

Demonetization and its effect on Banking Sector

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Abstract: Everyone is aware about the demonetization policy of the government by banning Rs. 500 & Rs. 1000 currency notes. One can understand that it would have a pretty bad impact on SMEs, small traders, real estate, transport sector, consumer durable goods industry. Not only these sectors but it would major affect the rural areas business as over there, majority of the transactions are made in cash. The ban of Rs. 500 and Rs. 1000 currency notes will impact those industries where hardcore cash transactions are made. Demonetization will affect the liquidity, but for a short term 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.

CURRENT SCENARIO

Before I state anything, a clear picture of all the banks and ATMs is present which depicts today's reality. Long ques of people waiting for currency exchange or deposits outside the banks and for cash withdrawals outside ATMs. But definitely this is for a short time.

Many industries are going to be benefitted due to the demonetization policy and many are going to suffer. But overall the demand is going to or rather has already reduced by 30%-40% due to lack of money with the consumers. As the demand goes down, the profits for the quarter ending December'16 is going to fall. The demand will catch the momentum as the dust settles down. The economy will stabilize as soon as there is enough new currency in the hands of people.

IMPACT OF DEMONETIZATION ON BALANCE SHEET OF BANKS

- Decline in currency in circulation on account of demonetisation led to a surge in bank deposits.
- Total currency in circulation declined by about ₹ 8,800 billion (₹8.8 lac crores). This, in turn, was largely reflected in sharp increase of about ₹ 6,720 billion (₹ 6.72 lac crores) in aggregate deposits of the banking system even after outflows in NRI deposits during the period.
- Between end-December 2016 and early March 2017, there was a net increase in currency in circulation by about ₹ 2,600 billion. During this period, deposits with banks also declined moderately.
- As per data for October 28, 2016 (prior to demonetisation) and February 17, 2017 (latest available), aggregate deposits of SCBs increased by ₹ 5,549 billion during the period.
- 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 ₹ 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. This may be due to the expected transitory nature of the bulk of such deposits and weak demand as reflected in the subdued growth of credit.

IMPACT OF DEMONETIZATION ON PROFITABILITY OF BANKS

- Banks' net profits essentially reflect the difference between interest earned on loans and advances and investments, and interest paid on deposits and borrowings, adjusted for operating costs and provisions.
- Loans and advances and investments, which are the main sources of interest income, together constitute more than 85 per cent (61 per cent accounted for by loans and advances and 25 per cent by investments).
- The sharp increase of 4.1 percentage points in the share of CASA deposits in aggregate deposits to 39.3 per cent (up to February 17, 2017) resulted in a reduction in the cost of aggregate deposits.
- Banks have also lowered their term deposit rates; the median term deposit rate declined by 38 bps during November 2016-February 2017.
- The decline in the cost of funding resulted in decline in the 1-year median marginal cost of funds based lending rate (MCLR) by as much as 70 bps post-demonetisation (November 2016-February 2017).
- Banks earned return of around 6.23-6.33 per cent under reverse repos and market stabilisation scheme (MSS) as against the cost of CASA deposits of around 3.2 per cent.
- Accordingly, for an average deployment of about ₹ 6 trillion in a quarter under reverse repos and MSS securities, banks' net interest income from increased deposits is estimated at about ₹ 45 billion in a quarter after demonetisation.
- Banks continue to enjoy the increased share of low cost CASA deposits, although it is gradually declining with the increase in currency in circulation.
- The increase in net interest income would need to be adjusted for the cost of managing withdrawal of SBNs and injection of new bank notes (such as calibration of ATM machines, staff overtime, security arrangements, lower fees/waiver of fees on digital modes of payments), the exact details of which are not available at this stage.

REVIEW OF LITERATURE

Nithin and Sharmila (2016) studied demonetization and its impact on Indian Economy. They opined that demonetization has short term negative impact on different sectors of the economy and such impacts are solved when the new currency notes are widely circulated in the economy. They also argued that the government should clear all the problems created due to demonetization and help the economy to work smoothly.

Nikita Gajjar (2016) deliberated a study on Black Money in India: Present Status and Future Challenges and Demonetization. She described the framework, policy options and strategies that Indian Government should adapt to tackle with this issue and the future challenges to be faced by the Government.

Vijay and Shiva (2016) examined demonetization and its complete financial inclusion. They felt that the rewards of demonetization are much encouraging and the demonetization is in the long-term interest of the country. They expressed that it had given temporary pain but it taught financial lessons. It influenced banking industries to do considerably investment on digitalization of banking services.

Manpreet Kaur (2017) conducted a study on demonetization and impact on Cashless Payment System. He said that the cashless system in the economy has many fruitful benefits less time-consuming, less cost, paper less transaction etc. and he expected that the future transaction system in all the sectors is cashless transaction system.

Lokesh Uke (2017) researched on demonetization and its effects in India. He studied positive and negative impact of demonization in India. The study was based on secondary data available in newspaper, magazines etc. The main purpose of demonetization is to eradicate the black money and diminish the corruption. He expressed that Government of India has become success to some extent. Demonetization had negative impact for a short duration on Indian financial markets. But he said that the real impact will be shown in future.

Sweta Singhal (2017) carried out research on Demonetization and E Banking in India. It was a case study to check the awareness level of people of rural areas in India about e-banking facilities and how much it has increased after demonetization. A sample size of 100 was used with ANNOVA test to show that rural people differ much with urban people in their awareness level as well as usage level of e-banking. It was found that urban male youth have higher awareness and usage of e-banking. She felt that the study shall also helpful for banks to improve their e-banking facilities.

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.

DEMONETIZATION AND BANK OPERATIONS

Demonetization has brought plethora of challenges in additions to the challenges which are already facing by Banks. The influences were short-term and long-term views. In short-term, it disrupted the banks and stressed strongly to carry out bank operations and in long run it helped the banks to pool the deposits without incurring of any cost. Here are four influences of demonetization on Banks.

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.
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.
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.
5. **Results of Post Demonetization on Bank Operations**
6. There are positive and negative results of Post Demonetization on Bank operations. Both have influenced
7. Banks' liquidity and profitability and employees too. The following are positive results of demonetization.
8. **Free flow of deposits:** Banks have gained deposits substantially after demonetization which they can invest
9. for improving their liquidity and profitability.
10. **Improved digital Interface:** Improvement in digital tools and equipment to execute bank transactions has avoided cash loss for various reasons like theft, dacoits and misappropriations.

11. **People's surplus at Bank:** cash is an idle asset which does not yield any income unless kept in a bank. So, demonetization made the people to keep their surplus money in a bank to earn some sort of income.
12. **Increased number of Customers:** Demonetization has influenced public to come and execute transactions with banks. It made even a non income group people to visit bank and have an account. It increased number of account holders in banks while increasing deposit corpus.
13. Similarly, Demonetization has brought some operational issues to Banks. It disturbed Banks' Employees,
14. Operational Costs and Profitability. The following are negative influences of Demonetization.
15. **Cash Reserve Requirement:** 100% CRR on incremental deposits meant that banks did not earn any interest on Rs. 3 Lakh crore of deposits for nearly a fortnight.
16. **Waived off ATM Charges:** ATM charges were waived off during banned note exchange and banks incurred a loss of Rs. 20 in every transaction.
17. **Waived off Merchant Discount Rate:** Banks incurred loss of 1% discount charges from merchants on using of every card transaction.
18. **Reduced SMEs's Sale and influence on NPAs:** During demonetization, some SME businesses had seen their sales drop by 50-80 percent and could default in their installments to banks. This led the banks to consider it as NPA and affected its level in banks.
19. **Stress on Employees:** Bank Employees were put under pressure and overtime work environment. It depressed them and kept imbalanced life style. Few cases were found where the employees committed suicide due to work pressure.

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. The series of currency will not be acceptable as valid currency. The demonetization was done in Nov 2016 in as an effort to stop counterfeiting of the current currency notes allegedly used for funding terrorism, as well as a crackdown on black money in the country. Demonetization is a generations' memorable experience and is going to be one of the economic events of our time. Its impact is felt by every Indian citizen. 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.

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