

# **Demonetisation and its Impact on Indian Economy**

**Presentation  
at  
Global Castor Conference - 2017**

18<sup>th</sup> February, 2017

# Content

➤ **Facts**

➤ **History**

➤ **Impact**

## How is India placed

Country	GDP 2016 (US\$ Bn)
US	18,562
China	11,392
Japan	4,730
Germany	3,495
UK	2,650
France	2,488
<b>India</b>	<b>2,251</b>
Italy	1,853
Brazil	1,770
Russia	1,268
S Africa	280

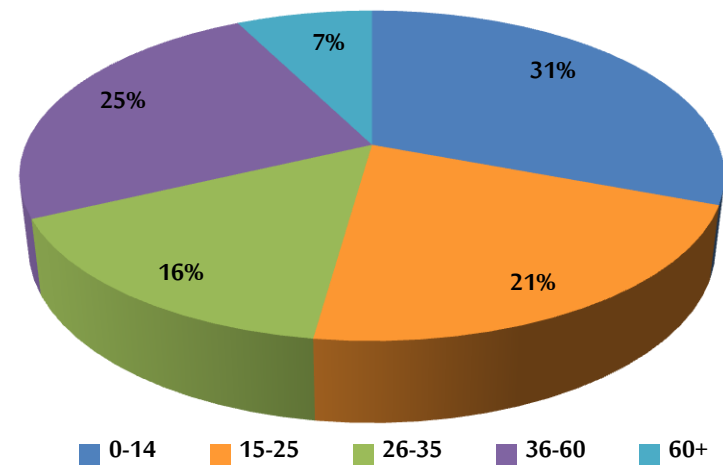
### INDIA

#### ➤ Composition of GDP (2015-16)

- Agriculture – 18.4%
- Industry – 28.2%
- Services – 53.4%

#### ➤ Debt to GDP (2015) – 67%

#### ➤ Demographics: ~1.3 bn Population




## Demonetisation

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- On 8<sup>th</sup> Nov 2016, the government announced the demonetization of high-denomination currencies – viz. INR 500 and INR 1,000 notes
- Total currency in circulation (*as on 8<sup>th</sup> Nov*) ~US\$260bn, of which INR 500 and INR 1,000 notes accounted for ~86% (US\$225bn or ~INR 15.4 trillion) ~ 10% of GDP
- Stated Objectives
  - To reduce black money (unaccounted income) in the system
  - Curb funding of “illegal” activities
  - Address the problem of fake currency notes
- New INR 2,000 note introduced

## Key Facts

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- Size of the black economy in India as per World Bank estimate (2007) ~23.2% of GDP – using the same estimate % : Current  
Size ~\$500 bn +
- Informal Sector\* – 45% of GDP, 80% of employment – large part is dependant on cash transactions
- Currency in circulation
  - As % of GDP – India 12%, EM Average of ~7%
  - Continued spike over the last 12 months (as % of GDP) – 11.3% to 12.3% 
  - As % of bank deposits – India 17.3%, Asian economies 4.3% to 10.4%



*\* Source: Citi Research*

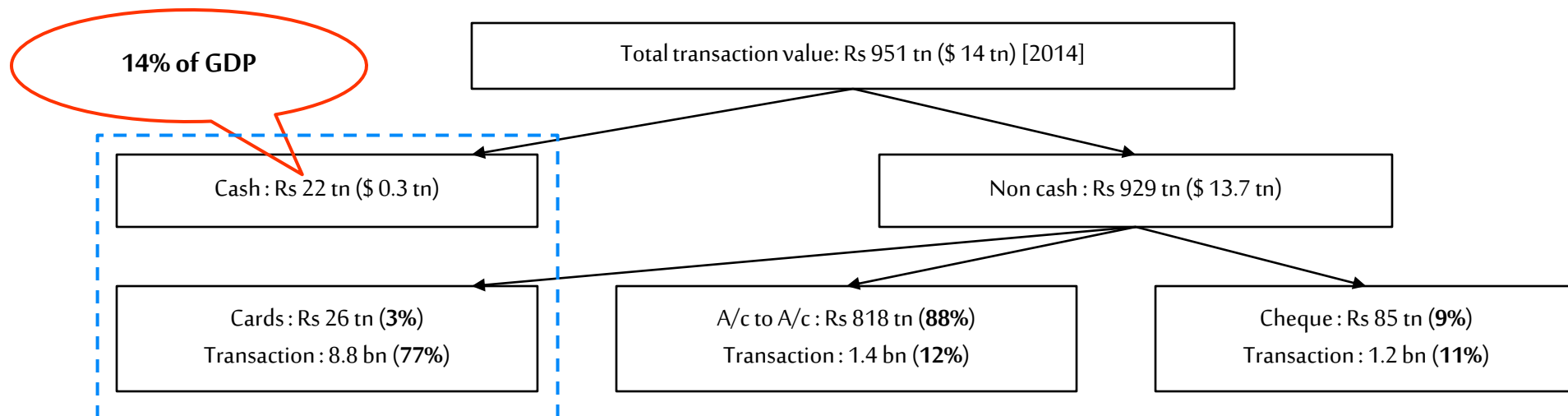
## Key Facts

### ➤ Banking Penetration

- Bank Branches – Urban: 66%, Rural: 34%
- Unbanked Population ~30-35% (*World Bank estimates*) (post Jan-Dhan)
- 43% of total accounts inactive, 23% of Jan-Dhan accounts inactive

### ➤ Cashless Transactions

- No. of non-cash transactions – India 11/person (*lowest among the BRICS*), US 403/person



- Withdrawal per debit card is one of the highest amongst EM countries
- E-money transactions – only 0.05% of all non-cash retail transactions by value

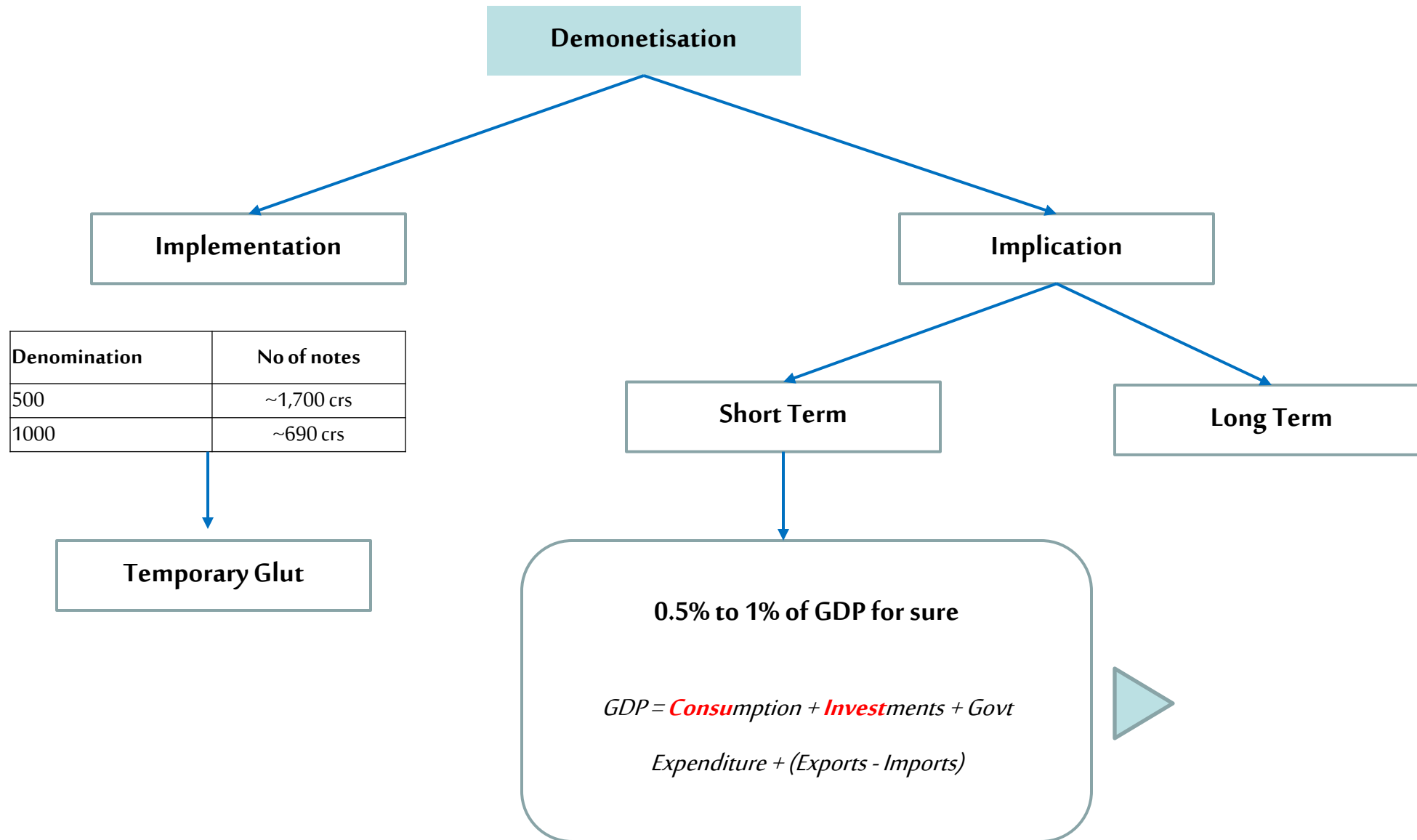
## History

- India has carried out demonetisation twice before – in 1946 and 1978 – no data for 1946
- In Jan-1978 exercise, currency worth Rs 1.46 bn (1.7% of total notes in circulation) was demonetised. Of this RS 1.0 bn (or **68%**) was tendered back
- The impact of the demonetisation exercise was as follows:

Variable	Impact
Deposit Growth	Rose sharply
Currency in Circulation	Moderated sharply
SLR Securities	Sharp increase in investment in Government securities by banks
Credit Growth	Initially subdued but started picking up after 4 months (by May 1978)
GDP Growth	No major impact as high –demonetisation notes which were cancelled only accounted for 0.1% of GDP

**In 1978 the value of demonetisation was very small (only 0.1% of GDP). However, the 2016 demonetisation covers 86% of the total currency in circulation (10% of GDP). Hence, this is a substantially more widespread exercise which will have far reaching implications**

# Demonetisation Impact





## Demonetisation – Current Status

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When 45% of GDP is informal i.e. cash dependent - consider this

- To remonetise, 20-24 bn pieces of currency notes to be printed - (estimated time of 7-8 months) - assuming the work started in mid September, the challenge to continue till Mar/Apr 2017
- As per RBI, as on Jan 27, of \$ 225 bn of currency - \$ 113 bn i.e. 50% is remonetised – of which \$ 100 bn withdrawn by public till Jan 20

**Some lose of GDP in Q4 CY16 and Q1 CY17 seems unavoidable**

## Near-term Impact – Consumption growth pushed by two quarters (1/2)

- Both manufacturing and services PMI have moved to contractionary zone

	Oct-16	Nov-16	Dec-16	Jan-17
Manufacturing PMI	54.4	52.3	49.6	50.4
Services PMI	54.5	46.7	46.8	48.7

- Consumer discretionary space also impacted

- 2-wheeler demand fell in November and continue to decline in December
- Passenger car demand fell in November however year end discount supported demand in December
- Commercial vehicle sales were down 7%YoY in November but recovered in December

- Impact

Units Sold	Avg of Last 12M	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17
Commercial Vehicles	67,009	71,035	75,795	54,705	61,965	61,239
Two Wheelers	16,39,794	20,75,399	19,84,883	14,32,157	11,10,418	12,62,141
Passenger Vehicles	3,08,005	3,49,390	3,48,242	3,05,139	3,05,138	2,65,320
Three Wheelers	66,279	79,078	82,790	57,012	45,666	31,345
<b>Total</b>	<b>20,81,087</b>	<b>25,74,902</b>	<b>24,91,710</b>	<b>18,49,013</b>	<b>15,23,187</b>	<b>16,20,045</b>
% change (MoM)				-26%	-18%	6%

## Near-term Impact – Consumption growth pushed by two quarters (2/2)

- Real estate market going through a transaction freeze in anticipation of lower prices / interest rates, may be lack of currency.....??
- December volumes were more impacted than November in the cement industry (*however market expects recovery post Jan/Feb '17*)

➤ Telecom subscriber additions were lower in November than in October

	Sep-16	Oct-16	Nov-16	Dec-16
<b>Cement Production</b>	5%	7%	1%	-9%

➤ FMCG sales growth

(Mn units)	Avg of Last 12M	Sep-16	Oct-16	Nov-16
Urban	5.05	17.91	17.96	16.69
Rural	2.45	2.95	10.72	4.4
<b>Total Subscriber</b>	<b>7.50</b>	<b>20.86</b>	<b>28.68</b>	<b>21.09</b>
<b>% change (MoM)</b>				<b>-26%</b>

<i>M-o-M Growth %</i>	Oct-16	Nov-16	Dec-16
<b>Sales Value Growth</b>	9.9%	2.7%	3.5%

## Other Parameters affecting Growth

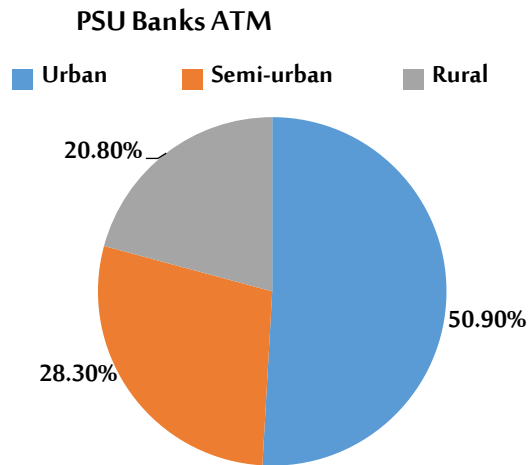
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- Consumers to postpone non-essential consumption; rural demand to be hit the hardest
- Loss of productivity (*people queueing up for hours every day to deposit and withdraw cash – for about 6-8 hrs*)
- Supply-chain disruption, particularly in the SME segments, is likely to be a drag (*Some stress in the SME segment could start impacting financial institutions also and affect credit flow*)
- Drop in purchasing power and effect of “conversion cost” on purchasing power (*marginal propensity to consume out of the stored black money is low, but the wealth effect could impact discretionary consumption*)
- Construction activity could be impacted, resulting in significant impact on employment scenario (*2004 to 2011 construction accounted for ~50% of the non-manufacturing jobs*)

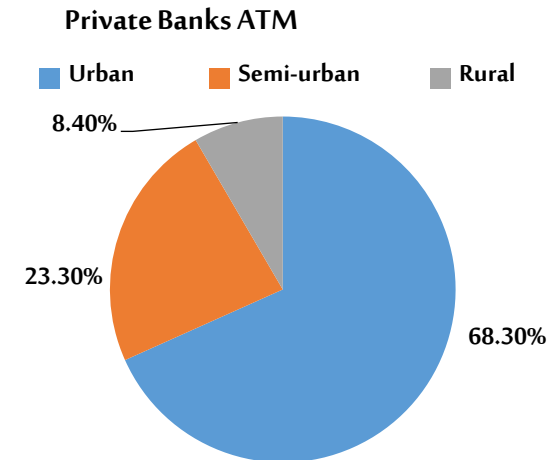
## Long Term Impact – How soon digitisation will usher in?

➤ **Illicit / Illegal transactions** → YES, but need effective enforcement of tax regulations

➤ **Digitisation** → YES, but rural coverage & challenges



Total ~220K ATMs



➤ **Cost of Digital transaction**

To Merchant
<ul style="list-style-type: none"> <li>PoS machine charges</li> <li>Delayed payment</li> </ul>

To Customer
<ul style="list-style-type: none"> <li>2% credit card transaction cost</li> <li>0.7%/1% debit card transaction cost</li> </ul>

## Positive Developments

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- Financial Services
  - Higher deposit growth
  - Lower lending rates and higher deposits could be growth positive (*once demand comes back*)
  - Better financial inclusion and faster technology adoption – money stays in system
  
- Tax Revenues
  - Increase in tax base might reduce tax rates (*medium term*) (*India Tax/GDP is 16.7%*)
  - Additional direct tax revenue - better public finances (*IDS accretion - pushover to FY18*)
  
- Financial Savings
  - Increase in proportion of household financial savings [*FY10: 12%, FY11: 10%, FY15: 7.7%*] (*As hoarding cash becomes difficult in the future*)
  - Indirect impact on gold imports and hence CAD
  
- If cashless transactions increase then it could increase productivity too (*medium term*)

## Long Term Impact

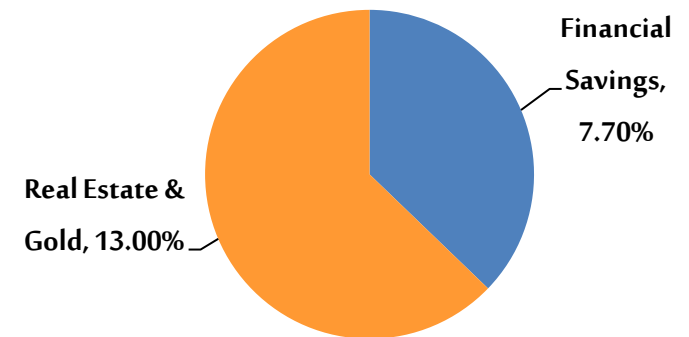
- Economic laws
- Policy reforms
- Administration
  - Minimum Government
  - Maximum Governance
- Tax / GDP —————→16.7%

3.7 crs tax payers	76 lakh have income > INR 5 lakh
1.25 crs car buyers	2 crs flew abroad in 2015

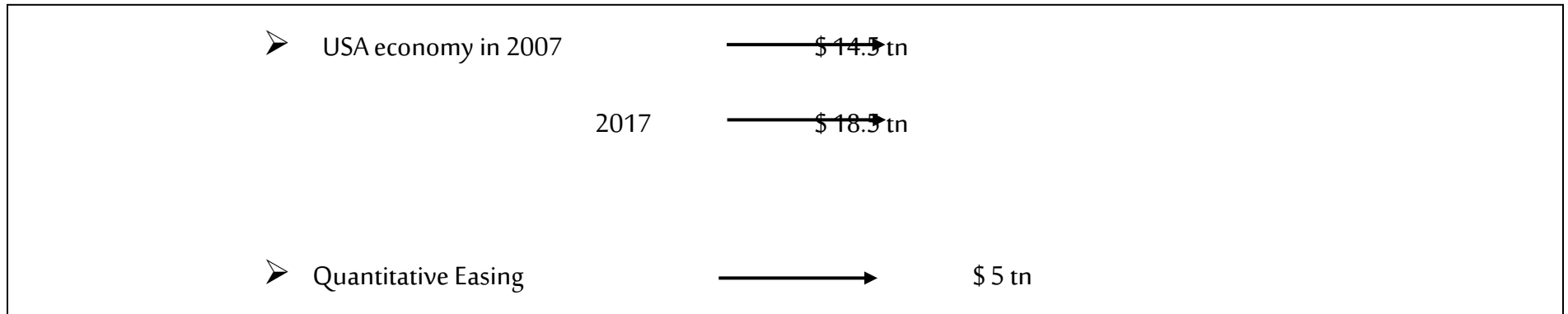
- Mkt Cap / GDP —————→68.5%
- Household Saving / GDP —————→20.7%

Country	Tax to GDP (Dec-15)
US	25.4%
China	19.4%
Japan	30.3%
UK	32.9%
Italy	42.6%
Brazil	33.4%
Russia	34.8%
S Africa	24.7%

### Household Savings



## Time Impact – US Economy – an Empirical Study



### ➤ Unemployment

%	Dec-07	Dec-08	Dec-09	Dec-15	Dec-16
Unemployment rate	5.0%	7.2%	10.0%	5.0%	4.7%

➤ PROMISE in 2008:                    QE for Employment

REALITY in 2016:    same unemployment post \$ 5 tn QE

➤ GAP BETWEEN INTENTIONS AND OUTCOME



**The World is Full of Willing People**

**Some Willing to Work**

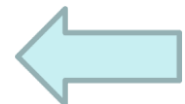
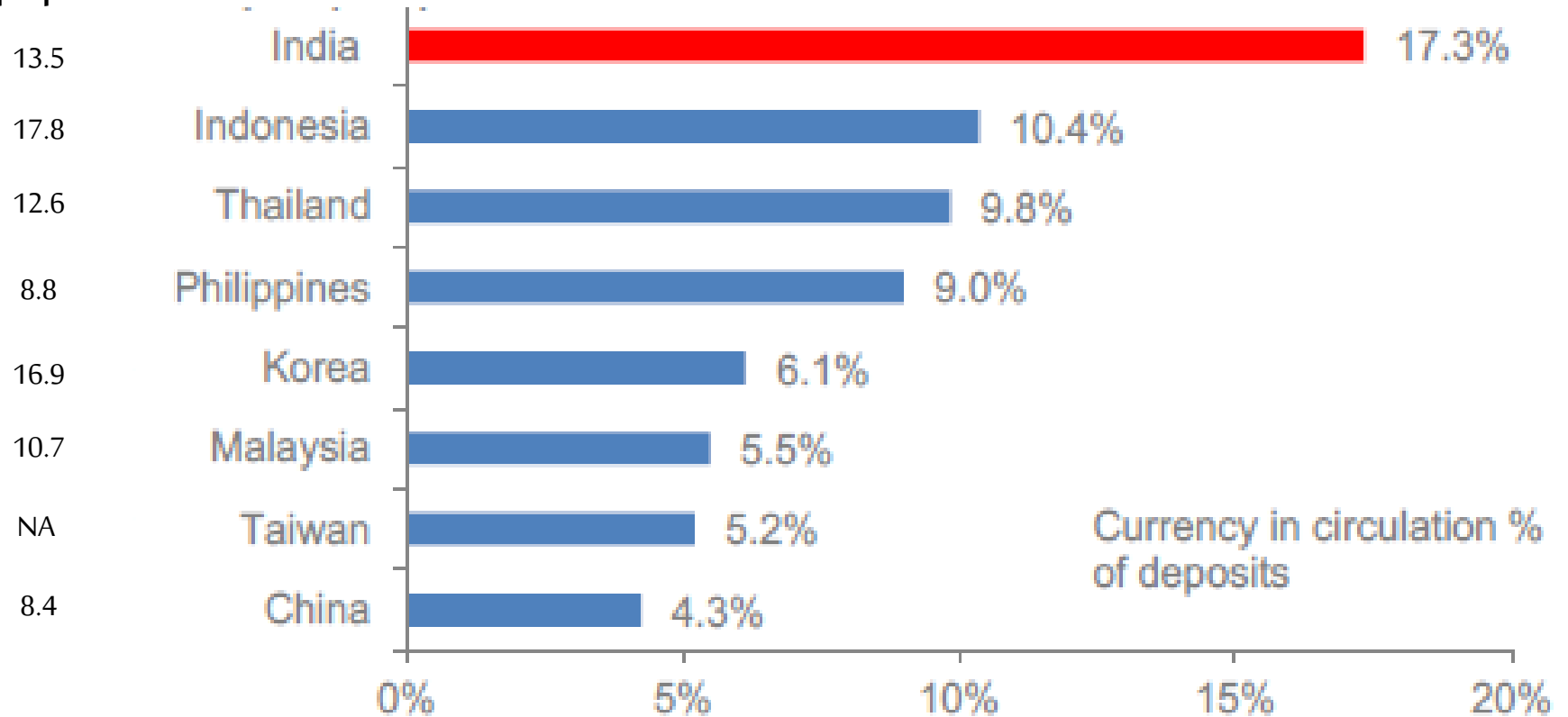
**and**

**Others Willing to let Them**

**THANK YOU**

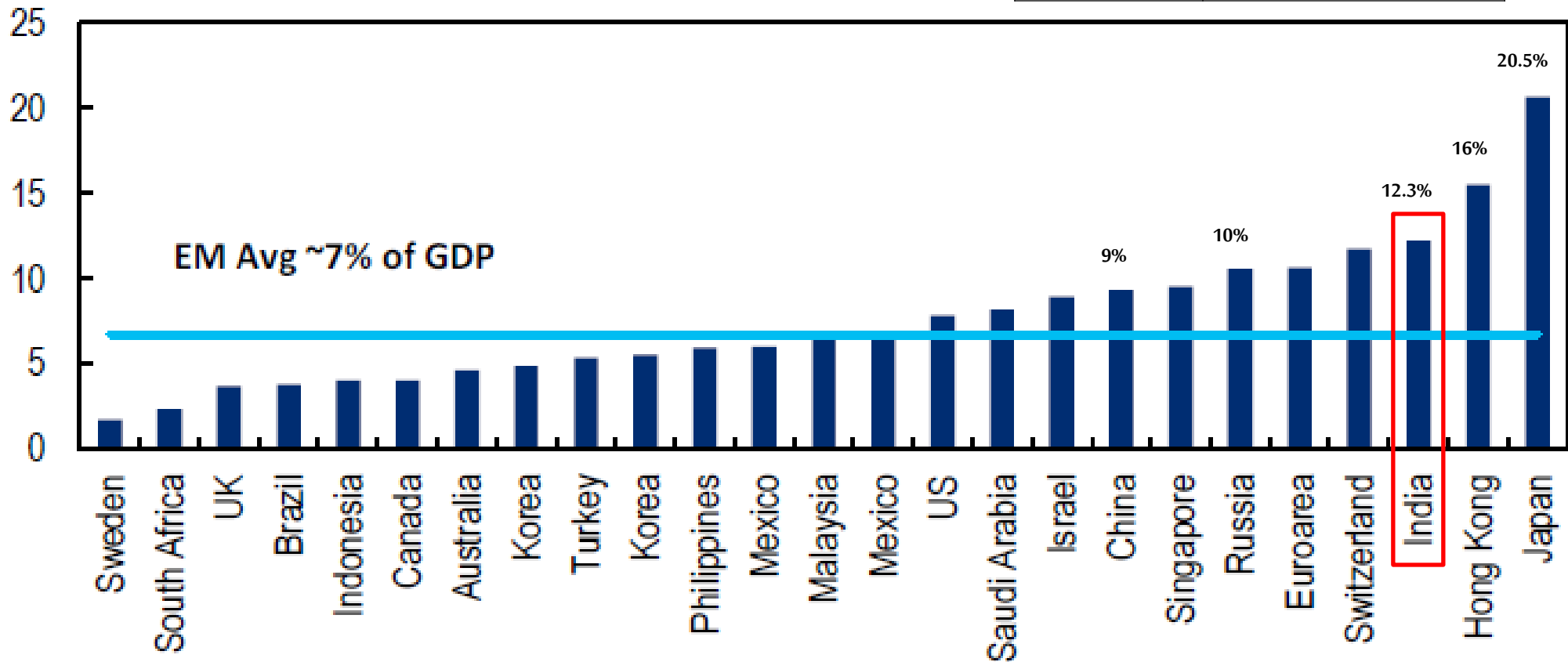
## Currency in Circulation as % of Bank Deposits

Bank Branch / 1 lakh  
people

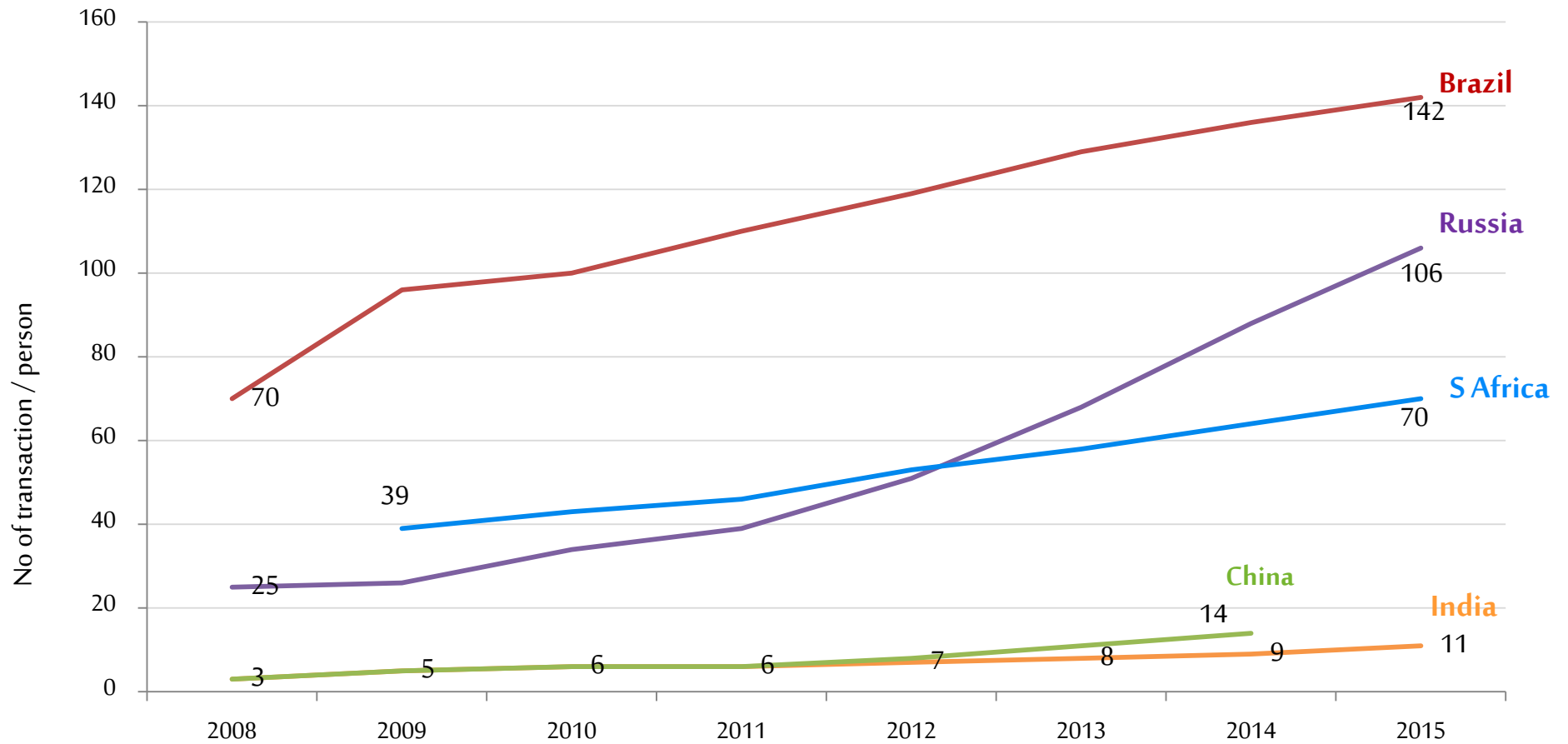


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Russia	1,268



# Non-Cash Transactions



Source: BIS



## Capex Spending Stagnated as % of GDP

(INR Bn)

Year	GDP (at Current Prices)	Capex	Capex as % of GDP
FY14	1,12,366	1,877	1.67%
FY15	1,24,337	1,967	1.58%
FY16	1,36,753	2,530	1.85%
FY17	1,50,754	2,798	1.86%
FY18	1,68,475	3,098	1.84%

