



A STUDY OF IMPACT OF DEMONETISATION IN INDIAN ECONOMY

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ABSTRACT

The argument posited in favour of demonetisation 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 remonetise. 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

Introduction:

Prime Minister Narendra Modi's announcement of the discontinuation of currency notes of 500 & 100 denominations is a landmark policy decision which will have a far-reaching impact on the Indian Real Estate. Significant reduction in black money and hoarding of cash is expected. The secondary real estate would be severely impacted by this step because of the currency involvement in such transactions. The primary real estate market will be slightly less affected as it is far more structured and less exposed to cash dealings. A short-term crash in secondary real estate prices can be expected and this could be as much as 20-30% which will be good for the sector as yields will go up and volumes will return to the market. This correction will be more of a short-term thing, as long-term fundamentals of Indian Real Estate still say strong. The rental yields from properties are also expected to rise. The economy is doing better than before and the currency overhaul will only lead to further progress in the economy. With a more transparent outlook, Indian real estate, will now come at par with global standards and help it achieve a significant status in the global real estate market. So, should one still consider real estate investment? Definitely. With black money

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disappearing from the scene, this would be a major step towards an organized and transparent real estate market. Once the initial knee-jerk reaction settles down, significant volume jump should happen. It will also change the way how real estate is transacted in India. Online aggregators like Square Yards have been working hard towards creating an ecosystem of transparency and accountability dealings in real estate. This move will aid their efforts. Also, a lot of secondary market brokers will consolidate. We will also see the share of volumes of non-cash primary transactions rise. The demand for online aggregators and organized consultants will go up. As a proxy play to developers and asset plays, aggregators should attract more interest now.

However, the immediate fallout would be on asset prices, which will fall, giving impetus to high volume sales. This is the beginning of organized real estate market in India.

What is Demonetization?

Demonetization means that Reserve Bank of India has withdrawn the old ₹500 and ₹1000 notes as an official mode of payment. According to Investopedia, demonetization is the act of stripping a currency unit of its status as legal tender.

Impact of Demonetization in Indian Economy :

1) Black Money:

Black money stored in the form of ₹500 and ₹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.

2) Terror Funding:

Fake Indian Currency Notes (FICN) network will be dismantled by the demonetisation 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 Naxalite hit states.

3) 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.

4) **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 rejig campaign strategies in light of expected cash crunch.

5) **Moving towards digital payments:**

Demonetization will likely result in people adopting virtual wallets such as Paytm, Ola Money etc. This behavioural change could be a game changer for India. Govt. is also introducing schemes of discounts for digital transactions. E.g.: Fuel stations/Railway tickets/Life Insurance etc.

6) **Temporary chaos and confusion:**

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

7) **Reduction of interest rates –**

With rise in deposits with banks, there is increased likelihood that interest rates would fall in the near future

Impact on Real Estate Sector :

• Positive Impact :

1. Fall in interest rate will make HomeLoans cheaper and lower the EMI
2. Lesser interest could make it an attractive investment proposition with higher RoI
3. More funds in banks and higher eligibility to borrow
4. Government may spend more in infrastructure which in turn will have positive impact on the sector
5. Level playing field across the country

• Negative Impact

1. In the short term, prices and demand could go down by up to 30% from present levels
2. Real Estate Investor class might disappear

3. Without the incentive of adjustment of black money, real estate may not find many takers as the ticket size is big, transaction and carrying cost are way too high and liquidity is an issue.

Effects of Prohibition of Benami Property

Transaction Act, 1988 as amended by Benami Transactions (Prohibition) Amendment Act, 2016.

- Property purchased after 1988 is covered.
- Wider definition in 2016 amendment Act
- Power to punish both the beneficial owner and the Benamidar.
- Power to confiscate the property
- Imprisonment up to 1 to 7 years for entering into such transaction and 6 months to 5 years for giving false information.

CONCLUSIONS:

The demonetisation 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, this argument is based on impressions rather than on facts. While the facts are not available to anybody, it would be foolhardy to argue that this is the only possibility. As argued above, it is possible that these cash balances were used as a medium of exchange. 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 demonetisation on the economy and its agents. It is likely that there would be a spurt in the banking deposits. While interpreting the phenomenon, however, one has to keep in mind that a large part of their deposits were earlier used for transactional purposes.

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