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To Study Impact of Demonetization on Finance with Reference to Gross Domestic Product (GDP)

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ABSTRACT

The research encompasses all impacts of demonetization in Indian economy. Primary emphasis is drawn upon the economic instability of India during the demonetization. It also shows how the key factors were affected during this critical phase. Core highlights of research are to check the volatility of GDP rate as well as the impact on finance sector in Indian economy. 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 remonetize.

Keywords: *Demonetization, Economy, Volatility.*

1. INTRODUCTION

8th of November 2016, Government 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. People had time span until December 30, 2016, to exchange the notes held by them. 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".

Demonetisation move also had an impact on FY17 numbers. The growth was revised upwards to 8% for the previous year from 7.9% due to revision in the IIP and WPI series.

2. OBJECTIVES

- To study aspects economic condition of India during demonetization face.
- To study Comparison between fragments of GDP factors leading to volatility

3. STATE OF ECONOMY

The Indian government claims that the demonetization effort is to stop the counterfeiting of the current currency notes allegedly used for funding terrorism across the border by the neighboring countries, and as an attack on the black money in the country. The move was claimed as an initiative to curb corruption, trafficking of drugs, and smuggling across borders. The supply of currency notes of all denominations has seen an increase by about 40% during the period between 2011 and 2016, the Rs. 500 and Rs. 1,000 denomination notes has increased by 76% and 109% respectively during this period due to forgery. This forged cash is usually used to fund various terrorist activities against India. The outcome of the decision is to eliminate currency notes of selected denominations has been taken (Governor of the Reserve Bank of India, Urjit Patel, and Economic Affairs secretary, Shaktikanta Das). Nations demonetize their local units of currency for various reasons. Some include combating inflation or corruption and to discourage a dominative cash system.

Constituents of Money in an Economic System

- Supply of money refers to the total stock of domestic payments i.e. Currency notes and coins in circulation as a legal tender as well as the demand deposits with banks.
- The flow of money adheres to the circulation of money over a period.
- The original constituents of money in Indian economy for study are:
  (A) Traditional money
  (B) Modern money

- Traditional Approach
  Readily accepted money in economy

$$M_{1=} C+DD$$

C= Currency note and coins DD=Demand deposits.

- Modern Approach
  Close substitute of money in measure of medium of exchange

$$M_{2=} C_{c+} DD+ TD+ SD+ GS+ CM$$

C= Currency note and coins DD=Demand deposits.
TD=Term deposits SD=saving deposits
GS=Government securities CM=Credit or near money

RBI's Measure of Money Supply

- In order to control the money flow and curb up the excess amount of circulated money in economy RBI uses the following steps to control the same:

$$M_1=C+DD+OD$$
$$M_2=M_{1+}SD$$
$$M_3=M_2+TD$$
$$M_4=M_3+TDP$$

- Demonetisation after every 10 years of the circulated money by the RBI with reference to which ever political party is into ruling party, it is mandatory to have demonetization of money

Factors Influenced Highly During the Demonetization

- The economic factors influenced during demonetization in accordance with GDP were:
  i. Interest rate
  ii. Yield curve
  iii. Key indicators

- The focus of this research is on the Key Indicators of Economy of India :
  An economic indicator is only useful if one interprets it correctly. It is observed showing a strong correlation between economic growth (as measured GDP) and corporate profit growth.

Table No: 1 Key Factors Affected During Demonetization

Leading Factor	Lagging Factor	Concurrent factor
• Stock Market	• Income	• Trade
• Manufacturing	• Inflation	• Production
• Inventory levels	• Currency strength	• Retail sale
• Real estate	• Interest rate	
• New business	• Balance of payment	

The above factors were at its peak point during the demonetization phase. It had a diversifying effect on the money circulation process in above factors. Since the payments and the transactions involved in this sectors is very high. Monetary policy held by Reserve Bank of India (RBI) during demonetization was incompatible in order circulate and help back the above factors to stand to recover with a proper source and utilization of money.

GDP Rate and Effects

GDP (gross domestic product) at market price = value of output in an economy in the particular year - intermediate consumption
At factor cost = GDP at market price - depreciation + NFIA (net factor income from abroad) - net indirect taxes

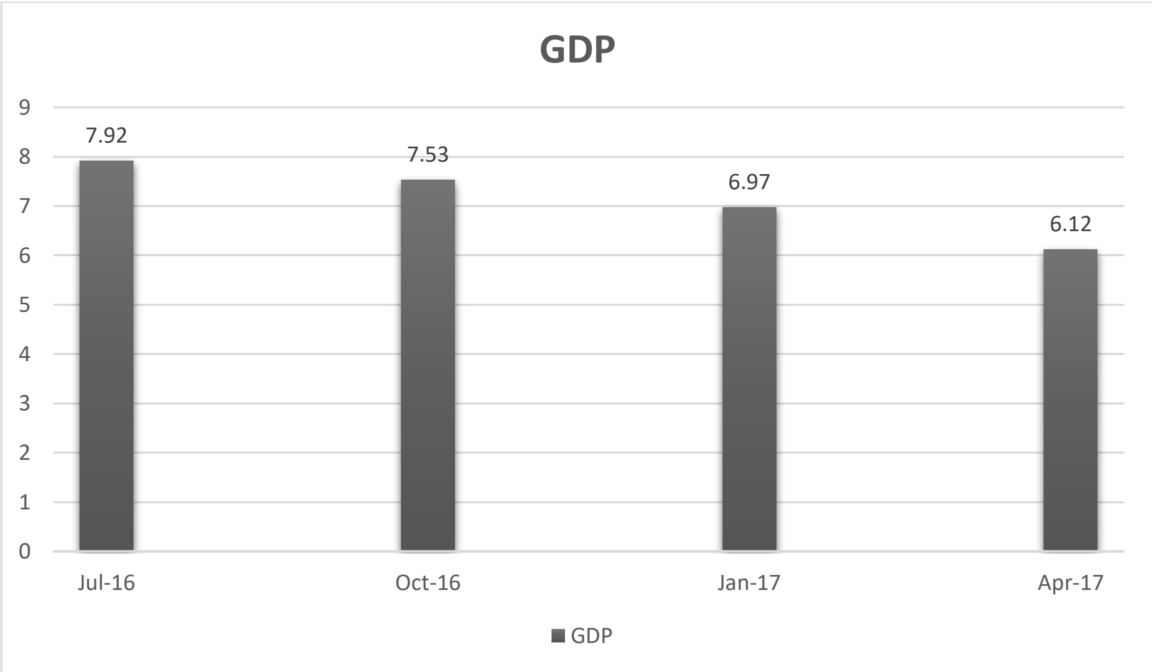
Money is spent within the economy, and then combines them to find the total output:

GDP= C+I+G+(X-M)

Where,

C= household consumption expenditures / personal consumption expenditures
I = gross private domestic investment
G = government consumption and gross investment expenditures
X = gross exports of goods and services
M = gross imports of goods and services

Note: (**X** - **M**) is often written as $\mathbf{X_N}$ or less commonly as **NX**, both stand for "net exports"



Graph no: 1 GDP of India from July 2016- April 2017

- The above graph shows a decline in the economic status of Indian economy during the pre and posts demonetization stage it depicts the drastic decline in the phase of from the October 2016- January 2017. The reason behind this greater fall in GDP rate was due to the low level of money in circulation.

4. FINDINGS

- Outcome of the study proven to be vital and helpful in understanding the flotations GDP rate as well its interlinked Growth rate of Indian economy
- Demand and Supply of money during demonetization
- Effects prevailing to urgency/requirement of money by an individual as well as its flow in the economy.
- Heavy impact on the Business with production matters.
- The Key Indicators of the economy were highlighted through the research matters.

5. SCOPE

This research emphasis on the wider range perspective of understanding the impact of demonetization on the Gross Domestic Product. This research would be helpful in understanding how the economic flow i.e. demand and the supply of the money for the same had an effect on the individual, corporate and on Economy as a whole. Greater focus is given to money flow in the system with its speed to circulate with people and banks.

6. CONCLUSION

- Considering the above factors it is mandatory to control the velocity of money
  I.e. Transaction velocity of money,
  It refers to ratio of the annual volume of transaction to the stock of money held in an economy

Transaction Velocity (TV) = Total value of transactions/ Total money supply

- The money available for the domestic trade supply as well as the International trade had a sarcastic effect on Indian economy.
- The individual had an adverse effect due to the money available for purchasing drastically dropped to more the expected rates. Even the amount of new legal tendered money was restricted in banks.

- The business even after having a planning for the various production function the demand for the products dropped in the market thus the goods were either damaged or produced in excess.
- Only 8,000 and 900 crore black money was collected from total money in circulation during demonetization.

7. REFERENCE

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