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Demonetization-Its Impact on Banking Sector

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Abstract

The term demonetization is not new to the Indian economy. As Indians struggle to come to grip with the second de-monetization of currency since independence (the previous one was in 1978 and restricted to Rs1,000, Rs5,000 and Rs10,000 notes), the scale and scope of this action is significantly bigger. The government's decision on November 8 to immediately demonetize the Rs 500 and Rs 1,000 notes in circulation, which account for 86% of all currency in circulation, has impacted a raft of sectors. Consumers have turned frugal, causing a sharp drop in demand for goods and services. While farmers and small industries will bear the brunt and sectors like transport and real estate will visibly be in pain, several other industrial sectors will have to scale back services or production. Now, with the massive, irreversible and comprehensive push on 'going cashless' and 'adopting digital', the banking industry is going to adopt financial technology with a new scale and scope. Investments will indicate the direction towards a system where intelligent technology and robust software takes care of most of the parts in the chain. Due to Demonetization there is a huge surge of liquidity in the banking sector. This paper is an empirical study which is focused on impact of demonetization on Indian economy with key sectors, and specially the analysis has been done for before and after the demonetization and its impact on banking sector .

Key words: Demonetization, Currency, Cashless, Banking, digital

Introduction

The Process of removing a currency from general usage, or circulation is known as demonetization. For example, gold was demonetized in this way when it ceased to be used as an everyday currency. The Indian rupee (INR) is the official currency of India. The recent sudden move to demonetize Rs 500 and Rs1,000 currency notes is not new. Rs 1,000 and higher denomination notes were first demonetized in January 1946 and again in 1978. The highest denomination note ever printed by the Reserve Bank of India was the Rs 10,000 note in 1938 and again in 1954. But these notes were demonetized in January 1946 and again in January 1978, according to RBI data. To check undisclosed black money, corruption and fake currency the Government of India on the 8 November 2016 announced demonetization of high denomination currency notes Rs 500 and Rs1000. A new redesigned series of Rs 500 and Rs 2000 banknote is in circulation since 10 November 2016.

Objectives

- The main objective of this paper is to study the impact of demonetization on select companies of banking

sector before and after demonetization.

- To study the impact of demonetization on Indian economy in general.
- To study the relationship between the select banking companies before and after demonetization.

Methodology:

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

Demonetization –Its Impact on Indian Economy

Demonetization affects the economy through the liquidity side. Its effect will be a telling one because nearly 86% of currency value in circulation was withdrawn without replacing bulk of it. As a result of the withdrawal of Rs 500 and Rs 1000 notes, there occurred huge gap in the currency composition as after Rs 100; Rs 2000 is the only denomination.

Demonetization technically is a liquidity shock; a sudden stop in terms of currency

availability. It creates a situation where lack of currencies jams consumption, investment, production, employment etc. In this context, the exercise may produce following short term/long term/, consumption/investment, welfare/growth impacts on Indian economy. The intensity of demonetization effects clearly depends upon the duration of the liquidity shocks. Following are the main impacts.

- Liquidity crunch (short term effect)
- Welfare loss for the currency using population
- Growth momentum
- Impact on bank deposits and interest rate
- Impact on black money
- Impact on counterfeit currency

Demonetization impacting on key sectors

REAL ESTATE:

Developers and consultants say that home sales have slowed down significantly as consumers defer home purchases. Land transactions are at a standstill. Developers have deferred launches of premium projects while prices of land and properties, particularly luxury homes, are likely to drop in the next 3-6 months. Even secondary

(resale) property markets sales have dropped by 50%, say brokers and analysts. Going forward what we believe is this step will take the real estate sector in a much evolved manner and increase the transparency and cleanse the entire system. As a result we expect a lot of transparency that will help institutional funding, which is the need of the hour.

AIRLINES

There has been a significant impact on inbound travel. Some airlines have seen bookings go down by about 16% in the week after demonetization compared to the one before that. Discretionary travel has been the worst hit. Poor sales have forced all airlines to bring forward their airfare sales—usually reserved for the low season starting January. International traffic to West Asia and South-East Asia, especially by traders and low-wage workers, has been hit. Business jet operators say several charter flights have been cancelled as payments are often made in cash. Demonetization had a significant downward impact on inbound travel in the beginning; however things seem to be getting better every day. With the continued low airfares, the passenger demand will likely continue to be strong.

AUTOMOBILES:

Demand has been hit. Most firms expect to see a decline in sales. In two-wheelers, where transactions are through cash, sales have taken a massive hit. Hero MotoCorp Ltd, for instance, sold 480,000 units in November, down from a monthly average of 600,000 units. There has been a serious short-term impact, which is largely temporary in nature. It will go back to normal as liquidity comes back... Impact is largely on retail sales, which will be reflected on a long-term basis. Wholesale data does not reveal the actual picture. Footfalls had come down, but they have started to come back. People who were selling old cars, that market will be impacted because that entire market was cash.

TOURISM:

The most difficult period of demonetization sits squarely in the busiest season for the tourism industry. There was a slump in hotels and associated services bookings in the first week after the currency withdrawal. However, the premium hotel segment has not seen any impact as bookings are mostly done in advance and online. So the hit has mostly been confined to the unorganized sector. There has definitely been an impact in the industry due to demonetization but we will only be able to assess this after some

time. It is too early right now. People are prioritizing their purchases and discretionary expenses are being delayed. Since the Winter 2016 bookings have already been done in advance, there is no effect on this. However, there might be an effect on the summer 2017 bookings due to demonetization.

The Impact of Demonetization on Banking Sector

The government's decision on November 8 to immediately demonetize the Rs 500 and Rs 1,000 notes in circulation, which account for 86% of all currency in circulation, has impacted a raft of sectors. Consumers have turned frugal, causing a sharp drop in demand for goods and services. A big surge in low-cost deposits will help banks in the short-term. It means lower cost of funds and better margins. The rise in balance sheet size will also help when credit growth picks up. As yields fall, owing to excess liquidity, banks stand to book treasury gains too. However, on the flip side, loan disbursements are stagnating. With production estimates reduced, there is no need for working capital either. Lenders will be hard pressed to find incremental credit demand even during the busiest of the seasons. And asset quality could worsen as the economy slows. We believe

demonetization and RBI’s move to publish data at more frequent intervals will nudge consumers and intermediaries to adopt digital channels of payments... The impact of removing MDR fees by most banks

would be negligible as the credit card is a greater revenue driver than debit card. The impact is Mixed over short-term, neutral to positive in the long term.

Descriptive Statistics of Select Banking Companies Before Demonetization

Descriptive Statistics	NIFTY	SBI BANK	PN BANK	ICICI BANK	AXIS BANK	ANDHRA BANK
Mean	-0.09365	-0.0534	0.023695	0.120277	-0.57869	-0.43303
	4	3	2	1	6	5
Standard Deviation	1.061379	1.635366	2.735285	2.558138	2.139595	2.116108
	1	2	6	5	4	3
Sample Variance	1.126526	2.674421	7.481782	6.544073	4.577868	4.477912
Kurtosis	0.245281	-0.12205	1.119063	0.657134	4.051031	1.710717
Skewness	-0.176	0.230183	-0.08464	0.672026	-1.70739	-0.9966
Confidence Level(95.0%)	0.389317	0.599857	1.003311	0.938333	0.78481	0.776195

The mean return of ICICI Bank is high followed by Punjab National Bank, NSE Nifty, state Bank of India, and Andhra bank. The standard deviation of nifty is high followed by SBI, Andhra bank, Axis bank,Punjab National bank and ICICI bank. Except Axis bank rest all other banks and index following Platykurtic measure means they are observing flat returns and Axis bank follows Leptokurtic measure means abnormal losses.

Correlation between Select Banking Companies Before Demonetization

CORRELATION						
	NIFTY	SBI BANK	PN BANK	ICICI BANK	AXIS BANK	ANDHRA BANK
NIFTY	1					
SBIN	0.799917	1				
PNB BANK	0.791341	0.874282	1			
ICICI BANK	0.797321	0.597233	0.481016	1		
AXIS BANK	0.671067	0.420902	0.432044	0.539827	1	
ANDHRA BANK	0.803803	0.843975	0.874744	0.474304	0.350507	1

Except Axis bank all other banks are more positively correlated and Axis bank is moderately correlated.

All banks and index are more positively correlated with SBI while ICICI bank is moderately and Axis bank is less correlated with SBI.

All banks and index are more positively correlated with PNB while Andhra bank, axis bank ,ICICI banks are less correlated with PNB.

All banks and index are more positively correlated with Andhra bank while ICICI, Axis banks are less correlated with Andhra bank.

ICICI bank is more positively correlated with index and SBI and while other banks are less correlated with ICICI bank.

Axis bank is moderately correlated with index and less with others.

Descriptive Statistics of Select Banking Companies After Demonetization

Descriptive Statistics						
Type	NIFTY	SBI BANK	PN BANK	ICICI BANK	AXIS BANK	ANDHRA BANK
Mean	-0.24231	0.064556	-0.46409	-0.35432	-0.21725	-0.21568
	4	1	6	5	3	2
Standard Deviation	1.344057	2.462912	3.166929	1.903539	1.79623	2.155376
	1	5	6	3	2	4
Sample Variance	1.80649	6.065937	10.02944	3.62346	3.226442	4.645644
Kurtosis	0.991135	4.518939	9.178032	1.646908	-0.04019	9.596301
Skewness	0.632241	0.522501	1.531819	0.059407	0.413148	2.222364
Confidence Level(95.0%)	0.501879	0.919667	1.182551	0.710793	0.670723	0.80483

After Demonetization

The mean return of state bank of India is high, followed by Andhra bank, Axis bank, Nifty ,ICICI bank, Punjab National bank.

The standard deviation of Nifty is high followed by Axis bank, ICICI Bank ,

Andhra bank, SBI and Punjab National bank.

Kurtosis after Demonetization

According to Kurtosis tools the 3 public sector banks following Leptokurtic measure, other two banks and index following Platykurtic measure.

SBI and Andhra bank have observed abnormal losses.
 abnormal profits and PNB has observed

Remaining has observed flat returns.

CORRELATION						
	NIFTY	SBI BANK	PN BANK	ICICI BANK	AXIS BANK	ANDHRA BANK
NIFTY	1					
SBI BANK	0.753454	1				
PN BANK	0.802459	0.887257	1			
ICICI BANK	0.860748	0.630643	0.597101	1		
AXIS BANK	0.724489	0.435321	0.539989	0.580782	1	
ANDHRA BANK	0.791698	0.837406	0.882027	0.725342	0.553981	1

Correlation after Demonetization

All banks are positively correlated with bank index.

All banks and index are more positively correlated with SBI while ICICI, Axis and Andhra banks are moderately correlated with SBI.

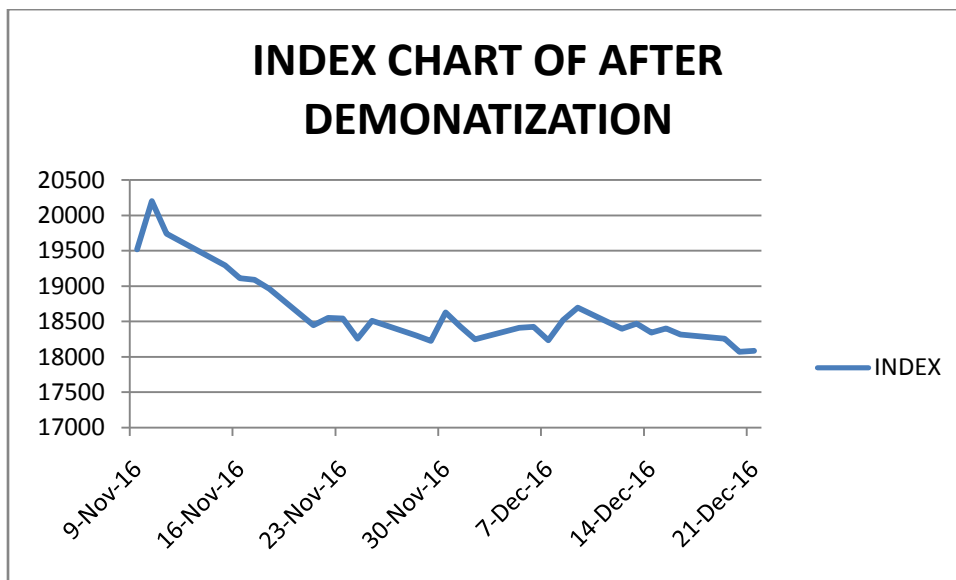
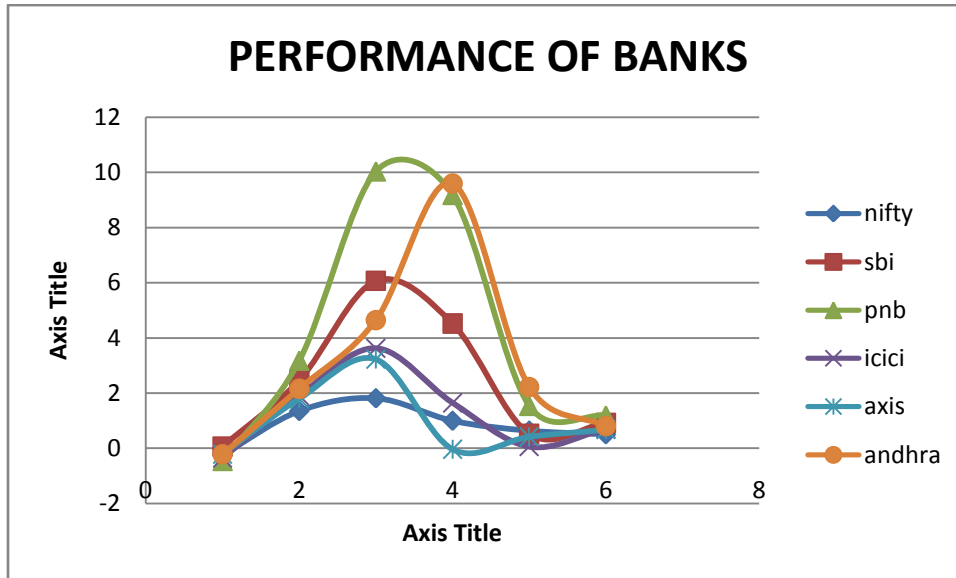
All banks and index are more positively correlated with PNB while ICICI, Axis and Andhra banks are moderately correlated with PNB.

All banks and index are more positively correlated with Andhra bank while ICICI, Axis banks are moderately correlated with Andhra bank.

ICICI bank is more positively correlated with index and while other banks are moderately correlated with ICICI bank.

Axis bank is moderately correlated with rest others.

According to the above observations it is come know that banking sector is very organized in manner.



Conclusion

The demonetization undertaken by the government is a large shock to the economy. The impact of the shock in the medium term is a function of how much of the currency will be replaced at the end of the

replacement process and the extent to which currency in circulation is extinguished. While it has been argued that the cash that would be extinguished would be “black money” and hence, should be rightfully extinguished to set right the perverse

incentive structure in the economy. In other words, while the cash was mediating in legitimate economic activity, if this currency is extinguished there would be a contraction of economic activity in the economy and

that is a cost that needs to be factored in while assessing the impact of the demonetization on the economy and its agents.

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