

# SMART

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### *Editorial*

#### **Demonetization in India-2016**

*The Government of India declared that the five hundred and one thousand rupee notes would no longer be legal tender in India from midnight, 8th November 2016. It was further stated that the RBI would issue new notes of two thousand rupee and five hundred rupee, which would be placed in circulation from 10th November 2016. Other notes of one hundred, fifty, twenty, ten, five, two and one rupee would remain legal tender and would remain unaffected by this decision. This measure proposed to initiate a stern campaign against corruption, black money and counterfeit notes. The probable consequences of this decision, on various economic variables and entities, are as follows.*

**1) Effect on Parallel Economy:** The removal of old notes, which would be replaced by new Rupee Notes, is expected to remove black money from the economy since the owners would not be in a position to deposit the same in the banks. Further, it would temporarily stall the circulation of large volume of counterfeit currency and also curb the funding for anti-social elements like smuggling, terrorism, espionage, etc.

**2) Effect on Money Supply:** Until the new Rupee notes get widely circulated in the market, money supply is expected to be reduced, in the short run. To the extent that black money (which is not counterfeit) does not re-enter the system, the money supply would decrease permanently. However, as the new notes get circulated gradually in the market and the mismatch gets corrected, money supply would pick up.

**3) Effect on Demand:** The overall demand is expected to be affected to an extent, the following areas like consumer goods, real estate and property, gold and luxury goods, and automobiles. These sectors are expected to face certain moderation in demand, from the consumer side, owing to the significant amount of cash transactions involved in these sectors.

**4) Effect on Prices:** Price level is expected to be lowered, due to moderation from the demand side.

- **Consumer goods:** Prices are expected to fall only marginally due to moderation in demand as use of cards and cheques, could be used for some purchases.
- **Real Estate and Property:** Prices in this sector are largely expected to fall, especially for sales of properties where major part of the transaction is cash based, rather than through bank transfer or cheque transactions. In the medium term, the prices could regain at some level as developers would rebalance their prices (probably charging more on cheque payment).

**5) Effect on various Economic Entities:** Until the new notes are spread widely into circulation, certain sections of the society, as noted below, could face short term disruptions, in facilitation of their transactions. The nature, frequency and amounts of the commercial transactions involved, with the sectors, would necessitate cash transactions.

- Agriculture and related Sector
- Small Traders
- SME
- Services Sector
- Households
- Political Parties
- Retail outlets
- Professionals like doctor, carpenter, utility service providers, etc.

**6) Effects on Bank:** As per the direction of the Government, the old Rupee notes are to be deposited or exchanged in banks (subject to certain limits). This would automatically lead to more amounts being deposited in Savings and Current Account. This, in turn, would enhance the liquidity position of the banks, which can be utilized further for lending purposes. However, to the extent that households have held on to these funds for emergency purposes, there would be withdrawals at the second stage.

**7) Effect on Online Transactions and Alternative Modes of Payment:** Alternative forms of payment would see a surge in demand. Digital transaction systems, E wallets and apps, online transactions, using E banking, usage of Plastic money (Debit and Credit Cards), etc. would

definitely create substantial increase in demand for cash. This should eventually lead to strengthening of such systems and the infrastructure required.

In spite of the initial hiccups and disruptions in the economic system, this change would eventually be well assimilated and would generate positive impact on the economy in the long run. It is believed that black money hoarders would definitely lose out eventually, boosting the formal economy in the long run. Short term fall, in real estate prices, might benefit middle class citizens. The strategy of demonetization, along with the implementation of the GST would eventually make the system more accountable and efficient.

The Twenty Fifth Issue (Vol.13 and No.1) of the SMART Journal of Business Management studies consists of eight articles, written by authors of repute, on different themes of contemporary relevance. I hope readers would find the Journal academically challenging and strategically stimulating.

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