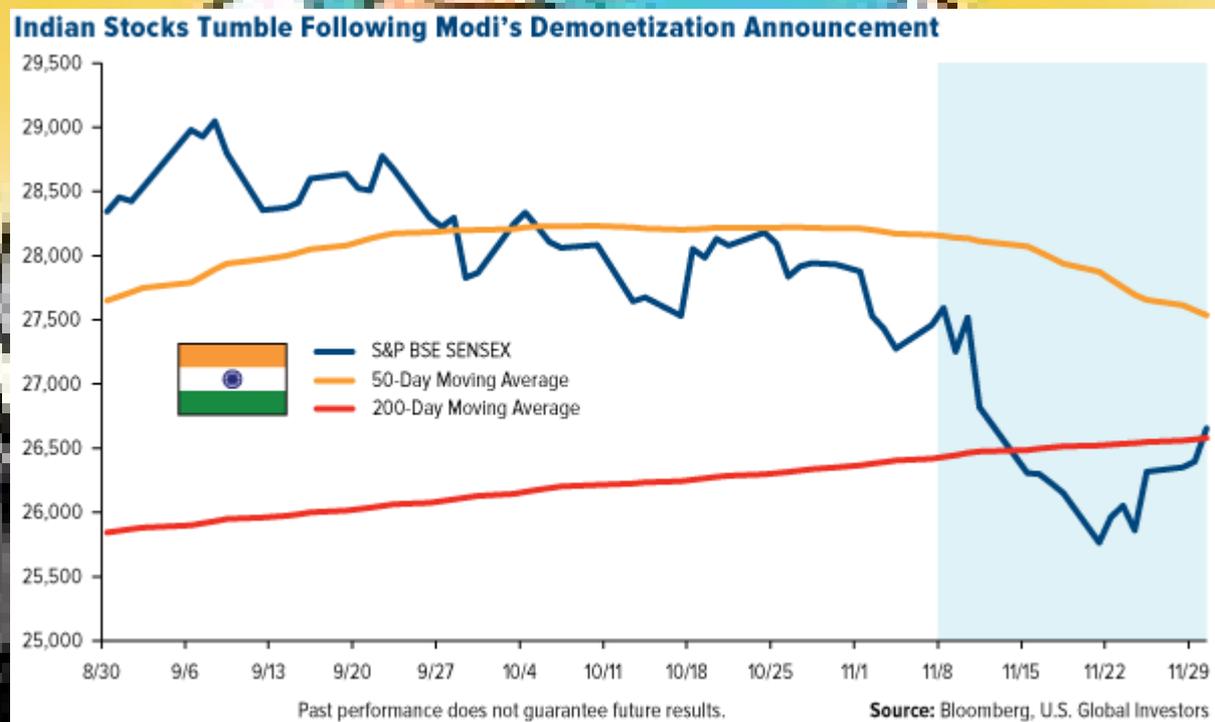
"Such an exercise seldom produces striking results. Most people who accept illegal gratification or are otherwise the recipients of black money do not keep their ill-gotten earnings in the form of currency for long. The idea that black money or wealth is held in the form of notes tucked away in suit cases or pillow cases is naïve. And in any case, even those who are caught napping— or

waiting—will have the chance to convert the notes through paid agents as some provision has to be made to convert at par notes tendered in small amounts for which explanations cannot be reasonably sought. But the gesture had to be made, and produced much work and little gain.”

AFFECTS OF THE DEMONETIZATION DRIVE

INDIAN STOCK MARKET

Indian stock market has been affected to some extent by the demonetization drive. The day after the demonetisation move was announced the BSE Sensex opened with a massive loss of 1,300 points, but recovered later. It rallied on 10 November and reported net gains for these two days of trading, only to tank 700 points the next day. Indian stocks plunged below their 200-day moving average.



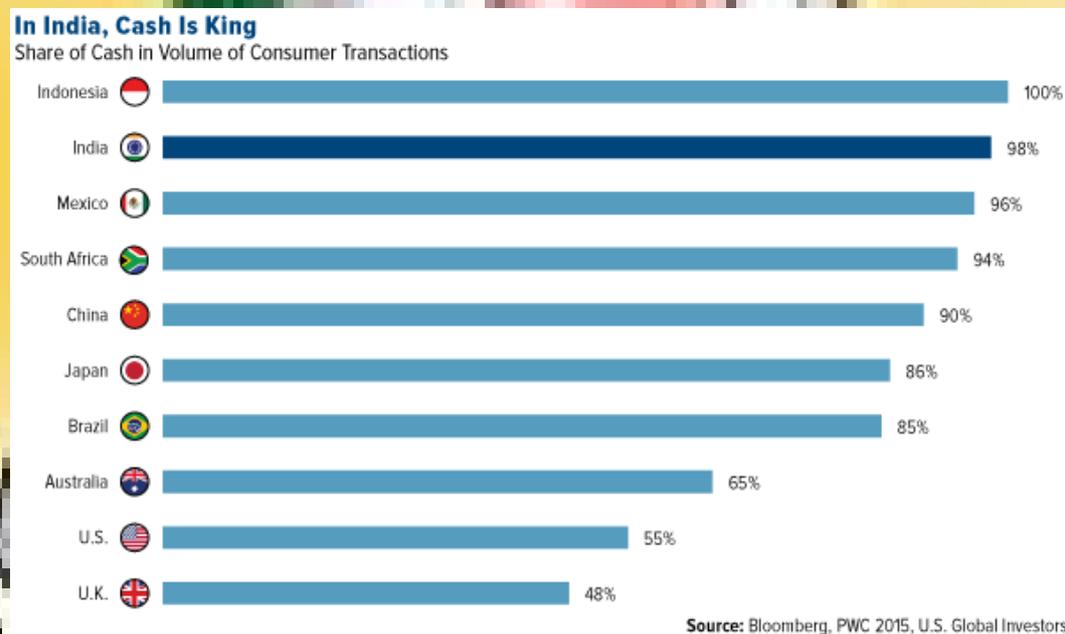
IMPACT ON THE INDIAN ECONOMY

The government followed up its decision to discontinue older high-denomination notes with a strong push towards fostering a digital payments ecosystem. A committee of secretaries led by Niti Aayog CEO Amitabh Kant was instructed to come up with the tools that could be used to make financial transactions without the involvement of cash. While most of these tools

were already rolled out previously, banks and other financial services firms have started prioritising their expansion.

Because India's economy relies predominantly on cash, the effects of demonetization are big. ATMs are scarce, and few rural Indians have a credit or debit card. An estimated 600 million Indians nearly half the country's population are without a bank account.

The following graph indicates the size of cash economy in India.



Due to the sudden increase in cashless transactions companies which deal in mobile wallets have shown an enormous increase in their customer base. Paytm a leading mobile wallet company is expected to process more transactions than the combined average daily usage of credit and debit cards

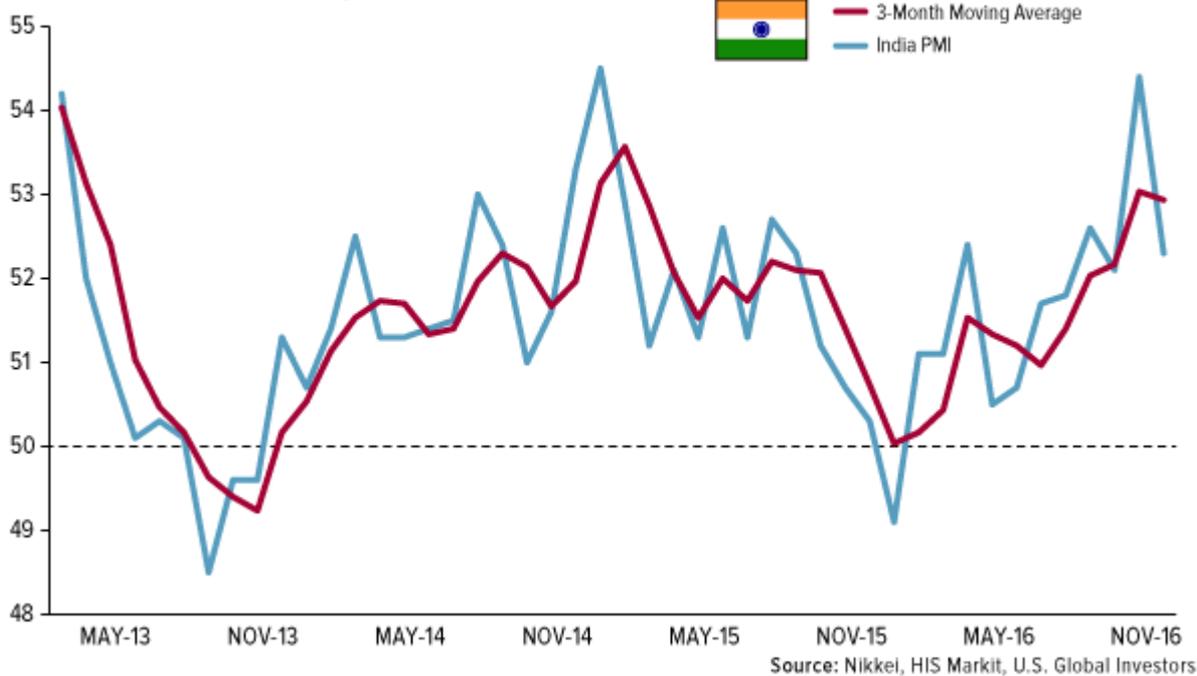
Mobile wallet companies including Paytm have seen manifold growth in transactions and new users coming on board as people turning to digital platforms as serpentine queues are seen outside ATM's. Within 10 days of the announcement of the demonetization drive Paytm processed 7 million mobile wallet transactions worth Rs 120 crore a day.

MANUFACTURING SECTOR

Demonetization has also weighed heavily on the country's manufacturing sector. The Nikkei India Manufacturing PMI fell to 52.3 in November from October's 54.4. Although still in expansion mode, manufacturing production growth slowed, possibly signalling further erosion in the coming months.

Indian Manufacturing Cools in November

India Nikkei Market Manufacturing PMI



WHAT IS AHEAD?

According to latest estimates it may take up to 6 months to replace all the demonetized currency notes based on capacities of currency printing presses. There is a likely surge in cashless transactions. Overall, Whether the policy of the government aimed at removing black money from the economy bears any results will be known only in the future. The benefits

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