

# Impact of Demonetization on Indian Banking Sector

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**Abstract:** *Demonetization refers to the process of stripping of currency unit of its status as legal tender. Demonetization was announced on 8<sup>th</sup> November, 2016 by the honorable Prime Minister, Mr. Narendra Modi with the objective to remove black money, corruption, terrorism and counterfeit notes. Demonetization was a massive step taken by the government of India which had an immense effect on the Indian economy especially on the banking sector as banks forms the core sector of Indian economy. The study aims at finding an insight of impact of demonetization on banking sector, the results indicates demonetization had an initial dip in the short run but in the long run demonetization is going to have a positive impact on the Indian economy in the form of reduced corruption, greater digitalization, tax compliance and better formalization of the Indian economy.*

**Keywords:** Demonetization, Banking Sector, Indian currency.

## I. INTRODUCTION

Demonetization refers to stripping of currency from circulation where the old currency is replaced with new currency. The concept of demonetization is not new in modern era as Indian government had demonetized bank notes twice that is in 1946 and 1978 respectively with a motive to combat tax evasion through black money. In 1946, Rs.1000 and Rs.10,000 notes were demonetized where as in the second instance that is in 1978, the government withdrew Rs.10,000, Rs. 5000 and Rs. 1000 notes.

On 8<sup>th</sup> November, 2016 demonetization was announced by the Prime minister Mr. Narendra Modi to strip of Rs.500 and Rs.1000 notes from circulation which forms 86% of the cash currency in the market with the objective to eradicate corruption, black money, terrorism and counterfeit notes and to make India a Cashless economy as it makes the spending convenient and increases the transparency of transactions.

The sudden implementation of demonetization had an impact on the various sectors of Indian economy including banks as banks forms the core sector of Indian economy, banks played a major role to in the implementation of demonetization. The present study aims to showcase the effect of demonetization on bank and its operations.

## II. RESEARCH OBJECTIVE

The objectives of the study are

1. To study the impact of demonetization on Banking Sector.
2. To determine the role played by banks in implementation of demonetization.

## III. REVIEW OF LITERATURE

The study includes a wide range of literature reviews

Shanbhogue Girish, Kumar, A. Prashanth, Bhat, Swathi and Shettigar, Chethan (2016) Demonetisation leads to cash shortages which witness detrimental to a number of small business, agriculture and transportation. The shortage of cash led to chaos and majority of people faced problems to exchange their banknotes due to long queues outside banks and ATMs across the country. In the history of Indian economy, demonetisation proved to be the biggest attack on black money, corruption and a move toward digitalization encouraging digital payments. They concluded that Demonetization is favourable in short, medium and long-term.

Muthulakshmi, E. Kamatchi (2017) stated that the country will not be benefited in short term when the money is withdrawn from the economy, on the other hand, if the currency paves its way into the economy it would have affirmative and meaningful impact. She also stated that demonetisation on one hand, was a serious charge on black money, corruption, counterfeit currency, hawala transaction, and terror financing. On the other hand, it had a negative effect on various sectors like real estate and commodities.

Veerakumar, K. (2017) Announcement of demonetization of 500 and 1000 currency notes is a big shock to Indian citizens. The highest currency notes are withdrawn from the Indian economy to counter the issues of tax evasion, counterfeit currency and financing of terror activities. It is shown that huge amount of money is being deposited into the bank accounts which are more than stipulated limits and are subject to penalties and taxes. There seems to be a tremendous increase in the usage of e-wallets, debit and credit card which will help in creating better cashless infrastructure.

AbhaniDhara K. (2017) Thisdemonetisation is proving to be more prosperous than the previous two. In the changing erapeople are using online banking as a mode of payment. To make demonetization successful bank employees are giving their best, their assistance is also important. Though the demonetisation has failed to grab complete black money in the Indian economy, but it has created fear in the minds of people holding black money. He concluded that demonetisation was a necessary move to tackle the problems of black money, corruption, terrorism etc.

**III. RESEARCH METHODOLOGY**

The present study is descriptive in nature. The study is based on Secondary data and the data has been collected from journals, articles and websites.

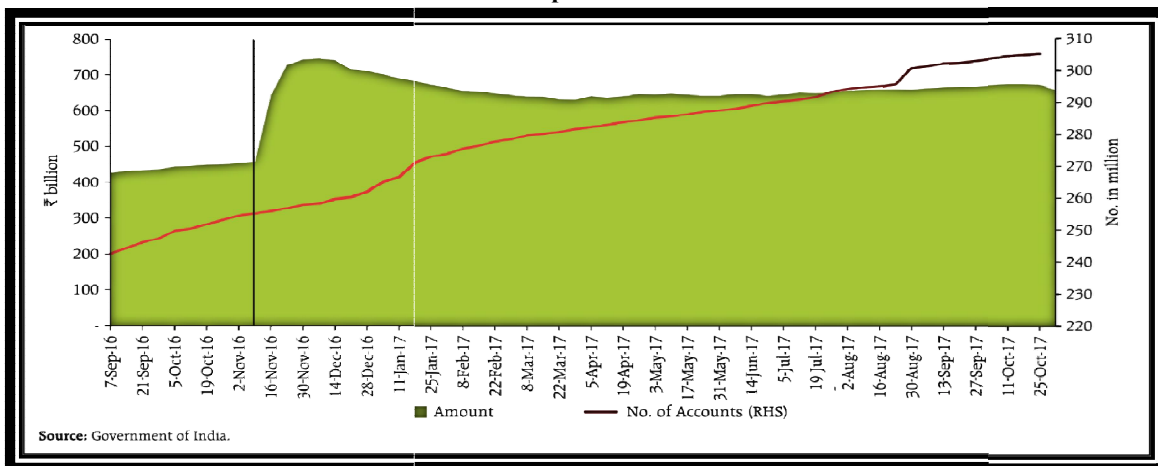
**IV. IMPACT OF DEMONETIZATION ON BANKING SECTOR**

Demonetization has brought enormous changes on the Indian economy especially on the banking sector. Banks are a core part of any economy, demonetization has brought a lot of challenges for the banking sector in short span however in long term banks are sustained to be the real beneficiary of demonetization. The influence of demonetization on banks is depicted as follows

**4.1 Increase in Deposits**

There was a significant increase in deposits as the government of India provided a time frame upto 31<sup>st</sup> December 2016 to deposit the old currency upto Rs. 10lakhs in each person account without a legitimate source of income stated. Banks were flooded with Rs.500 and Rs.1000 notes which helped the banks to increase their deposits that can be utilized to improve their liquidity and profitability.

**CHART 1: Deposits under PMJDY**



The Pradhan Mantri Jan Dhan Yojana was launched in August 2014 for increasing bank penetration, It had come into focus since demonetization was announced. As depicted in the chart-1, Deposits were rising in PMJDY, the total balance peaked up at around 746 billions with an immense rise in number of accounts as well as 50 million new accounts were opened.

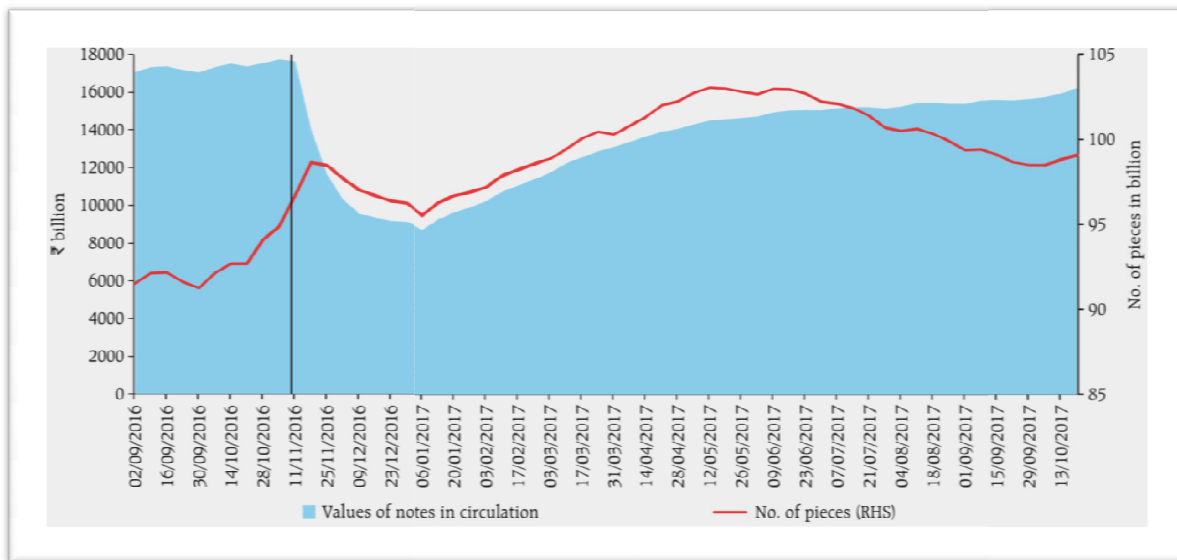
**4.2 Demand for Government Bonds**

As demonetization had an adverse effect on stock market as well, people preferred to invest in government bonds and securities.

**4.3 Currency in Circulation**

Demonetization stripped Rs.500 and Rs.1000 notes from circulation which forms 86% of the cash currency in the market.

**Chart 2: Notes in Circulation in India**



Source: RBI Bulletin November 2017

As observed in the above chart-2, there was a downward shift in currency circulation till 6<sup>th</sup> Jan, 2017, however this situation was overcome gradually. There seems to be an upward shift as new denominations of Rs.2000 bank notes were in circulation and on 25<sup>th</sup> August 2017, Rs.200 bank notes a new denomination was also added to fill the gap in currency circulation that has arisen due to demonetization.

**4.4 Digital Payments**

India is considered to be dependent on cash as majority of the transactions takes place through cash, after demonetization was announced there was lack of currency in circulation which lead to a boom in digital payments.

Month/Year	EFT/NEFT		Immediate Payment Service (IMPS)		Credit/Debit Cards (Usage at ATMs and POS)		Prepaid Payment Instruments (M-wallet, PPI card, paper vouchers)	
	Volume (Million)	Value (billion)	Volume (Million)	Value (billion)	Volume (Million)	Value (billion)	Volume (Million)	Value (billion)
Nov-2016	123.0	8807.9	36.2	324.8	896.1	1823.2	169.3	50.7

Mar-2017	186.7	16294.5	67.4	564.7	1089.4	2952.6	342.1	106.8
Aug-2017	151.6	12500.4	75.7	651.5	1097.8	3072.1	261.1	102.9
Growth rate (%) Mar-2017 over Nov- 2016	51.7	85.0	86.4	73.9	21.6	61.9	102.0	110.4
Aug-2017 over Nov- 2016	23.2	41.9	109.2	100.6	22.5	68.5	54.2	102.7

**Table 1:** Growth in Digital Mode of Payments

(Source: Reserve bank of India)

As depicted in the above Table.1 Electronic Fund Transfer/National Electronic Fund Transfer after demonetization had observed a growth of 186 million users with an increased value of transactions of 16294 billion, earlier usage of debit cards was mainly for withdrawing cash from ATMs but after demonetization there was a surge in debit card payments at Point of Sales, Immediate Payment service, prepaid payment instruments has also observed a substantial growth.

#### V. FINDINGS

1. The study found that Demonetization is a necessary action to be taken to curb black money, fake currency detection, to make India a cashless economy etc.
2. The study also founded that enormous deposits have helped the banks to improve their liquidity position and reduced interest rates.
3. Prolonged cash shortage lead to a significant disruption in Indian economy as in India majority of the transactions are cash dependent.
4. There was a significant positive impact of demonetization on digital payments.
5. Demonetization has created a positive impact on banks in the long run and banks are found to be the real beneficiaries of demonetization.

#### VI. CONCLUSION

Demonetization was a massive step taken by the government of India to curb black money, corruption, counterfeit notes and terrorism .The sudden implementation of demonetization has initially effected the operations of banks but the biggest beneficiaries of demonetization are sustained to be banks, as because of increased deposits banks were able to improve their liquidity position, reduced the interest rate on lending and increase in profitability. Digital payments witnessed boom after demonetization asto make India a cashless economy was among the huge step taken by the government as it makes the spending convenient and increases the transparency of transactions. The study concludes that there was an initial dip in the short run but in the long run demonetization is going to have a positive impact on the economy.

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