

DEMONETIZATION AND FINANCIAL SECTOR OF ECONOMY

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Abstract

Demonetization is a tool to battle Inflation, Black Money, Corruption and Crime, discourage a cash dependent economy and help trade. Its policy of the government by banning Rs. 500 and Rs.1000 currency notes has influenced all almost all the corner of the economy. Its effect on Banking Sector is significant as Bank is a center for channeling the legal tender money to all needs of the society. The biggest beneficiaries of demonetization are Banks. It made the banks to accept the deposits without any cost of promotion and drastically increased liquidity position of the banks. The present study is made out of available literature on post demonetization. It portrayed the effect of demonetization on Banking Sector. It encompassed the recent decision of the central government on Demonetization and its gradual effect on Indian banking sector.

Key Words: *Demonetization, Banks, Liquidity, digitization.*

Introduction

Banks are core part of any economy. They channelized the money to the smooth functioning of different sectors. Initiatives of Green Banking, made the banks to transform conventional banking services into modern banking services. The products and services are offered through electronic devices with the help of internet. Now a day, bank services are catered at the finger tip of customers. Surgical Strike on Black Money called 'Demonetization' brought enormous changes in all the sectors of the country. Banks are not exceptional from the influence of Demonetization and it made vibrations in the operations as well as products and services of Banks. It created greater demand to digital banking services where cashless transactions are prioritized. Day to day operations of Banks are affected and found tough in Management of liquidity and Employees. It made greater influence on Management of liquidity and its demand raised by customers in exchanging of their banned currency notes while minimizing risk and maximizing quality of service. At the same time meeting the guidance of Reserve Bank of India was challenging. Demonetization has disturbed the bank operations and made the employees to work under unconditional stress in extended working hours of a day. Most of the banks were not able to discharge other banking services while exchanging the banned currency notes. Hence, the present study is made to figure out the influence of demonetization on banking sector. It showcases post demonetization effect on banks and its operations.

Demonetization is the act of stripping a currency unit of its status as legal tender. It occurs whenever there is a change of national currency. Sometimes, a country completely replaces the old currency with new currency. The opposite of demonetization is remonetisation, in which a form of payment is restored as legal tender.. The currency was demonetized first time in 1946 and second time in 1978. On Nov. 2016 the currency is demonetized third time by the present Modi government. This is the bold step taken by the govt. for the betterment of the economy and country. Demonetization is a tool to battle Inflation, Black Money, Corruption and Crime, discourage a cash dependent economy and help trade. Its policy of the government by banning Rs. 500 and Rs.1000 currency notes has influenced all almost all the corner of the economy. Hereby analyzing the impact of demonetization on Banking Sector. A study by Bhupal Singh and Indrajit Roy, RBI directors from the monetary policy department and department of statistics and information management, published in August this year showed that the excess deposits accrued to the banking system due to demonetisation range between Rs 2.8-4.3 trillion. "Excess deposit growth in the banking system during the demonetisation period (i.e., November

11, 2016 to December 30, 2016) works out to 4-4.7 percentage points. If the period up to mid-February 2017 is taken into account to allow for some surge to taper off, excess deposit growth is in the range of 3.3-4.2 percentage points. The liquidity boost resulting from the demonetisation announcement on November 8, 2016 has stayed with the banking sector a year after the event, helping banks reduce their high-cost deposits and boosting their current account and savings account (CASA) ratio. CASA is abbreviation of current Account Savings Account. It is the ratio which indicates how much of the total deposits with bank in the current account and savings account. In a simple language, the deposits with the bank are in the current account and savings account. Banks do not pay interest on the current account deposits and pays a very low% of interest on savings on account deposits. Hence, it is a good measure to get deposits at no or very low cost.

Banking can be defined as the business activity of accepting and safeguarding money owned by other individuals and entities, and then lending out this money in order to earn a profit. However, with the passage of time, the activities covered by banking business have widened and now various other services are also offered by banks. The banking services these days include issuance of debit and credit cards, providing safe custody of valuable items, lockers, ATM services and online transfer of funds across the country / world. It is well said that banking plays a silent, yet crucial part in our day-to-day lives. The banks perform financial intermediation by pooling savings and channelizing them into investments through maturity and risk transformations, thereby keeping the economy's growth engine revving.

Objectives of the Study

1. To study the influence of demonetization on Banks operations.
2. To find out positive and negative results of post demonetization on Bank operations.

Methodology of the Study

The study is based on Secondary Sources of data. It includes available published literatures such as books, journals, newspapers and relevant government websites. The study tries to look at the extent of demonetization influence on normal banking operations.

Impact of demonetization are:

1. Increase in Deposits: Demonetization has increased the deposits in Banks. Unaccounted money in the form of Rs.500 and Rs.1000 were flowing to the Banks and the sizes of deposits have been increased. It helped the banks to grab the deposits and increase their deposits. Bulk of the deposits so mobilised by SCBs have been deployed in: (i) reverse repos of various tenors with the RBI; and (ii) cash management bills (CMBs) issued under the Market Stabilisation Scheme (which is a part of investment in government securities in the balance sheet of banks). Loans and advances extended by banks increased by Rs.1,008 billion. The incremental credit deposit ratio for the period was only 18.2 per cent. Additional deposits mobilised by commercial banks have been largely deployed in liquid assets.

2. Fall in cost of Funds: Over the past few months, the deposits are increased. It led the banks to keep a major part of deposits in the form of cash deposits. PSU Banks have a lion share (over 70%) of the deposits and biggest gainers of the rise in deposits, leading to lower cost of funds. Surplus liquidity conditions have helped facilitate the transmission of monetary policy to market interest rates. Post demonetisation, several banks lowered their domestic term deposit rates and lending rates. The median term deposit rates of SCBs declined by 38 bps during November 2016-February 2017, while the weighted average term deposit rate of banks declined

by 24 bps (up to January 2017). Combined with the sharp increase in low cost CASA deposits, the overall cost of borrowings declined, allowing banks to reduce their lending rates.

3. Demand for Government Bonds: After sharp rise in deposits on post demonetization, banks started lending such surplus deposits to the RBI under the reverse repo options. PSU Banks, particularly, deployed excess funds in government bonds. The return on bond investment is likely to add 15 to 20 per cent increase in the earnings of banks.

4. Sagginess in Lending: Lending growth of the banks is considerably less even after demonetization and its impact of growth in the amount of public deposit. Banks have tried to lend the money to the needy group by reducing their interest rates, but it shrunk over the last few months.

Opening of Jan Dhan Account

Post-demonetisation, 23.3 million new accounts were opened under the Pradhan Mantri Jan Dhan Yojana (PMJDY), bulk of which (80 per cent) were with public sector banks. Of the new Jan Dhan accounts opened, 53.6 per cent were in urban areas and 46.4 per cent in rural areas. Deposits under PMJDY accounts increased significantly post demonetisation. The total balance in PMJDY deposit accounts peaked at Rs. 746 billion as on December 7, 2016 from Rs. 456 billion as on November 9, 2016 - an increase of 63.6 per cent. As there were reports regarding the use of these accounts to convert black money into white, the Government issued a warning against the misuse of such accounts.

Push to Digital Banking

A cashless economy is one in the flow of cash within an economy is non-existent and all transactions have to be through electronic channels such as direct debit, credit and debit cards, electronic clearing, payment systems such as Immediate Payment Service (IMPS), National Electronic Funds Transfer and Real Time Gross Settlement in India.

Benefits of Cashless economy

- Reduced instances of tax avoidance because it is financial institutions based economy where transaction trails are left.
- Curb generation of black money.
- IT will reduce real estate prices because of curbs on black money.
- It will place universal availability of banking services to all as no physical infrastructure is needed other than digital.
- There will be greater efficiency in welfare programmes as money is wired directly into the accounts of recipients.
- Reduced cost of printing notes, instances of their soiled or becoming unusable, counterfeit currency.
- Reduced costs of operating ATMs.
- Speed and satisfaction of operations for customers as no delays and queues, no interactions with bank staff required.

Digital transaction platforms

- **UPI:** Unified Payment Interface (UPI) allows you to make payments using your mobile phone as the primary device for transactions, through the creation of a 'virtual payment address', which is an alias for your bank account. UPI was launched by the National Payment Corporation of India (NPCI).
- **BHIM App:** The Bharat Interface for Money (BHIM) is an initiative by the Govt to enable fast, secure and reliable cashless payments through mobile phones. BHIM is Aadhaar-enabled, inter-operable with other Unified Payment Interface (UPI) applications and bank accounts, and has been developed by the National

Payments Corporation of India (NPCI). This seals the government's push towards digital payments after the demonetization that resulted in the scrapping of high-value Rs 1,000 and Rs 500 currency notes.

- **Aadhar Pay:** There are lots of payment apps in the market. These are the UPI apps, SBI Pay, Paytm, Phonepe, Freecharge, mobile wallets etc. But, the Adhaar Payment App is special as you can pay through the Adhaar Payment App without phone. It is possible because you the customer does not require the app. The merchant or a person, who want money, have to arrange a smartphone, app, etc. The payer don't require anything. This app is made for the merchants and shopkeepers. Customer would only enjoy its benefits. The Adhaar Payment Appuses your fingerprints for the authentication. On the basis of this authentication, the money ispaid from your Aadhaar linked account.
- **IMPS:** Immediate Payment Service (IMPS) is an instant interbank electronic fund transfer service through mobile phones. It is also being extended through other channels such as ATM, Internet Banking, etc.
- **POS terminals:** A point-of- sale (POS) terminal is a computerized replacement for a cash register. Much more complex than the cash registers of even just a few years ago, the POS system can include the ability to record and track customer orders, process credit and debit cards, connect to other systems in a network, and manage inventory. Generally, a POS terminal has as its core a personal computer, which is provided with application-specific programs and I/O devices for the particular environment in which it will serve.
- **USSD:** USSD (Unstructured Supplementary Service Data) is a Global System for Mobile(GSM) Communication technology that is used to send text between a mobile phone and an application program in the network. Applications may include prepaid roaming or mobile chatting.

Challenges of a cashless rural economy

- **Currency dominated economy:** High level of cash circulation in India. Cash in circulation amounts to around 13 per cent of India's GDP.
- **Transactions are mainly in cash:** Nearly 95 per cent of transactions take place in cash. Large size of informal/unorganized sector entities and workers prefer cash based transactions. They don't have required digital literacy.
- **ATM use is mainly for cash withdrawals and not for settling online transactions:** There are large number of ATM cards including around 21 crore Rupaya cards. But nearly 92 per cent of ATM cards are used for cash withdrawals. Multiple holding of cards in urban and semi-urban areas show low rural penetration.
- **Limited availability of Point of Sale terminals:** According to RBI, there are 1.44 million PoS terminals installed by various banks across locations at the end of July 2016. But most of them remain in urban/ semi-urban areas.
- **Mobile internet penetration remains weak in rural India:** For settling transactions digitally, internet connection is needed. But in India, there is poor connectivity in rural areas. In addition to this, a lower literacy level in poor and rural parts of the country, make it problematic to push the use of plastic money on a wider scale. This is being overcome by application BHIM (Bharat Interface for Money) launched by the Prime Minister which will work on USSD i.e without mobile internet.

Demonetization crippled rural bank lending

The note ban hurt rural India, loan growth was far below its pre-demonetisation levels. Indeed, in the second half of FY2017, bank lending to rural Haryana, Punjab, Goa, Maharashtra and Kerala contracted. Lending to rural Maharashtra fell by as much as 9.2%. Putting that in perspective, bank loans in the second half of FY16 to rural Haryana increased by 18% and to rural Punjab by 12.2%, while rural Maharashtra saw an increase in lending of 5.8%. Not a single state had showed a contraction in rural lending in the second

half of FY16. In other words, the slowdown in rural lending in the second half of FY17 was very abnormal and may be attributed largely to demonetisation.

Conclusion

Demonetization is a tool used by central government to fight against corruption and black money. In the same path, it influenced and brought changes in all the corner of the economy. Banks are major institutions affected by demonetization. Banned denominations were ploughed back and allowed the citizens to exchange with the banks. While exchanging, it disturbed temporarily and influenced its regular operations. Though it affected badly to major extent of bank operations, it helped the economy to find growth and development of the country through financial institutions like Banks.

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