International Journal of Interdisciplinary and Multidisciplinary Studies (IJIMS), 2017, Vol 4, No.3,284-295. 284

Available online at http://www.ijims.com
ISSN - (Print): 2519 – 7908 ; ISSN - (Electronic): 2348 – 0343
IF:4.335; Index Copernicus (IC) Value: 60.59; UGC Recognized -UGC Journal No.: 47192. 1st July

An impression of demonetization on Indian economic slowdown

Surajit Ghosal
Assistant Professor
Department of Economics, College of Business and Economics ,Assosa University, Ethiopia

Abstract

One day the government of a large and fast-growing economy became convinced that curbing shadow economy of millionaires hoarding piles of illicit cash by withdrawing 86 percent by value of the cash in circulation in India remained highly under criticism. A broad cash crunch and broken supply chains threatened a sharp economic slowdown – a potential loss of economic activity and a drag on broader Indian economic growth as anticipated by us. But, the reality revealed that economy grew not below 7 percent in 2016-17 negating all our negative speculations and even the economy performed sound based on macroeconomic parameters, especially inflation. Some critics argued that GDP estimation may be misleading due to negative growth impact in informal sectors and hard to obtain true cost of demonetization. It is obvious that Demonetization brought about a surgical strike on informal sector and succeeded to control it to a greater extent. This paper attempts to clarify that even though the short term effects of demonetization was painful for the common mass of the society, but it did not cause Indian economic slowdown at all and further expanded public spending which is expected providing enhanced welfare to the society paving the way of 'cashless economy'.

Keywords: Black economy, Currency Shock, Demonetization, GDP, GVA, Inflation.

1. Introduction

On November 8, 2016, our honorable Prime Minister Mr. Narendra Modi had announced the demonetization of ₹ 500 and ₹1000 notes as no longer a legal tender with a view to curb black money, corruption in the informal sector and to fight against terrorism. Such notes called specified bank notes - SBNs, valued at ₹ 15.4 trillion, constituted 86.9 per cent of the value of total currency in circulation. It had also decided that December 31 as the deadline to exchange and deposit the defunct notes which caused common people scurrying outside banks and ATMs and also hit business operations and very common day to day transactions across the nation. It was forecasted to have a detrimental effect on the country's gross domestic product (GDP) in the fiscal year 2017, owing to reduced consumption amidst an environment of liquidity crunch by the individuals and agencies. Unlike previous demonetization, which was implemented with hint to the people, but the current one was 'bolt from the blue'. Like other monetary reforms designed to boost confidence in the currency, Mr. Modi's motivation was different. The primary aim of demonetization was reasonable enough intending to improve the functioning of the economy and boost its tax collection by demolishing the shadow economy. The vast majority of transactions in India take place in cash by escaping book-keeping practices. Economists estimate that India's black economy accounts for at least 20 percent of GDP. Such off-the-records activities evade taxes and allow corruption to flourish. Consequently, we expect a strong 'formalization effect' to play out as nearly half of the non-tax paying businesses in the informal sector (40 percent share in GDP) will become unviable and cede market share to their organized sector counterparts. Since ever the government announced its decision to demonetize high denominations currencies, there have been speculations regarding the move negatively impacting India’s output growth and other economic indicators affected severe short term effects over everyday life style of the entire nation. Due to cash crunch, existing level of transactions dropped immediately in the domestic market in anticipation of output growth to fall drastically in 2016-17 and thereafter. As a general perception, nation focused the short term effect of demonetization which was manifested in common men’s plight. It is commonly assumed that black money is often stashed in the form of real estate, gold, stocks and other offshore instruments, rather than in cash. But, the demonetization operation proved the possibility of holding black money in liquidation in lump sum beyond the general estimation. It can’t be ruled out that some illegal transactions (bribes, commissions etc.) and militant activities heavily depend on cash transactions. Even the people involved in unorganized sector will find other options to store their wealth. Obviously, cashless transactions which were sounded again and again after demonetization must provide the customers number of incentives. To coin the short term negative impact, firstly, the withdrawal of new notes ₹500 and ₹2000 with limit from banks and ATM imposed had left consumers cashless needed to complete day to day purchases. Secondly, the farmers had been halted without funds to buy seeds and fertilizers. Thirdly, disrupted supply chains of new currencies and time spent in queuing in banks and ATMs had meant lost hours of productive work rising consumers unrest followed by unnatural and untimely deaths of many people. There had been uncertainties over the impact of this move on the banking sectors. While some banks had reported large accumulations of deposits since demonetization began, a surge in low interest rate funding might had encouraged credit growth and support the economy.

2. Forecasts and GDP Figure

Earlier in February, 2017, the Reserve Bank of India (RBI) had lowered Real GDP or GDP growth forecast for the fiscal year 2016-17 to 6.9 percent, but furthermore projected a rebound in the next fiscal year at 7.4 percent. The International Monetary Fund (IMF) too in its annual report on India had forecast that the GDP growth would be slow to 6.6 percent in 2016-17 due to *temporary disruptions* caused by demonetization. It, however, had mentioned that demonetization would have only short-term impact on the economy, which would bounce back to its expected growth of more than 8 percent in the next years to come.India Ratings also lowered its GDP forecast for 2016-17 to 6.8 percent from 7.8 percent earlier, stating that the demonetization drive will lead to an erosion of ₹ 1.5 trillion this fiscal. This constituted a mere 12 percent of the black economy, leaving 88 percent of black money to remain in the system. Global experience has shown that the impact of such measures had been fairly short-lived as it does not attack or plug the mechanism that gives rise to black income. Soon after, the government estimated and announced a drop of GDP from last fiscal. These statistics were the “First Advance Estimates of National Income, 2016-17” based on sectoral data until October, 2016. No statistics on the effect of banning of old high denominations currencies were released.

Some highlights of the report are as follows-

- Agriculture sector reports a growth of 4.1 percent against previous year's 1.2 percent. Livestock products, forestry and fisheries, which comprise 39 percent of Gross Value Added (GVA) showed a combined growth of 3.7 percent.
- Mining and Quarrying sector reports a decline by 1.8 percent by as compared to growth of 7.4 percent in 2015-16. Production of coal went up 1.6 percent, production of crude oil went down by 3.5 percent and production of natural gas went down by 3.7 percent.
- Manufacturing sector reports a decline of 1.9 percent, which will now grow by 7.4 percent as compared to 9.3 percent in the previous year. Index of Industrial production (IIP) manufacturing registered growth rates of (-)1.0 during April-October, 2016-17 s compared to 5.1 percent during April-October,2015-16.The Wholesale Price Index(WPI), in respect of the manufactured products registered a growth of 2.0 percent during April-November, 2015-16.
- Electricity, gas, water supply and other utilities services sector is expected to grow by 6.5 percent as compared to 6.6 percent in the previous year. IIP of electricity registered a decline of 0.6 percent.
- Construction sector is expected to fall by 1 percent and will now grow by 2.9 percent as compared to previous year's 3.9 percent. Production of cement has seen a growth rate of 4.3 percent and consumption of finished steel has seen a growth rate of 3 percent.
- Trade, hotels & transport and communication & services related to broadcasting services have grown at 6 percent this year as against 9 percent in the previous year. Passengers handled by civil aviation increased to 19.6 percent as compared to 16.5 percent in the previous year. Sales of commercial vehicles fell to 4.7 percent as compared to 8.1 percent in the previous year.
- Financial, insurance, real estate and professional services sector has grown at 9 percent as compared to 10.3 percent in the previous year. Bank deposits have shrunk to 9.8 percent as compared to previous year's 10.5 percent, whereas bank credits have risen to 9.1 percent as compared to previous year's 8.8 percent.
- Public administration, defence and other services sector is expected to grow by 12.8 percent as compared to 6.6 percent in the previous year. The government expenditure net of interest payments and subsidies grew by 25.3 percent.

Table 1: GDP Growth Projections in FY 2016-17 Year on year (in percentage)

Forecasting Agency	Pre-Demonetization	Post-Demonetization
Ambit Capital	6.8	**3.8**
Reserve Bank of India	7.6	**6.9**
Fitch Ratings	7.4	**6.9**
Morgan Stanley	7.7	**7.3**
Care ratings	7.8	**7.6**
ICRA Ratings	7.9	**7.5**
ADB	7.4	**7.0**

Source: Mint Research

In its statement, CSO expressed Real GDP at constant prices (2011-12) in 2016-17 is likely to attain a level of ₹ 121.65 lakh crore, as against the first revised estimate of GDP for 2015-16 of ₹ 113.58 lakh crore, released in January 2017. According to CSO, the growth in GDP during 2016-17 was estimated at 7.1 percent as compared to the growth rate of 7.9 percent in 2015-16. Real GVA was anticipated to increase from ₹ 104.70 lakh crore in 2015-16 to ₹ 111.68 lakh crore in 2016-17. The 'agriculture, forestry and fishing' sector is likely to show 4.4 percent growth in its GVA during 2016-17, as against the previous year's growth of 0.8 percent. The second advance estimates of National Income, 2016-17 revealed that the growth in the GVA from 'manufacturing' sector is estimated to be 7.7 percent compared to 10.6 percent in 2015-16.

The existence of a large informal sector in the economy has been one of the most important factors in this dominance of a cash based economy. Nearly 45 percent of GVA in the economy (average value of 2011-15) was generated in the informal sector. The informal sector's growth has been mostly cash centric and its sustenance has been dependent on prevalence of cash transactions so far. Notwithstanding an overall lower (negative) rate of growth of savings and capital formation, this sector nonetheless contributed to around 40 percent of capital formation and two-thirds of investible funds (Table 2).

The per capita net national income (current price) during 2016-17 is estimated to be ₹ 1, 03,818 showing a rise of 10.2 percent compared to ₹ 94,178 during 2015-16 with the growth rate of 8.9 percent. Private Final Consumption Expenditure (PFCE) at current prices is estimated at ₹ 88.40 lakh crore in 2016-17 as against ₹ 79.00 lakh crore in 2015-16. At constant (2011-12) prices, the PFCE is estimated at ₹ 68.26 lakh crore in 2016-17 as against ₹ 63.66 lakh crore in 2015-16.

In terms of GDP, the rates of PFCE at current and constant prices during 2016-17 are estimated at 58 percent and 56.1 percent, respectively, as against the corresponding rates of 57.8 percent and 56.1 percent, respectively in 2015-16.

Table 2: Gross Value Added, Savings and Capital Formation (Average for 2011-15)

(in %)

	Gross value added	Gross savings	Gross capital formation
Formal or organized sectors			
Public non-financial corps	4.99	-1.32	3.06
Private non-financial corps	10.71	18.26	11.36
Public financial corps	6.26	-0.52	13.84
Private financial corps	9.56	13.26	0.91
Core government	9.55	-4.48	14.25
Informal sector			
Household sector	8.62	3.61	-0.18
Overall economy	9.07	7.99	6.13
Share of informal sector	45.41	63.96	39.43

Source: Reserve Bank of India, Ministry of Statistics and Program Implementation

The data further revealed that Gross Fixed Capital Formation (GFCF) at current prices is estimated at ₹ 40.97 lakh crore in 2016-17 as against ₹ 39.89 lakh crore in the last fiscal. At constant prices, the GFCF is estimated at ₹ 35.55 lakh crore in 2016-17 as against ₹ 35.35 lakh crore year-on-year. According to CSO, in terms of GDP, the rates of GFCF at current and constant (2011-12) prices during 2016-17 are estimated at 26.9 percent and 29.2 percent, respectively, as against the corresponding rates of 29.2 percent and 31.1 percent, respectively in 2015-16. The GFCF is expected to register growth rate of 2.7 percent at current prices and 0.6 percent at constant prices.

3. Formal and Informal Sectors under Demonetization

The unorganized sector accounts for about 45 per cent of GVA and 82 per cent of total employment (RBI, 2017). India's cash-run informal sector of the economy in which the removal of almost 86 percent of currency in circulation was reflected the most pain. Reinjection of liquidity into the system had been slow hurting both formal and informal sectors as shown in Table 3. According to Bloomberg Intelligence Economics (BIE) the shortcomings in GDP estimation methodology would prevent the full economic cost and even it is larger social costs from being fully reflected in GDP. Hence, partially, it also reflected some positive effects of demonetization on growth.

The ratio of currency to GDP in India, which averaged 8.4 percent during 1975-2000, crossed 10 percent for the first time in 2002-03 and has remained above this level since then. This ratio has averaged 10.8 percent in the last decade. There has not only been a relatively sharp increase in the ratio of currency to GDP during 2015-16 (Table 3) but a reversal of the negative trend witnessed in the previous three years. The increase in this ratio could have persisted through the current year as well before the demonetization of higher.

Table 3: The Currency Shock

The ratio of key monetary variables relative to GDP at current prices

(in %)

	Currency/GDP)	M3/GDP	Money multi-plier
2011-12	11.09	79.77	5.05
2012-13	10.91	79.48	5.4
2013-14	10.6	79.68	5.64
2014-15	10.56	80.49	5.73
2015-16	10.86	81.98	5.66

Source: Reserve Bank of India, Ministry of Statistics and Program Implementation

BIE also estimated that the share of the informal sector (excluding agriculture) in GDP is slightly less than 10 percent, based on data from the National Sample Survey Office's 2010-11 non-agricultural enterprise survey. The informal sector accounts for around a 14.5 percent share of overall manufacturing, and a 13.5 percent share of services (excluding construction and public services). In construction, the informal sector along similar lines is assumed to have around a 14 percent share. The remaining sectors of mining, electricity and public services are expected to be entirely within the organized sector. The enterprise surveys that estimate the GDP of the informal sector (excluding agriculture) are conducted only once every four to five years. In the interim, growth of these sectors is assumed to be the same rate as the formal sector. It is also difficult collect data from informal sector in short run. Hence, it is implied that the final GDP figures would merely capture the impact of demonetization on the organized sector of the economy.

As BIE has noted that agricultural component of the informal sector will not be affected by demonetization due to certain facts. *Firstly*, India's GDP is based on production-side data. So a bumper autumn *Kharif* crop harvest of 8.8 percent growth and a good winter *Rabi* crop sowing growth of 5.9 percent would add on directly into the GDP numbers. It does not matter for agricultural GDP whether a lack of currency notes led to a decline in sales of farm produce or waste of perishable food. There is anecdotage evidence of trucks being halted due to non-payment of cash wages to drivers and agricultural sales suffering due to a lack of currency for business transactions. If so, this adds to the case that the true cost of demonetization is unlikely to be fully reflected in the GDP data as pointed by BIE (Gupta, 2017).

The employment status in India shows a disproportionately higher share of workers in the informal sector relative to its contribution to GDP. The NSSO's latest 2015-16 unemployment survey shows that around 46 percent of employment is in the agricultural sector. The NSSO's 2010-11 non-agricultural enterprise survey shows another 25 percent employed in the informal sectors of manufacturing, trade and services.

Even if one ignores the direct economic cost on the informal sectors due to a lack of hard evidence, demonetization has imposed huge opportunity costs in terms of harassment of common men in short run. The long queues of people waiting outside the banks to exchange and deposit notes meant fewer people are working.

The impact of demonetization on the formal economy that got captured in GDP data has not so been deteriorating, as pronounced as it had been earlier and immediate positive impacts were on the informal sector. A number of forces are likely to counteract the successive impact in the second half of the current fiscal year. These include lower lending rates on ballooning deposit growth, a transfer of private 'black' money from high to low income households, booking of advance sales immediately post the demonetization announcement and a likely higher declaration of income that results in a surge in the government's revenue collection.

The immediate impact of demonetization on the informal sector has been strong. But the medium to long-run impact depends on how the government decides to spend the additional fiscal resources it accumulates. Productive capital expenditure aimed at improving livelihoods of the rural poor such as rural roads, rural electrification and skill development for rural unemployed, greater credit availability for meeting the financial needs of the less banked remote places would definitely go a long way in mitigating the impact on those hurt most.

According to the World Bank, India's shadow economy accounted for 23 percent of GDP in 2007. Using this ratio as the benchmark, the value of unaccounted money would amount to nearly USD 450 billion. While not all of it will be ploughed back into the formal economy, it will still be significant to help bridge the government's projected USD1-1.5 trillion spending on infrastructure.

4. Effects on the Economy

According to the statistics, demonetization hardly drags the economic momentum. The construction sector and some of the labor-intensive manufacturing sectors such as textiles, leather, gems and jewellery and the transportation sector engage casual/migrant laborers extensively. The loss of wage income for workers is also expected to have caused a drag on consumption demand. The wealth effect is another channel through which demonetization could have impacted economic activity. However, the precise estimate of currency that returned to the banking system is not yet available as the reconciliation process is still on. Hence, the adverse wealth effect on account of SBNs not returning to the banking system could be assessed only after the reconciliation exercise is complete (RBI, 2017).

India's GDP growth slowed only marginally to 7 percent (year on year) in Q4 from 7.4 percent in Q3 negating expectations around 6 percent. Private Consumption, fixed investment and industrial output growth all accelerated in Q4, with only the services sector witnessed a slowdown. On the expenditure side, the better than expected real GDP reading in Q4 was driven by all components of domestic demand including private consumption, government spending and fixed investment, leading to a sharp jump in domestic demand rise (8.4 percent year on year vs. 205 percent year on year in Q3). Particularly, robust private consumption growth in Q4 came as a big surprise, especially given other consumption indicators including sales volume of major consumer companies declined sharply in the Q4 as highlighted in demonetization impacts. Net exports contributed negatively to GDP growth after positive contribution for the prior two consecutive quarters.

Some economists noticed the growth in alternate channels e.g. e-commerce during the demonetization. According to Madan Sabnavis, chief economist of Care Ratings, "It is a positive surprise. Demonetization did impact construction, real estate and trade sectors". Since the CSO now collate data from profit and loss accounts of companies, many of the SME and informal sector is left out. Some of the alternate channels line e-commerce has seen a spurt during demonetization, which has offset the fall in output in sectors like trade. What has also driven the GDP growth is agriculture sector that grew 6 percent during October-December as compared with a 2.2 percent fall in the same quarter of last year and 3.8 percent in July-September. Manufacturing output slowed to 8.3 percent from 12.8 percent in the same period last year. During Quarter 3, mining was up 7.5 percent, electricity 6.8 percent and construction 2.7 percent. Among the services sector, the trade, hotels, transport and communication was up 7.2 percent while financial sector grew 3.1 percent and public services 11.9 percent. Industry body FICCI said the consumption activity was gradually picked up and the effect of demonetization were expected to wane off by June 2017. According to Didar Singh, Secretary General of FICCI, "It is extremely critical to push the domestic cape cycle which has been persistently weak. We are hopeful that going ahead the planned increase in public expenditure, will crowd in private investments. We also look forward to a further reduction in lending rates by the banks. This will help boost consumption and prop-up investments through low-cost finance".

Table 4: Quarterly GVA and GDP

	Dec-16	Sep-16	Jun-16	Mar-16	Dec-15
% chg yoy					
Gross Value Added	**6.6**	6.7	6.9	7.4	7.0
Agriculture	**6.0**	3.8	1.9	2.3	-2.2
Industry	**6.6**	5.1	6.1	7.9	9.5
Services	**6.8**	8.2	8.8	8.7	9.4
Net Indirect Taxes	**11.6**	16.4	11.4	12.5	6.7
Gross Domestic Production	**7.0**	7.4	7.2	7.9	6.9
Private Consumption	**10.1**	5.1	6.8	8.3	6.8
Government Consumption	**19.9**	15.2	15.5	2.9	3.7
Fixed Investment	**3.5**	-5.3	-2.2	-1.9	3.2
Exports	**3.4**	-0.9	2.1	-1.9	-9.0
Imports	**4.5**	-7.4	-2.7	-1.6	-10.2
Domestic demand	**8.4**	2.5	4.8	4.0	5.5
% chg qoq, sa, annualized					
Gross Value Added	**1.0**	7.7	9.6	8.8	0.0
Gross Domestic Product	**0.6**	8.3	7.1	12.9	0.8

*Gross Domestic Product$_{market\ prices}$= Gross Value Added$_{basic\ prices}$ + net indirect taxes

Source: Reserve Bank of India, Ministry of Statistics and Program Implementation

If the government would have allowed exchanging defunct notes for new ones for indefinite period, it would not be clear when the RBI might recognize its cancelled liabilities on balance sheet. Of the ₹ 14 trillion ($207 billion) invalidated by demonetization, an estimated approximately ₹8.5 trillion had been deposited by the 1st week of December 2016. According to the analysis by Credit Suisse, a bank, another ₹3 trillion could remain un-exchanged by that time.

Theoretically, money is considered a liability of the central bank of a nation means a debt and the debt is reflected on balance sheet and is offset, on the asset side, by holdings of securities like government bonds. The old and un-exchanged notes, if they are recognized as cancelled liabilities, would therefore create a huge positive asset position on the central bank's balance sheet. Under such circumstances, the RBI had chosen rightly to create new currency liabilities by printing new notes and transfer that money to the government for spending. The economists expect the money will be recycled back into the economy through a fiscal expansion which might help relieving some of the pain caused by demonetization.

Table 5: GDP and Per Capita Income Growth

	LAST 3 YEARS OF UPA			**3 YEARS OF NDA**		
FYs	2011-12	2012-13	2013-14	2014-15	2015-16	**2016-17**
India's GDP Growth (%)	-----	5.5	6.5	7.2	7.9	**7.1**
Per Capita Income Growth rate at current prices (%)	-----	12.5	11.5	9.3	8.6	**10.1**
Global GDP Growth (%)	3.5	3.4	3.5	3.4	3.1	**3.5**

Source: Reserve Bank of India, Ministry of Statistics and Program Implementation

The inflow of money into bank accounts would reduce interest rates and that had a stimulatory effect upon economic growth. The government were reducing the budget deficit as some of that black money gets taxed, which would reduce inflation causing beneficial result. But there's yet one more thing we need to consider and that's the effect upon the money supply, which is surprisingly difficult to judge. The velocity of money is the ratio between GDP and money in circulation which RBI estimates to be around 1.3 for India. However, in economics by 'money', we mean a part of cash in circulation called high powered money or M_0 and the other part is broad money, also known as M_3 where we include bank deposits, post office savings and other bits and pieces of financial savings. M3 and M0 in India are linked by a factor of 6—so roughly speaking, R1 of cash in circulation, ultimately adds up to R6 worth of broad money. So, if velocity of money calculated using broad money is 1.3, then it equates to six-times the amount, or 7.8 with respect to cash in circulation. So we now have a measure of how quickly transactional cash changes hands in the legitimate Indian economy (Tim, 2016).

Judging by macroeconomic parameters, especially inflation controlling, the record of the BJP-led NDA government during its 3 years in power has been impressive (Table 5). In 2012-13, 9.9 percent Consumer Price index (CPI) has been fallen to 4.5 percent in 2016-17(2011-12 Base). Wholesale Price Index (WPI) was 5.2 percent in 2013-14and further falls to 1.8 percent in 2016-17(2011-12 Bases). Falling trend in inflation allowed reducing rate of interest by cutting repo rate 8.5 percent in January, 2012 to 6.25 percent in January, 2017. Generally, the anticipated aftermath of demonetization was rising inflation rate which has been controlled judiciously.

According to Table 5, despite demonetization, GDP growth didn't fall below 7 percent and per capita income growth regained double digit figure. India's retail inflation softened for the fourth consecutive months to 3.63 percent in November, 2017 from 4.2 percent a month ago, as a squeeze in cash availability impacted prices of perishable commodities. Food inflation declined from 3.7 per cent (year-on-year, y-o-y) in October 2016 to 2.6 per cent in November, to 2.0 per cent in December and further to 1.3 per cent in January 2017. This was mainly on account of vegetables and pulses. Vegetable prices declined by 6.2 per cent on a month-on-month (m-o-m) basis in November 2016 and further by 11.7 per cent in December 2016. The vegetable price decline continued in January 2017 *albeit* at a lower rate of 4.7 per cent. Pulses prices declined by 7.4 per cent between October 2016 and January 2017. The sharp decline in prices of pulses and vegetables was due to a number of factors. The Reserve Bank of India (RBI) on 7 December surprisingly kept its interest rates unchanged holding that crude oil prices may firm up in the coming months which could reverse the gains from softer vegetable prices (RBI, 2017).

Investment demand was also expected to benefit from the improved transmission of the cumulative 175 bps cut in the repo rate to lending rates amidst structural surplus liquidity conditions in the banking system. Many banks reduced their MCLR post-demonetization. The positive revenue impact stemming from better reporting of transactions and tax enforcement/compliance was also expected to create space for higher public investment. Economic activity in the cash-intensive sectors such as retail trade, hotels and restaurants, and transportation, as well as in the unorganized sector, was expected to be rapidly restored. The overall business climate should improve with the medium-term positive effects of demonetization starting to gain traction (RBI, 2017).

As we look into the financial sector, importantly, currency in circulation in terms of number of pieces and value has been steadily rising since early January 2017. Banks furnish data on their major assets and liabilities on a fortnightly basis. As per data available for the reporting Fridays of October 28, 2016 (prior to demonetization) and February 17, 2017 (latest available), aggregate deposits of SCBs increased by ₹ 5,549 billion during the period. Post-demonetization, there has been a surge in the current account and saving account (CASA) deposits of banks. 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 (RBI, 2017). Since February 2017, the Indian rupee has appreciated by 1.8 per cent mainly due to net equity inflows led by the policy announcements made in the Union Budget and the change in the monetary policy stance of the Reserve Bank from accommodative to neutral (Chart 10). Thus, the impact of demonetization on the foreign exchange market appeared to have been transitory (RBI, 2017).

What we estimated, it was undeniable that an unprecedented economic seizure materialized during Q3 of Fiscal year 2017. By tracking 17 indicators, economy’s health derailed 10 of their stream as pointed by some economists. Particularly, RBI data indicated that non-oil bank credit growth in Q3 of Fiscal year 2017 was recorded at a multi-year low 5 percent in nominal terms focusing economic slowdown to an extent. Similarly, Ambit capital research pointed that RBI credit growth was recorded at a multi-year low in Q3 of Fiscal year 2017.

Secondly, it is pointed that CSO was exaggerating growth figure due to its inability to collect data from informal sector in short run and the informal sector was mostly hurt by the demonetization. The rapid growth of manufacturing sector at 8.3 percent might be reflected that only.

Thirdly, some critics pointed that agricultural production and government spending were not expected to have been impacted too much by demonetization and GVA even suggests that growth has fallen marginally after demonetization (as shown in Table 4).

On the other hand, World Bank appeared to acknowledge that the negative impact of demonetization would likely be short term – with the positives resting in liquidity expansion in the banking system, it did warn that the “challenges encountered in phasing out large currency notes and replacing them with new ones may pose risks to the pace of other economic reforms (e.g. Goods and Services Tax, labor, and land reforms)”. India is expected to regain its momentum, with growth rising to 7.6 per cent in Fiscal Year 2018 and strengthening to 7.8 per cent in FY 2019-20, (World Bank, 2017).

Overall, the demonetization has had some negative macroeconomic impact, which however, has been transient as re-monetization has moved at an accelerated pace. More interestingly, demonetization is expected to have a positive impact over the medium to long-term. As the impact of the liquidity shock was assessed to largely dissipate by mid-February, growth was estimated to bounce back in 2017-18. With rapid re-monetization, pent up demand was likely to boost consumption demand. After demonetization, some workers were reported to have received wage payments in advance, but in the form of credit to bank deposits. Since the propensity to consume is high for the working class population, their consumption was expected to increase with the improving access to cash.

Accordingly, consumption demand was expected to get a boost in 2017-18 as compared with the second half of 2016-17 (RBI, 2017).

5. Conclusion

Most agencies had cut down India's GDP by at least 1 percent including the IMF, citing temporary negative consumption shock caused by demonetization. But the agencies also believed that the country would regain its momentum in the coming years and would become a robust economy that is expected to grow 7.5 percent to 8 percent a year. Going by the 6.6 percent growth perception of the IMF, India would still be lacking behind China this year as it is expected to grow by 6.7 percent. Commenting on the impact on demonetization, Economic Affairs Secretary Mr. Shaktikanta Das stated that the government succeeded in maintaining the economy's growth at 7 percent against the negative projection by many individuals and institutions.

The immediate impact of demonetization on the informal sector has been tremendous. But the medium- to long-run impact depends on how the government decides to spend the additional fiscal resources it garners. Productive capital expenditure aimed at improving livelihoods of the poor such as rural roads, rural electrification, skill development for unemployed, greater credit availability for meeting the financial needs of the less banked — would all go a long way in mitigating the impact on those hurt most.

Post demonetization lending rate is expected to come down along with property prices due to liquidity expansion in the banking system, which will help in boosting economic activity. If, at all there is no substantial increase in loans, banks going in losses will have to cut down interest rates drastically, which could also have a negative impact on the economy. Credit rating agency Fitch recently said, "The positive effects were unlikely to be strong and sufficiently enduring to support credit profiles. The positive impact on funding conditions will depend on deposits remaining in banks beyond the next few months". Since the demonetization implemented, ₹. 25000 crore of payments has been done through digital systems. People using digital transactions have grown three-fold, but surprisingly, electronic payment systems like NEFT, RTGS and IMPS have seen a sharp drop in the number of transactions with the addition of evolving other players like 'Paytm'. It is obvious that demonetization caused us to take advance jump towards 'cashless transaction' to 'cashless economy'.

Some of the critics argued that demonetization was to curb the black economy in which lots of illicit funds is held not in cash but invested in property, gold or jewellery. Such heavy measures of withdrawing 86 percent legal tender of payments from the fastest growing economy could undermine the credibility of important government institutions. Fear that such measures might be used again in future could weaken confidence in the currency as a store of value – paving the way for some broader institutional failure, like hyperinflation. Long-run trust in the judgment of the state might be threatened.

Some opined that the demonetization move would pose a risk to Goods and Services Tax (GST) and labor and land reforms. Although the country needs bold reforms to transform its economy, it also needs to tweak the tax slabs, stimulate its fiscal policy and a good budget, which had been attempted in the last budget.

Further, old currency notes that did not get exchanged, due to factors like tax liability or fears over black money revelation, will ultimately be invaluable, costing the economy a net loss of ₹. 5 trillion; however, this will likely reduce the Reserve Bank of India's (RBI) liabilities, allowing for a special dividend payment to the government. Furthermore, over the medium term, the demonetization will also discourage cash hoarding, leading to higher tax compliance and widening of the tax base.

There is no doubt that a lot of persisting uncertainty when the cash economy gets going again although CSO's numbers suggest that the worst is perhaps over. The latest Economic Survey pegged growth in 2017-18 at a more rapid clip of 6.75 percent to 7.5 percent. At the third meeting of the Monetary Policy Committee, the RBI governor noted that re-monetization of the economy has been taking place at an accelerated pace. Economic activity thus was picked up from the latter part of Q4 of 2016-17, although CSO number is a bit lower. Discretionary consumer demand is expected to bounce back. All of this makes for improved growth prospects for 2017-18.

References

1. DNA Web Team (2017). Despite demonetization India's GDP remains robust at 7 for Oct-Dec Quarter. http://www.dnaindia.com/money/report-despite-demonetization-india-s-gdp-remains-robust-at-7-for-oct-dec-quarter-2337965. Accessed on February, 2017.
2. ENS Economic Bureau (2017), Demonetisation effect: IMF cuts India FY17 GDP forecast to 6.6 per cent. http://indianexpress.com/article/business/economy/demonetisation-effect-imf-cuts-india-fy17-gdp-forecast-to-6-6-per-cent-4477529/. Accessed on January, 2017.
3. Gupta Abhishek, (2017), GDP measure blind to demonetization's true cost. Bloomberg Intelligence, January 24, 2017. https://www.bloomberg.com/.../blog/gdp-measure-blind-demonetizations-true-cost/ Accessed on February, 2017.
4. Mishra Asit Ranjan (2017). India GDP growth bucks note ban, logs 7% in December quarter. http://www.livemint.com/Politics/vPKAQv51PpXVUO0lckVm3L/December-quarter-GDP-growth-slows-to-7.html. Accessed on March, 2017.
5. Mohan N Chandra (2017). No demonetisation impact on India's GDP growth? Too good to be true, www.hindustantimes.com/analysis/no-demo-impact-on-growth-too-good-to-fFVnFKzespsMvvPEyZXfFP.html. Accessed on March, 2017.
6. Ray Raj Kumar (2017). India retains fastest-growing major economy tag despite demonetization,http://www.hindustantimes.com/businessnews/indiasgdpgrowthslowsto7inoctoberdecember/storyqDIU0AOhDrLrL5y1ZKKqwL.html. Accessed on March, 2017.
7. Reserve Bank of India (2017), Macroeconomic Impact of Demonetization – A Preliminary Assessment, 10 March, 2017. https://rbidocs.rbi.org.in/.../MID10031760E85BDAFEFD497193995BB1B6DBE602 Accessed on April, 2017.
8. Singhi M.C., Gopalan R. (2016). Demonetisation and its impact on GDP growth, http://www.livemint.com/Opinion/7aViGbD9xu8GJJO65gmDJK/Demonetisation-and-its-impact-on-GDP-growth.html. Accessed on December, 2016.
9. World Bank Report (2017), Demonetization chips away at India's GDP. http://thebricspost.com/world-bank-demonetization-chips-away-at-indias-gdp/#.WSrVwOuGPIU. Accessed on January, 2017.
10. Worstall Tim (2016). Effects Of Demonetisation On India's GDP - Difficult To Calculate, We Don't Even Know The Sign**.** https://www.forbes.com/sites/timworstall/2016/11/19/effects-of-demonetisation-on-indias-gdp-difficult-to-calculate-we-dont-even-know-the-sign/#22e6ceb47969. Accessed on December, 2016.