

Impacts on Demonetization: Organized and Unorganized Sector

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Abstract

The argument posited in favour of demonetization is 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. While the facts are not available to anybody, it would be foolhardy to argue that this is the only possibility. Therefore, it is imperative to evaluate the short run and medium-term impacts that such a shock is expected to have on the economy. Further, the impact of such a move would vary depending on the extent to which the government decides to demonetize. This paper elucidates the impact of such a move on the availability of credit, spending, level of activity and government finances.

Keywords: *demonetization, cashless transactions, credit, tax evasion*

I. Introduction

The government has implemented a major change in the economic environment by demonetizing the high value currency notes – of Rs 500 and Rs 1000 denomination. These ceased to be legal tender from the midnight of 8th of November 2016. People have been given up to December 30, 2016 to exchange the notes held by them.¹ The proposal by the government involves the elimination of these existing notes from circulation and a gradual replacement with a new set of notes. In the short term, it is intended that the cash in circulation would be substantially squeezed since there are limits placed on the amount that individuals can withdraw. In the months to come, this squeeze may be relaxed somewhat. The reasons offered for demonetization are two-fold: one, to control counterfeit notes that could be contributing to terrorism, in other words a national security concern and second, to undermine or eliminate the “black economy”.

There are potentially two ways in which the pre-demonetization money supply will stand altered in the new regime: one, there would be agents in the economy who are holding cash which they cannot explain and hence they cannot deposit in the banking system. This part of the currency will be extinguished since it would not be replaced in any manner. Second, the government might choose to replace only a part of the currency which was in circulation as cash. In the other words, the rest would be available only as electronic money. This could be a mechanism used to force a transition to cashless medium of exchange. The empirical extent of these two components will be unraveled only over the next six months. These two would have different effects on the economy in the short term and in the medium term, as will be explored below.

To understand the effects of these dimensions, it is important to first understand what is it that cash does in the economy? There are broadly four kinds of transactions in the economy: accounted transactions, unaccounted transactions, those that belong to the informal sector and illegal transactions. The first two categories relate to whether transactions and the corresponding incomes are reported for tax purposes or not. The third category would consist largely of agents who earn incomes below the exemption threshold and therefore do not have any tax liabilities. The uses that cash is put to for these various segments of the economy can be summarized in the form of Table 1. Finally, there would be demand for cash for illegal purposes like bribes in elections, spending over sanctioned limits, dealings in crime and corruption. If one takes a snapshot of the location of cash at any given point of time, it is difficult to predict what the breakup of the cash according to these categories would be, but it would be safe to say that each of these components would be represented in that snapshot.

II. Definition of 'Demonetization'

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: The current form or forms of money is pulled from circulation and retired, often to be replaced with new notes or coins. Sometimes, a country completely replaces the old currency with new currency. The opposite of demonetization is remonetization, in which a form of payment is restored as legal tender.

III. Effect of Denomination of Currency Notes on Some Sectors

Here are a few sectors that would be heavily impacted by the recent ban on Rs 500 and Rs 1,000 currency notes in India:

a) E-commerce startups

Majority of tech savvy consumers prefer to pay using e-wallets or online transfers such as Net Banking, Airtel Money, Paytm, etc. E-commerce industry is growing at a rapid pace and many customers avoid the option of COD (cash on delivery) as the cost may be slightly high due to inclusion of carrying cost. However, we can't ignore people who are not familiar in using virtual cash. This may affect sales to a marginal extent in volume and amount. Considering the growth of E-commerce startups in India, it can be said that almost all end consumers will get accustomed in avoiding COD.

b) Cab startups:

They have their own wallet system and the demonetization move is not going to make them bleed. Many people in India use smartphones and pay for cabs through their e-wallets.

c) Wallet startups:

It goes without saying that the recent ban on Rs 500 and Rs 1000 currency notes are going to boost the revenue of these startups. From teenagers to youth to middle-aged people, everyone will be downloading relevant apps in the next few days and even after that. E-wallet startups may also give higher amount of cashback to the new customers to attract higher number of downloads. Eventually, after a few months, the cashback given by these entities would reduce to nil.

d) Food delivery startups:

These startups allow customers to pay for their food orders through debit cards, credit cards, net banking, e-wallets, etc. So, it is quite understandable that food delivery startups like Wow Momo, FoodPanda, Cafe Coffee Day, etc., will be undisturbed by the recent policy implemented.

e) Information technology startups:

Their services are generally highly priced so the likely mode of acceptance of payments are via bank cheque, bank draft, NEFT, RTGS, net banking, etc. Therefore, it is very understandable that ban of currency notes of two particular denominations are not going to hurt these IT firms.

f) Accounting and financial consultancy startups:

They mostly prefer accepting payments other than physical cash. It goes without saying that they would function smoothly irrespective of such massive pan India-based economic policy adopted by the Central Government.

IV. Impacts of Demonetization In India

a) Black Money



Black money stored in the form of Rs 500 and Rs 1000 notes will be taken out of our system. As predicted by ICICI Securities Primary Dealership the government's plan to scrap ₹ 500 and ₹ 1,000 notes will uncover up to ₹ 4.6 lakh crore in black money.

b) Terror Funding



Fake Indian Currency Notes (FICN) network will be dismantled by the demonetization measures. Taking out 500 and 1000 rupee notes out of circulation will have a lasting impact on the syndicates producing FICN's, thus affecting the funding of terror networks in Jammu and Kashmir, North-eastern states and Nasalite hit states.

c) Real estate may see significant course correction



The demonetization decision is expected to have far reaching effects on real estate. Resale transactions in the real estate sector often have a significant cash component as it reduces incidence of capital gains tax. Black money was responsible for sharp appreciation of properties in metros; real estate prices may now see a sharp drop.

d) Political parties in crisis ahead of polls



With nearly five state elections in 2017, demonetization has stunned political parties. Especially, in large states like Punjab and Uttar Pradesh, cash donations are a huge part of "election management". In one stroke, big parties will find themselves hamstrung as cash hoards are often undeclared money. Parties will have to completely reign campaign strategies in light of expected cash crunch.

e) Moving towards digital payments



Demonetization will likely result in people adopting virtual wallets such as Paytm, Ola Money etc.: This behavioral change could be a game changer for India.

f) Temporary chaos and confusion



Public will face minor problem for a few days owing to the scarcity of lower denomination notes in the system.

g) After ban on 500 & 1000 Rs Notes



There is currently a lot of debate happening on how the government's demonetization move and Trump's triumph will impact the real estate sector. The NIFTY Realty Index fell by almost 12% as a reflection, purely on sentiment. While bellwethers are hinting at dark days ahead, these fears can at best be called unfounded when it comes to the Indian real estate business. Let's look at how....

- a) **Commercial real estate:** There will be a minimum impact on office / industrial leasing and transactions, given that cash components do not play a significant role in such transactions.
- b) **Residential real estate:** The primary sales segment is largely influenced by home finance players, and deals tend to be facilitated in a transparent manner. This segment will, therefore, see at best a limited impact in the larger cities, though some tier 2 and tier 3 cities where cash components have been a factor even in primary sales will see a business crunch. The secondary or resale market will, however, certainly be impacted, since this segment does see the involvement of cash component.
- c) **Real estate investment markets:** Projects could get stretched as informal sources of capital may not be available. This, in fact, spells more opportunities for institutional capital. FDI, private equity and debt players will suddenly find the market even more transparent and attractive. Moreover, banks could start funding land transactions, thereby decelerating land prices.
- d) **Retail real estate:** Retailers could see some impact on their business in the short-to-medium term due to reduced cash transactions. The luxury segment is likely to be hit because of the historically high incidence of cash acceptance. However, credit / debit cards and e-Wallets should come to the rescue. Overall, the domestic consumption story remains intact, with no threat to the overall strength and growth of the Indian retail industry.
 - a. **Land sales:** Where land transactions have been happening in the realm of joint ventures, joint development or corporate divestments, will see very little impact of the demonetization move. All of these are quite institutionalized, with little or no cash involvement. However, those carrying out direct land deals will doubtlessly suffer - especially when it comes to agricultural land transactions, which tend to involve significant cash involvement.
 - b. **Developers:** There will be minimal impact on large institutionalized players with a solid brand and governance framework. Sales, largely driven by the salaried class or investors with limited cash involvement would not suffer.

Smaller developers are understandably very concerned right now because many of them have depended on cash transactions. We are very likely to see a clean-up of non-serious players due to this 'surgical strike' on the parallel economy. The impact of RERA will further discipline the industry, which will be good for its health in the long term. Hotels and hospitality-related real estate in the organized sector will see negligible impact by the demonetization.

V. The Effect of Demonetization on Organized Sectors

Organized sectors are already familiar with banking and other formalities in one way or other. But mostly the unorganized sector, the farmers and laborers will suffer the most as they had been used to get and save in currency notes. Electronic or transactions by bank was limited to below 20% of daily transactions.

Over the short and medium terms, the demonetization drive will have varied effects on the many sections of the hospitality industry in the country, but in the long term will positively impact the growth of the hospitality sector.

Often, the strong season for the hospitality sector in the country extends from October to March, which to a large extent defines the success for the industry in any given year. The lack of available currency will force some hospitality customers to either postpone / cancel their travel and accommodation or to use hospitality products that easily allow the use of the other modes of payments.

The demonetization drive will benefit the organized hospitality sector in India the most. Combined with the general uptake in the sector, the movement of customers to the organized sector due to ease of alternate modes of payment will positively impact the market. However, given the larger base of hotel rooms in the country is in the unorganized sector, we anticipate the general performance of the industry to witness some stress in the short term.

The hospitality and the tourism markets are renowned for their ability to create a large number of direct and indirect jobs in the country. With the inability of customers / tourists to easily spend on frills due to lack of available currency, the unorganized industry will suffer the most in its ability to create new jobs. The impact of demonetization will also be felt by the suppliers of consumable goods, who often work on cash transactions with their wholesale counterparts.

The unorganized inventory of hotels in the industry will be most impacted by this move. In addition, the leisure sector hotels and restaurants segment will see a higher impact on account of the discretionary nature of spending in this sector, and the substantially larger base of cash transactions that occur in its when compared to mainstream business hotels.

Also, the restaurants business – both in hotels and standalone – will see a short-term slowdown in growth on account of the reduced availability of cash and the generally high usage of cash spending in restaurants.

The organized banqueting business will witness growth, as customers move from the almost cash-only unorganized sector of standalone party venues and farm houses to hotels for want of non-cash means of payment. The weddings business will also return to Indian hotels from their Overseas counterparts, as unofficial channels for offshore transfers of cash have dried up, forcing the cancellation of many Indian weddings from foreign locales back to hotel venues in India.

The tourism and hospitality sectors are intrinsically tied to the economic conditions of any country. The boost provided by the demonetization move to the macro economy of the country will effectively trickle down to the industry.

With banks being flush with liquidity, we anticipate a major reduction in interest costs, which augurs well for the growth of the industry. As more liquidity enters the organized sector along with some further softening of land rates and gradual movement towards cleaner real estate transactions, we anticipate investments into the sector to increase from the organized players who have, in the past, shied away due complexities associated with underlying real estate.

VI. The Effect of Demonetization on Unorganized Sector in India?

The unorganized sector in India will be the worst hit by the November demonetization of high value currency, while lots of industries in the organized sector would be impacted by the shortage of cash required to run business, a market analyst said on Monday. "The unorganized sector is expected to bear higher brunt of demonetization. Within the organized space, a lot of industries would get impacted owing to the sucking out of daily liquidity needed to run the business," Centrum Wealth Research said in a report.

a. The Situation:

India was heavily depended on currency in handling financial transactions. Electronic or transactions by bank was limited to below 20% of daily transactions. People used to save money in currency as it was essential to handle day to day transactions. 90% of the stores in markets was not accepting electronic money. They all insisted on cash in currency. Generally India had a stable economy and people started trusting currency and they trusted the economy enough to keep the savings in currency. (Remember it is not practical in fluctuating economy where people will convert money into tangible assets including Gold and it will affect the transacting capability of the people). India remained stable for long only because people maintained their money flexible for transactions.

b. The Issues:

One of the issue was fake currencies. Some source pumped huge amount of fake currencies into India. The source is within the country or outside the country is still open to discuss. But it is a fact that Indian Intelligence has utterly failed to check the flow of fake currency into Indian economy and it is a big failure of the governments mainly after 2000. I do not believe the Intelligence was incapable of identifying the sources of fake currency but I strongly feel even our Intelligence department was corrupted and took advantage from illegal activities.

c. Why Restrictions on Currency:

- 1) Government want to block further infiltration of fake currency into Indian economy. I strongly feel the Government got information from some sources that huge amount of fake currencies are being pumped into Indian markets. It may be one reason why government decided to ban the currencies.
- 2) Then what is the possibility of breaking black money with ban on currency? The effect is quite negligible because all transactions through bank are not white money either.

d. Can the Restrictions Stop Black Money:

- 1) Those who have stored huge value currency in stock have the right links to convert it through banks. We have corrupt links everywhere including government servants and banks.
- 2) Those who kept the black money outside India are unaffected! There are people who pumped currency into people as loans for a certain period and they may take it back with an interest as well. Those farmers who took the money from them are going to have hard days ahead.
- 3) There are few events of dumping or burning currencies of 1000s but it was quite negligible. There are very few who kept 1000s of crores as 1000s and 500s currency. But do not think everyone had black money are that senseless.

VII. The Impact of This Move Will Be Felt Across Sectors With Differing Intensities And Across Varied Time Zones.

a. Effect on parallel economy: Cash Economy to Witness Contraction

The currency of the aforementioned denominations constitutes around 86% of the total value of the currency in circulation. It is expected to remove black money from the economy as they will be blocked considering the holders will not be in a position to deposit the same in the banks, temporarily halt the circulation of large volumes of counterfeit currency and curb the funding for anti-social elements like smuggling, terrorism, espionage, etc.

b. Effect on GDP: Downward Bias to GDP Growth

The sudden decline in money supply and simultaneous increase in bank deposits is going to adversely impact consumption demand in the economy in the **short term**. This, coupled with the adverse impact on real estate and informal sectors may lead to lowering of GDP growth.

c. Lower Money Supply has a Deflationary Effect:

With the older 500 and 1000 Rupees notes being scrapped, until the new 500 and 2000 Rupees notes get widely circulated in the market, money supply is expected to be reduced in the short run. Reduction in money supply can also have a deflationary effect in the economy.

d. Impact on Bond Markets:

Surge in deposits will create more demand for government bonds and other high rated bonds in a situation of tepid demands for credit, leading to lower bond yields especially in the shorter end of the curve.

e. Credit Impact across Sectors:

Impact of this policy measure will flow to the economy mainly through the Real Estate sector, which has strong linkages with sectors such as cement and steel and which will turn credit negative in the short-run.

f. Effect on Banks

As directed by the Government, the 500 and 1000 Rupee notes, which now cease to be legal tender are to be deposited or exchanged in banks (subject to certain limits). This will automatically lead to more amounts being deposited in Savings and Current Accounts of commercial banks.

g. Effect on Online Transactions and alternative modes of payment:

With cash transactions facing a reduction, alternative forms of payment will see a surge in demand. Digital transaction systems, E wallets and apps, online transactions using E banking, usage of Plastic money (Debit and Credit Cards), etc.

h. Bank Deposit Rates to Soften:

We can expect a large amount of cash in circulation to be brought within the purview of the formal banking system by way of deposits. This is structurally positive for banks, as part of this cash gets deposited as current account and savings account (CASA) deposits, reducing banks dependence on higher cost borrowing.

i. NBFC's Asset Quality Faces Pressure:

We believe in the asset quality of Retail Asset Lenders, especially NBFC's which have developed expertise in the credit assessment of the informal segment and have built models around it to stay under pressure in the short term. Within NBFC's, asset quality of lenders with a large dependence on cash collection remain vulnerable in the short term. In the longer term the implications could be a risk profile shift for the NBFCs, as the stronger borrower profile could potentially migrate to banks.

j. Payment Banks to Benefit: Payment banks and others entities which are part of the transaction ecosystem are likely to be long term beneficiaries, as more and more cash finds its way into the formal banking channels.

k. Investment in Financial Products:

Investors in the short term will now believe that Cash is not the safest asset and there is little point in hoarding it. This will shift them from physical asset to financial assets where returns are also higher

l. Impact on Consumption Sectors

- **Agreement Cost of Real Estate May Rise:** We expect that the real estate demand from end users is unlikely to be impacted, since a majority of them are backed by funding from bank loans. In the medium term, the prices in this sector could regain on many fronts as developers rebalance their prices (probably charging more on cheque payment).
- **Used car Sales May Fall:** Sales of vehicles in the second hand market for original equipment manufacturers will get impacted, which will cause a ripple effect on New Car sales, as buyers will not be able to dispose of their old vehicles easily.
- **Slowdown in Discretionary Spending to Hurt Consumer Durable Sales:** Sales of White Goods like TV, Refrigerator & Washing Machine could slump as much as 70% as a good portion of the market is driven by Cash. This may continue for next Six Months till the dust settles down and there is adequate circulation of the new currencies. Prices are expected to fall only marginally, due to moderation in demand, as use of cards and cheques could compensate for some purchases.
- **Demand for Gems and Jewellery to Decline:** We can expect the demand for gems and jewellery to decline in the next two to three quarters. This would result in a weakening in the credit profile of industry players due to the high working capital cycles and high operating leverage.
- **High End Retail Demand to fall:** We expect the impact on high end fashion retail and luxury goods to be more pronounced as discretionary demand in this segment will be curtailed. In case of Quick Service Restaurants, although 60%-70% of the transactions are currently in cash, the impact is likely to be moderate due to the low ticket size of purchases and high likelihood of patrons adapting to plastic money.
- **Private Educational Institutions:** Since Private Educational Institutions take huge amounts of donations in Cash which is 40 % to 50%, we expect that this move will impact the Private Education Institutions receipts.
- **Medical Institutions (Both Hospitals & Medical Colleges):** Again, as Medical Institutions like Hospitals and Colleges take huge amounts of donations in Cash which are more than 100 % of fees, we can keep on expecting that this move will impact not only the admissions but also the receipts.
- **Political Parties:** Elections & Political Parties are major sources of Black Money transactions. Most of the funding of National Political Parties is in Cash which is 40% to 50%, and when it comes to Regional Parties it goes upto 50% to 60%. The sources of more than 90% of such funds are never disclosed. Candidates as well as their donors even the Political Parties will feel cash strapped. An assembly seat candidate spent on an average Rs. 4-5 Crores on Campaigning that is likely to go down drastically.
- **Dabba Trading (Bucketing):** It may kill Dabba Trading. Trades done outside bourses, Satta Bazaar & Illegal Betting market may die a natural death as currency gets a new face. Demonetisation was a jolt for Dabba traders, who were thriving in equity markets for many years now.

VIII. Effect On Various Economic Entities

The key segments of the economy where cash transactions play a vital role are real estate / construction, gold and the informal sectors as such. The role of cash transactions in case of real estate and gold is mostly dubious, however in case of the informal sectors it is the lifeline. For example, small and marginal farmers in the fruits and vegetables category typically require off-loading of their produce in the local Mandi in cash and could see an immediate impact. A sudden demonetization will adversely impact this segment of the economy and it will witness immediate contraction, though this impact will diminish over time.

With cash transactions lowering in the short run, until the new notes are naturalized widely into circulation, certain sections of the society could face short term disruptions in facilitation of their transactions. These sections are:

- Agriculture and related sectors
- Small traders
- SME
- Services Sectors
- Households
- Professionals like doctors, carpenters, utility service providers, etc.
- Retail outlets

The nature, frequency and amounts of the commercial transactions involved within these sections of the economy necessitate cash transactions on a more frequent basis. Thus, these segments are expected to have the most significant impact post this demonetization process and the introduction of new notes in circulation.

IX. Demonetisation And Its Impact On GDP Growth



Some rating agencies have estimated a decline of around 40 basis points in GDP growth for 2016-17 and of a smaller magnitude in 2017-18. Photo: PTI

Cash is the preferred mode of transaction globally, accounting on average for 85% of them. In some of the developed countries, transactions carried out through cash are less than 50% of total transactions. In India, this ratio is at around 95%. Easy accessibility, its certainty of acceptance and efficiency as the settlement is not dependent on any additional infrastructure, and no additional charges make it universally the most preferred mode. The only problem of cash transactions is the anonymity and difficulty of establishing an expenditure trail which make it an ideal mode for unreported transactions as well.

The ratio of currency to GDP (gross domestic product) in India, which averaged 8.4% during 1975-2000, crossed 10% for the first time in 2002-03 and has remained above this level since then. This ratio has averaged 10.8% in the last decade. There has not only been a relatively sharp increase in the ratio of currency to GDP during 2015-16 (*table 1*) 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 denomination notes announced on 8 November.

The existence of a large informal sector has been one of the most important factors in this dominance of a cash-based economy. Nearly 45% of gross value added (GVA) in the economy (average 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% of capital formation and two-thirds of investible funds (*see table 2*).

Demonetization of high denomination notes (of Rs1,000 and Rs500) has put over 85% of currency out of circulation. This has resulted in short-term disruptions in transactions in agriculture and related sectors, small establishments, households and among professionals. Since injection of liquidity is slow, incomes in both formal and informal sectors have been affected with the intensity of adverse impact being greater for the informal sector. Since self-employed and casual workers dominate in the overall economy, their incomes may suffer a

setback. While some may view it as deferring expenditure and income, a part of it may actually be revenue and income forgone forever.

Demonetisation fallout: ADB reduces India GDP growth forecast to 7%

Some rating agencies have estimated a decline of around 40 basis points in GDP growth for 2016-17 and of a smaller magnitude in 2017-18. These estimates are based on quicker liquidity injection and a sharp shift to cashless transactions. However, there is a section of the population which will still like to deal in cash because of religious beliefs. The estimation of a 40 basis point decline in GDP, given the casual nature of employment for nearly 80% of workforce, may not materialize, at least in the time frame envisaged. In our view, the dent in GDP growth may be larger than anticipated and recovery to the normal growth trajectory may take three to four quarters.

It is indeed difficult to predict the likely growth trajectory post demonetization. But assuming that the formal sectors maintain the observed growth (average of last 10 quarters) and the informal sectors have a flat growth in the third quarter (Q3) of 2016-17 (with an estimated contraction in informal economic activity in trade, road transport and construction sectors by 5%), Q3 growth may decline to 4.1% in a best case scenario. In case the contraction extends to industrial and professional services sector and is a little sharper in construction and trade, Q3 growth may dip as low as 1.5%.

Growth is expected to recover gradually in the fourth quarter (Q4) of 2016-17 and in the first quarter (Q1) of 2017-18 before returning to its normal trajectory thereafter. It is indeed true that increase in liquidity in the formal banking sector will increase GDP growth originating in this sector, but with its share of around 6% in GDP and with an increase in growth of 0.5 and 1.0 percentage points factored in, this sector's growth in Q3 and Q4, respectively, its overall impact on GDP growth assessed may not be significant. The impact of easy availability of credit to the formal sector on account of this additional liquidity may take some time to materialize, and in Q3 and Q4 it may not be significant. Further, a decline in demand in general may also keep the demand for investible funds at moderate levels.

How these informal sector issues will get incorporated into the quarterly GDP numbers of the ministry of statistics and programme implementation is important as the quarterly estimates of GVA are compiled by the benchmark-indicator method. The previous year's annual estimates are extrapolated with the growth rates observed in indicators such as quarterly estimates of forecast crops and livestock, index of industrial production, steel and cement dispatches, sales tax returns, sale of commercial vehicles, deposit and credit growth of banks, service tax, revenue expenditure of government, all of which are for the formal sectors. The inherent assumption in this tracking approach is the assumption of uniformity of growth for the formal and informal sector. This assumption has little relevance under the current circumstances, and we may still be surprised with a better official rate of GDP growth for Q3 and Q4. If so, we have to take it with a pinch of salt.

X. Demonetisation: Let's Compare The Long Term And The Short Term Impact



As the debate around demonetisation rages on in the country, the economists have expressed varied opinions on this unprecedented reform. Here is the long term and short term impact of government's move to make India a cashless economy.

	Short-term impact	Long-term Impact
GDP Growth	GDP growth to be negatively impacted by 0.5-1% due to drop in consumption	With a tax net widening after restriction on cash economy, GDP in the long-term likely to get a boost
Inflation	Inflation likely to come down due to low demand owing to liquidity problem	Since effect of lower demand can have a lagging impact on inflation, prices may remain flat or fall in the long term

Interest rates	With Banks flush with cash, interest rates may come down in the short-term	If demonetization boots formal banking and more cash continues to come in the system, interest rates may fall further
G-sec yield	Yields likely to fall as liquidity in the banking system means interest rates are likely to fall	Likely to remain flat to positive depending on how inflation plays out and how's the country's fiscal situation
Fiscal Deficit	Unlikely to have much impact as most of the gains (RBI surplus, higher tax collections, penalties) will accrue after FY2017.	With likely increase in the size of formal economy, tax collections would improve improving the country's fiscal situation.

XI. Demonetisation Effects In India To Disappear In Medium Term: World Bank

WASHINGTON: The World Bank today said that the "adverse effects" of demonetisation in India will disappear in the medium term, saying any reform has short-term costs. "Any reform has short-term costs but ultimately reforms will bring long-term gains. In the case of India, we expect whatever the adverse effects of these changing of notes to basically disappear in the medium term," Ayhan Kose, Director of Development Prospects Group at the World Bank told reporters during a conference call.

In its latest report, the World Bank revised its estimates of India's growth rate in 2016-17 fiscal year from previous projection of 7.6 per cent to seven per cent. But, Kose said the World Bank is expecting growth picking up over the period FY18 and FY19, supported by private consumption, infrastructure spending, and a rebound in investment growth.

"So, India has already undertaken a wide range of reforms. These reforms we are expecting loosened domestic supply bottlenecks and increased productivity and, in the coming years, moderate inflation and civil service pay raise should continue to support real incomes and consumption," he said in response to a question.

The World Bank expects private investment to accelerate as firms and banks undertake the necessary measures and the effects of important structural reforms start being felt. "India is a cash-intensive economy. We know that. The cash accounts for over 80 per cent of the transactions, almost two-thirds of the value of all transactions. There have been questions over whether the Reserve Bank of India has printed sufficient new currency to replace the old ones, with disruptions, of course, affecting rural areas and urban poor," Kose said in response to another question.

"But having said all of this, we expect the growth to increase in 2017, after this brief period associated with the change in notes. And the effects of this change in notes are expected to weigh in, in the medium term, with growth, as I mentioned, picking up momentum in FY18-FY19, supported by private consumption, infrastructure spending, and a rebound in private investment," he said. Kose said the Indian Government has made a decision and implemented this decision swiftly with the objective that this could help reduce informal--the size of the informal economy.

"Whenever these types of policy changes are implemented, they have effects during the transition. The part of the reason the government implemented the scheme was to curb corruption, tax evasion, and counterfeiting. If that were expected, that by broadening the tax base, revenues will eventually go up, besides reducing the size of the informal economy," Kose said.

XII. Conclusion

Business houses are an integral constituent of the country's economy. While medium and large scale business is unaffected to such ban, many small-size commercial establishments are deeply affected by such sudden move by the government. The economy of the country may experience recession in the coming few weeks but is expected to get back to its shape shortly after the influence of Modi government. Central government's recent decision to demonetise the high value currency is one of the major step towards the eradication of black money in India. The demonetization drive will affect some extent to the general public, but for larger interest of the country such decisions are inevitable. Also it may not curb black money fully, but definitely it has major impact in curbing black money to large extent.

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