

Demon-etization in India

On the 8th of November, the Prime Minister of India, Narendra Modi held a surprise press release and withdrew the tender of Rs 1000 and Rs 500 currency notes with a motive to eradicate black money (non-declared / taxed wealth) and fake currency. This move however led to the scrapping of 85% of the available cash in an economy which is almost 90% reliant on it.





Overview






This bold and audacious move against corruption and black money aimed at spurring the economy to heightened growth in turn rendered millions of people in India effectively unable to engage in day-to-day transactions and hampering businesses and individuals who hadn't yet evolved digitally to pay and receive payments for their goods or services. The situation had remained grim post two months of this move - instead of booming business or large new investments, the images that had reflected India's current economic story included snaking lines outside bank branches / ATM's (now largely normalized as cash has been made available and withdrawal limits enhanced), distressed workers migrating back to their villages, and tax raids on jewelers and officials caught with hordes of allegedly illicit cash.

While the intent was lauded widely, the policy's below expectation implementation—through an avalanche of amendments, rollbacks and patchwork fixes—undercuts the government's reputation around efficiency and also damaged the credibility of India's central bank that was caught unprepared.

From a business standpoint, the larger corporate houses have remained largely immune on account of lesser dealing in cash be it for wages or payments or receivables. However, the worst hit seems to be daily traders, vendors and small scale industries. Rural India which has low penetration of the banking system witnessed the worst impact with the inability to pay for daily needs and proper cash distributing infrastructure causing widespread stress.

From a sector standpoint, the following tables would explain the impact:

Sector	Impact	Issues / Gains
Agriculture		Inability to pay for seeds and fertilizers; and the selling of fresh / perishable produce has impacted this sector negatively.
Real Estate		Where we see a huge population of migrant laborers employed. The daily wages are paid in cash –the sucking out of the currency rendered them jobless and many are heading back to their villages where there is a lack of job / livelihood earning capabilities.
Manufacturing		Taken a hit. With reduced consumer spending, manufacturers are forced to cut production and deal with piling inventory. However once the cash is back in the system, this would ease off.
Services		Financial Services have been hit adversely for lending business, while the payment and liabilities side picked up momentum. Other B2C services have been hit temporarily, expected to pick up in the medium term once the cash situation eases off.

Financial Services	Impact	Issues / Gains
Banking		Gains largely on account of flushed liquidity. Ability to earn better margins on loans. However, this may act as a deterrent if they are unable to deploy this money immediately.
Asset Management		Banking Channel hit as there is a larger deployment of workforce around distribution of cash / currency.
Life Insurance		Temporary gain, as people see this as a vehicle to invest in to avoid penalties / additional tax.
Non-Banking Finance Companies (NBFC)		Rural NBFC's worst hit as they disburse as well as collect in cash. With the cash being sucked out of the system, NPA's are expected to witness a sharp rise.
Microfinance		
General Insurance		With the car sales dipping, which is a huge portion of GI Sales volumes, the sector is likely to see pressure in the rural areas where the economy is largely dependent on cash.

While the decision has inflicted pain to the economy in the short run owing to its poor implementation, it has helped the liquidity situation which will mean lower interest rates in a scenario where commercial and personal lending is expensive. The central bank is keeping a hawk eye on inflation which has eased off and is expected to go down further in the medium to long term.

Demonetization has also helped with bringing the larger population under the banking remit. With grant of Payment and Small Finance Bank Licenses, the Government and Central Bank have made it very clear on the go forward strategy. Also there is a constant push to use the larger available technology platform for transactions over the conventional brick and mortar set ups of branches. There are also few “Christmas Schemes” announced by the Government to push digital / app based payments where there will be cash back / sops provided to the user on transacting through these channels. And with tax declaration schemes being lapped up by people, the tax receipts are likely to be substantially higher.

While the current estimates indicate a 0.5-1% hit on the GDP over the next few months, the benefits of demonetization will be visible with greater financial inclusion, lower inflation, a healthier GDP to Tax ratio and a cashless economy in the long run.

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Author Contact Information

Roopank Chaudhary

Associate Partner, McLagan
Aon Hewitt | Talent, Rewards & Performance
+91 22 403 45000
roopank.chaudhary@aonhewitt.com

Surya Shekhar De

Senior Manager, McLagan
Aon Hewitt | Talent, Rewards & Performance
+91 22 403 45000
surya.shekhar.de@aonhewitt.com

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