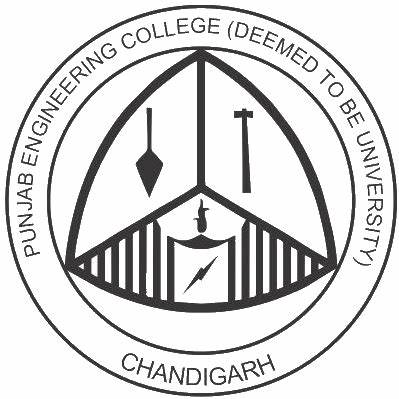
**Report**

Impact of Demonetisation on Indian Economy.



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25 March 2025

# DECLARATION

We hereby declare that the report "Impact of Demonetization on Indian economy" is our original work, which we prepared in good faith for academic purposes. The information in this report is based on our investigation, analysis, and understanding of the subject.

We attest that all the data, facts, and figures in this report were taken from trustworthy, publicly available sources and were appropriately referenced where necessary. Every piece of information gathered from outside sources has been appropriately referenced in accordance with academic standards.

To the best of our knowledge, no information in this report has been taken from any source available or published on internet or in part from another source. We also want to express our gratitude to our teacher and fellow students for their guidance and help in preparing this report.

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We sincerely appreciate the collective effort that has contributed to the successful completion of this report on The Impact of Demonetisation on the Indian Economy. This project has been an insightful learning experience, and we are truly grateful for the guidance, resources, and teamwork that have made it possible.

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We are also thankful for the various research materials, including academic studies, government publications, news reports, and expert analyses, that have provided us with valuable insights into the subject. These sources have helped us better understand the short-term and long-term effects of demonetisation on different sectors of the Indian economy. The statistical evidence, case studies, and expert perspectives have been instrumental in shaping our conclusions.

Moreover, we recognize the significance of teamwork and collaboration in completing this project successfully. Engaging discussions, brainstorming sessions, and shared problem-solving efforts have helped us refine our perspectives and present a well-structured report. The support and encouragement from one another throughout the process have played a crucial role in overcoming challenges and ensuring clarity in our research.

This project has not only enhanced our understanding of economic policies and their real-world impact but has also strengthened our skills in research, analysis, and teamwork. We are proud of the knowledge we have gained and hope that our findings contribute meaningfully to discussions on demonetisation and its economic effects.

Thank you.

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# List of abbreviations

|  |  |
| --- | --- |
| **Abbreviation** | **Definition** |
| GST | Goods and Service Tax |
| UPI | Unified Payments Interface |
| RBI | Reserve Bank of India |
| GDP | Gross Domestic Product |
| BSE | Bombay Stock Exchange |
| NIFTY | National Index (Index of NSE) |
| SENSEX | Sensitivity Index (index of BSE) |
| WPI | Wholesale Price Index |
| NEFT | National Electronic Funds Manager |
| ITR | Income Tax Return |
| CRR | Cash Reserve Ratio |
| FDI | Foreign Direct Investment |
| ROI | Return on Investment |
| GNP | Gross National Product |
|  |  |

# Abstract

Demonetization, announced by the Indian Government on 8 November 2016, involved the withdrawal of legal tender character of the ₹500 and ₹1,000 bank notes, which formed around 86% of currency in circulation. The main reasons were to end black money, abolish fake currency, decrease corruption, and move towards a cashless and digital economy. The unexpected policy action had far-reaching impacts on the Indian economy with short-term disturbance as well as long-term structural change.

In Short term, demonetization resulted in a cash crunch leading to severe hits for small businesses, the informal economy, and the daily wage earners, who used a large portion of cash. Consumption and investment dipped short term, causing a growth slowdown in GDP. Agricultural, retail, and manufacturing sectors suffered the brunt due to decreased availability of cash. But the policy also resulted in higher bank deposits, a growth in digital payments, and an expanded tax base as more transactions were formalized.

In the long term, demonetization helped towards more financial inclusion, robust digital payment infrastructure, and better tax collection. The step complemented other economic reforms, including the rolling out of the Goods and Services Tax (GST) and the drive for financial digitization. Critics point out that the economic burden was more than the benefits, as most of the demonetized currency re-entered the banking system, questioning the effectiveness of containing black money.

This report offers a detailed evaluation of the economic effect of demonetization, considering its successes and failures. Through the examination of macroeconomic indicators, sectoral impacts, and policy implications, this research seeks to present a thorough understanding of how demonetization redefined India's economic environment.

# 

# Chapter 1: Introduction

Demonetisation is a financial policy wherein a government withdraws certain currency notes from circulation, often as a measure to address issues such as black money, corruption, counterfeit currency, and tax evasion. On November 8, 2016, the Government of India made a landmark decision to demonetise ₹500 and ₹1,000 notes, effectively rendering approximately 86% of the total cash in circulation invalid overnight. The primary objectives of this move were to curb unaccounted wealth, promote digital transactions, and strengthen the formal financial system. However, the abrupt nature of the implementation led to significant disruptions, particularly in cash-dependent sectors like agriculture, small businesses, and informal labor markets.

Given India's heavy reliance on cash transactions at the time, the sudden withdrawal of high-denomination currency created liquidity constraints for individuals and businesses alike. Small and medium enterprises (SMEs), daily wage workers, and rural communities, who primarily transacted in cash, faced considerable financial hardships. Banks and ATMs were overwhelmed with long queues as people rushed to exchange their old notes, while a temporary decline in consumer spending slowed economic growth. Despite these immediate challenges, demonetisation also encouraged financial inclusion by increasing bank account registrations, boosting digital payment adoption, and improving tax compliance.

This report explores the broader impact of demonetisation on the Indian economy, analyzing its effects on GDP, employment, banking operations, and digital financial systems. It also examines the challenges faced by different economic sectors, assesses the effectiveness of the policy in meeting its intended goals, and highlights key takeaways from its implementation. By evaluating both its short-term disruptions and long-term implications, this study aims to provide a well-rounded understanding of how demonetisation reshaped India’s economic and financial landscape.

# 

# **Chapter-2**

**Review of Literature**

Overnight, ₹500 and ₹1,000 notes—86% of circulating currency—were invalidated, triggering a liquidity crisis that disrupted cash-dependent sectors like agriculture, SMEs, and informal trade. The policy aimed to combat black money, counterfeit currency, and corruption while promoting digital finance. However, its execution exposed critical challenges: banks faced liquidity mismatches, rural cash shortages paralyzed agricultural cycles, and GDP growth plummeted to 5.7% in 2016–17. Despite these setbacks, the initiative spurred a 41.8% rise in personal income tax collections and a 400% surge in digital transactions by 2017, reflecting its dual role as a disruptive shock and a catalyst for financial formalization.

**1.**The RBI (2017) highlighted macroeconomic strains, including reduced liquidity and GDP contraction, while acknowledging gains in tax compliance and digital adoption. Abhani (2017) and Tandon & Kulkarni (2017) noted its short-term success in destabilizing cash-based black money but questioned its long-term **Effectiveness in Reducing Illegal Money**. Financially, the RBI’s detection of ₹410 crore in counterfeit currency and the surge in suspicious transaction reports (480% increase) underscored mixed outcomes in combating financial crimes.

**Need of the Study**

Demonetization had two sides: it boosted tax collection and digital payments but also worsened cash shortages and slowed GDP growth. These mixed results teach us about designing better policies and managing risks. Adding GST around the same time made things harder, as both policies together caused confusion in tax compliance and disrupted supply chains. To truly grasp how such sudden moves shape financial habits, market confidence, and the shift to a formal economy (especially in cash-heavy countries), a clear, step-by-step analysis is needed.

**Research Gaps**

Three gaps dominate demonetization’s financial discourse**. First**, temporal limitations: most studies focus on immediate impacts, neglecting long-term effects on tax compliance trends or digital payment scalability.

**Second**, regional disparities: urban-rural divides in cash availability and banking access remain underexplored, masking inequities in policy outcomes.

**Third**, policy synergy: the compounded effects of demonetization and GST on inflation, formalization, and market confidence lack rigorous empirical analysis. Additionally, the informal sector’s financial resilience—adaptations like informal credit networks or barter systems—warrants deeper inquiry to understand grassroots survival strategies in liquidity shocks. Addressing these gaps would refine future monetary interventions, balancing disruption with equitable financial inclusion.

**2. Impact of demonetisation on stock market**

The 2016 Indian demonetization, aimed at curbing black money and corruption, triggered significant volatility in the stock market. While initial reactions were marked by sharp declines in indices like the Sensex and Nifty, subsequent studies reveal mixed outcomes, necessitating a deeper understanding of its short- and long-term impacts on equity markets, investor behaviour, and sectoral resilience.

**Review of Literature**  
Existing research highlights demonetization’s dual impact on India’s stock market. Bhagat and Sharma (2018) observed immediate declines in share prices and heightened volatility, driven by liquidity crunches and investor divestment. Naveen et al. (2017) echoed these findings, noting reduced earnings per share and price-to-sales ratios across 11 S&P BSE-500 firms, though dividend yields temporarily surged. Conversely, the study by Neelkamal (2022) revealed that firms with pre-announced investment plans outperformed others, suggesting resilience tied to strategic preparedness. Post-demonetization, indices like the Sensex and Nifty eventually rebounded, buoyed by improved liquidity and investor confidence in long-term reforms. However, smaller firms and cash-dependent sectors, such as banking and manufacturing, faced prolonged distress due to disrupted cash flows.

**Need of the Study**  
The mixed outcomes of demonetization—initial market crashes followed by recovery, sectoral disparities, and contrasting investor responses—underscore the need for a holistic analysis. While short-term liquidity shocks are well-documented, long-term effects on market stability, investor psychology, and structural reforms remain underexplored. Additionally, the interplay between demonetization and concurrent policies like GST requires scrutiny to disentangle their compounded effects on equity markets. This study is critical for policymakers and investors to design risk-mitigation strategies and anticipate market behaviour during similar fiscal disruptions.

**Research Gaps**

1. **Long-Term Market Dynamics**: Most studies focus on immediate impacts (e.g., liquidity shocks), neglecting long-term trends in investor confidence, sectoral recovery, or integration of digital finance.
2. **Sectoral Heterogeneity**: Limited analysis exists on how cash-reliant sectors (e.g., SMEs, agriculture) versus digitally adaptable industries (e.g., fintech) navigated post-demonetization challenges.
3. **Behavioural Insights**: The psychological impact on retail investors, shifts in risk appetite, and adoption of alternative assets (e.g., gold, ETFs) remain understudied.
4. **Impact of demonetisation on cashless payment**

**Review of Literature**  
Existing studies highlight demonetization’s dual role in India’s cashless transition. Roy (2017) emphasizes its role in enhancing financial transparency and attracting foreign investment through digitization. Mitra et al. (2017) identify critical prerequisites for digital adoption, such as banking access, connectivity, and mobile penetration. Batra & Kalra (2016) underscore resistance to digital wallets due to ingrained cash habits. Pahuja & Virk (2012) stress the need for banks to evolve into "financial supermarkets" to support digital transitions. Collectively, these studies acknowledge demonetization’s short-term disruption but highlight persistent challenges like technological gaps and uneven adoption across demographics.

**Need of study**  
The study addresses critical gaps in understanding the sustained impact of demonetization on cashless adoption. While prior research focuses on immediate transactional shifts, this analysis delves into long-term behavioural trends, infrastructural bottlenecks (e.g., rural connectivity), and socio-economic disparities in digital access. Additionally, it evaluates the role of incentives (e.g., cashbacks) in driving adoption and identifies barriers like fraud risks and merchant reluctance. Such insights are vital for policymakers to design inclusive digital frameworks and for businesses to tailor fintech solutions.

**Research Gaps**

1. Regional Disparities: Limited exploration of urban-rural divides in digital adoption, particularly in technologically underserved areas.
2. Long-Term Sustainability: Most studies focus on short-term transactional spikes (e.g., post-demonetization surge), neglecting long-term retention of cashless habits.
3. Behavioural Barriers: Inadequate analysis of psychological resistance to digital payments among low-income and elderly populations.
4. Infrastructure Constraints: Scant empirical data on how poor internet connectivity and limited POS terminals hinder cashless transitions in semi-urban and rural regions.

**4.Demonetisation in India: Who Did It Hit the Hardest?" by Prachi Mishra et al. The paper examines the demographic categories that were most hit by demonetization, concentrating on changes in consumption and income.**

The 2016 Indian demonetization, which made 86% of the country's money worthless overnight, is a seminal event in monetary economics. Chodorow-Reich, Gopinath, Mishra, and Narayanan's study "Cash and the Economy: Evidence from India's Demonetization" provides an all-encompassing analysis of this event's influence on the economy. An awareness of the imperative of this research and the prevailing research gaps allows for a gainful insight into the wider consequences of such monetary policy.

**Need for the Study :**

1. **Unprecedented Monetary Experiment**: Demonetization of such a scale was unprecedented, touching a large and diverse economy. Understanding its short-term and long-term implications is essential for policymakers and economists to realize the possible implications of such future interventions.
2. **Effect on Cash-Based Economies:** India's economy, which is built with a large informal sector, is highly dependent upon cash transactions. Understanding the impact of a sudden scarcity of cash on economic activities, employment, and consumption habits is crucial to analyze the vulnerabilities and strength of these economies.
3. **Policy Evaluation:** The major aims of demonetization were to control black money, fake money, and encourage online payments. A review of how successful these efforts have been offers lessons in the effectiveness of such policy initiatives in attaining preferred economic results.
4. **Theoretical Implications:** Most economic theories tend to presume monetary neutrality in the long-term perspective. A sharp monetary shock, such as demonetization, provides a rare opportunity to try out such theories and gauge the true impact of money supply on the economy.

**Research Gaps**:

1**. Granular Data Analysis:** There was limited empirical research on the localized impact of demonetization before this study. Using district-level data, the authors offer a rich analysis of how regions felt the economic impact in varying degrees depending on the intensity of cash shortages.

2**. Informal Sector Analysis:** Most of the literature available was centered on the formal economy, and the informal sector, which accounts for a large percentage of India's GDP and employment, was usually ignored. This research fills that gap by examining employment surveys and nightlight data to reflect informal economic activity.

3**. Adoption of Alternative Payments:** Although promotion of electronic payments was a declared objective of demonetization, empirical data on the adoption and success of digital payments was lacking. This study explores how areas with acute cash shortages improvised by adopting greater use of alternative payments, highlighting lessons learned and successes in becoming a less-cash economy.

4**. Dynamics of the Banking Sector:** Previous studies did not adequately investigate how cash shortages interplayed with bank activities, such as credit distribution and mobilization of deposits. This research focuses on how demonetization shaped banking behavior in terms of knowledge about the dynamics of the banking sector's reactions to monetary shock.

5**. Short-Term vs. Long-Term Effects:** While there were some studies that lingered on the immediate consequences of demonetization, there was a lack of research on its long-term effects. The authors compare the immediate reduction in economic activity with the later recovery stages, providing a holistic temporal outlook.

Finally, the research "Cash and the Economy: Evidence from India's Demonetization" is critical in comprehending the very inherent complexities of abrupt monetary policy shocks. Through the bridging of the research loopholes highlighted above, it provides informative inputs on the intricacies of cash-driven economies and presents empirical evidence that may inform future policy action in the same context.

**5.Macroeconomic Effects of Demonetization: Evidence from India" by Gabriel Chodorow-Reich et al. The authors study the macroeconomic impacts of demonetization, including its effects on GDP and employment.**

India's 2016 demonetization, which made 86% of the country's money useless overnight, is an important case study in monetary economics. The study "Cash and the Economy: Evidence from India's Demonetization" by Gabriel Chodorow-Reich and others provides a detailed analysis of the macroeconomic effects of this phenomenon, including factors like GDP and employment. An understanding of the need for this research and the gaps in research that it fills is an important insight into the larger implications of such monetary policy.

**Need for the Study :**

1. Unprecedented Monetary Policy Intervention: Demonetization of such magnitude was unprecedented, touching a huge and heterogeneous economy. Examining its short-run and long-run implications is essential for policymakers and economists to understand the possible ramifications of such interventions in the future.

2. Effect on Cash-Based Economies: India's economy, with its large unorganized sector, is greatly dependent on cash transactions. Research into the effects a sudden cash shortage has on economic activity, employment, and consumption trends is necessary in order to comprehend the vulnerabilities and resilience of such economies.

3. Policy Evaluation: The main aims of demonetization were to control black money, fake currency, and encourage electronic transactions. Measuring the success of these aims offers lessons in the effectiveness of such policies in attaining preferred economic results.

4. Theoretical Implications: Conventional economic theories tend to assume long-run monetary neutrality. But an unexpected and large-scale monetary shock, such as demonetization, provides a natural testing ground for such theories and the actual impact of changes in the supply of money on the economy.

**Research Gaps:**

1. Granular Data Analysis: There was very little empirical research on the localized impact of demonetization before this study. Using district-level data, the authors offer a detailed picture of how regions faced different levels of economic shocks depending on the severity of cash scarcity.

2. Informal Sector Analysis: Most of the literature so far was on the formal economy, and the informal sector, which makes up a considerable percentage of India's GDP and jobs, was largely ignored. This research closes that gap by utilizing employment surveys and nightlight data to measure informal economic activity.

3. Alternative Payment Adoption: Even though the facilitation of digital payments was cited as a stated aim of demonetization, no empirical studies had been done on its adoption and success. This study explores how areas where cash shortages were dire coped by ramping up the utilization of alternative means of payment, throwing light on challenges and success of moving toward a less-cash economy.

4. Banking Sector Dynamics: The dynamics between the scarcity of cash and banking operations, including deposit mobilization and extension of credit, were not comprehensively examined in earlier studies. This research investigates how demonetization affected banking conduct, having implications for the financial sector's adaptation to monetary shocks.

5. Short-Term and Long-Term Effects: While some research has skirted around the short-term consequences of demonetization, little research has been conducted on its long-term effects. The authors examine both the short-run decline in economic activity and the subsequent recovery periods, providing a rich temporal insight.

In summary, the research "Cash and the Economy: Evidence from India's Demonetization" is instrumental in comprehending the various implications of abrupt changes in monetary policy. Through closing the above-discussed research loopholes, it provides insightful perspectives on the nature of cash-based economies and supplies empirical evidence for future policy considerations in such environments.

**6."The Impact of Demonetisation on the Informal Economy" by Indrani Chakraborty and Partha Ray. This study examines the impact of demonetization on India's informal sector, where transactions primarily use cash.**

India's 2016 demonetization, which nullified 86% of the country's currency in one night, had significant effects on India's economy, especially its informal economy. This research titled "The Impact of Demonetisation on the Informal Economy" by Indrani Chakraborty and Partha Ray examines this crucial problem in detail. It is useful to comprehend the need for this research and to recognize gaps in research that it fills with insights into the greater consequences of such monetary measures.

**Need for the Study :**

1. Dominance of the Informal Sector: India's informal sector is enormous, covering a large part of employment as well as economic activities. The sector largely depends on cash. Demonetization's abrupt withdrawal of cash presented immediate challenges, which necessitated an examination of its unique effects on the sector.

2. Policy Evaluation: While demonetization was intended to strike at black money and counterfeit notes, its spillovers on the shadow economy required rigorous analysis. Identifying these spillovers is important for policymakers to craft interventions that counterbalance unintended effects on vulnerable segments.

3. Economic Stability and Growth: The informal sector contributes substantially to India's GDP. Disruptions in this sector can have cascading effects on overall economic stability and growth. Analysing demonetization's impact provides insights into the resilience and adaptability of the informal economy during monetary shocks.

**Research Gaps :**

1**. Limited Empirical Evidence:** There was limited empirical research available on demonetization's effects on the informal economy before this study. This study bridges the gap by presenting evidence-based analysis of how the sector was influenced.

2**. Sectoral Analysis:** Most existing literature analyzed the formal economy's response to demonetization. This study shifts the focus to informal sectors like agriculture, small-scale manufacturing, and services, offering a more comprehensive understanding of the policy's reach.

3**. Regional Disparities**: The informal economy varies across regions. This study examines how different areas experienced demonetization's effects, highlighting regional disparities and the factors influencing them.

4**. Adaptation Mechanisms:** How informal enterprises coped with cash shortages—whether by embracing digital payments, scaling down operations, or otherwise—was not well understood before. This research illuminates these adaptation mechanisms.

In summary, "The Impact of Demonetisation on the Informal Economy" by Indrani Chakraborty and Partha Ray is a seminal study that fills important gaps in the comprehension of how big-bang monetary policies impact informal sectors relying on cash. By examining this neglected segment, the study provides essential lessons for designing equilibrium policies that foster economic growth without disproportionately hurting disadvantaged groups.

**7."A Critical Appraisal of Demonetisation in India" by Rabinarayan Samantara and Monika. The authors critically assess demonetization's objectives and its immediate economic effects, including challenges in implementation.**

**Need for the Study:**

Demonetisation, as implemented in India on November 8, 2016, was a landmark economic decision that aimed to address multiple macroeconomic and policy issues. The primary objectives were:

1. **Curbing Black Money:** The government sought to eliminate undisclosed income and untaxed wealth that was hoarded in cash.
2. **Eliminating Fake Currency:** With the rise of counterfeit currency, particularly in high-denomination notes, demonetisation was expected to strike a blow against illegal financial activities.
3. **Preventing Terror Financing:** It was argued that terror outfits and organized crime networks relied on illicit cash reserves. Demonetisation aimed to dismantle these funding sources.
4. **Promoting Digital Transactions and a Cashless Economy:** A significant push toward digital payments and financial inclusion was expected, reducing dependency on physical currency.

While these goals were ambitious and theoretically impactful, their actual execution and effectiveness required an objective assessment. The sudden withdrawal of 86% of the currency in circulation created economic disruptions that needed a critical examination.

This study was necessary because:

* The immediate effects of demonetisation were widely debated, with strong arguments both in favor and against it.
* The short-term impact on businesses, employment, and liquidity had not been comprehensively documented.
* It was important to evaluate whether demonetisation met its intended objectives or led to unintended economic hardships.
* The efficiency of the implementation process and the preparedness of financial institutions needed scrutiny.

**Research Gap:**

While several studies had been conducted on demonetisation, many focused on singular aspects, such as:

* Theoretical economic justifications for demonetisation.
* Its impact on specific sectors like real estate, small businesses, or agriculture.
* Policy recommendations for future demonetisation attempts.

However, gaps in existing literature included:

1. **A Holistic Appraisal of Both Objectives and Execution:** Many studies either focused solely on the theoretical aims or on the difficulties faced. This study aimed to bridge both perspectives—analyzing whether the government’s stated goals were met while also assessing the execution challenges.
2. **Short-Term vs. Long-Term Impact:** Immediate economic consequences were widely discussed, but a balanced analysis of both short-term disruptions and potential long-term benefits was needed.
3. **Challenges in Implementation:** While most discussions centered around policy intent, fewer studies critically examined logistical issues, ATM recalibration problems, bank cash shortages, and the social consequences of demonetisation.
4. **Gaps in Empirical Data:** Many reports relied on anecdotal evidence. This study sought to compile empirical data to provide a more structured evaluation.

By addressing these gaps, the authors contributed to a more nuanced understanding of demonetisation’s actual impact, rather than relying on either political narratives or theoretical economic models.

**8."Impact of Demonetisation on the Micro Finance Sector" by Dr. V.R. Palanivelu and S. Narmada. This paper examines how demonetization affected microfinance institutions and their clients, particularly in cash-dependent sectors.**

**Need for the Study:**

The microfinance sector plays a crucial role in financial inclusion by providing small-scale credit to low-income individuals who often lack access to traditional banking services. Microfinance institutions (MFIs) primarily operate in cash-intensive environments, where loan disbursements and repayments are largely conducted in physical currency. Demonetisation, which led to an immediate withdrawal of 86% of the cash in circulation, severely impacted this sector.

The need for this study arises due to the following reasons:

1. **Heavy Dependence on Cash Transactions:**
   * The clientele of MFIs, including small traders, farmers, and daily wage laborers, rely on cash for their economic activities. The sudden demonetisation move disrupted their ability to conduct transactions, affecting both loan repayments and access to fresh credit.
   * Unlike larger financial institutions that could transition to digital transactions relatively easily, MFIs and their borrowers faced significant difficulties in adapting to cash shortages.
2. **Loan Repayment Disruptions:**
   * Since borrowers repay loans in small, frequent installments, demonetisation led to an inability to meet repayment deadlines.
   * This created financial distress for both lenders and borrowers, leading to rising default rates.
   * MFIs, in turn, faced liquidity shortages, making it difficult for them to sustain their lending operations.
3. **Impact on Financial Inclusion:**
   * One of the objectives of demonetisation was to promote digital transactions. However, the question arises whether MFI borrowers, who mostly operate in informal economies, could seamlessly transition to digital financial services.
   * Understanding the adaptability and challenges faced by these low-income borrowers is critical in assessing the long-term effects of demonetisation on financial inclusion.
4. **Operational Challenges for MFIs:**
   * Many MFIs experienced a significant decline in their collection efficiency immediately after demonetisation.
   * The operational framework of MFIs, including field visits by loan officers for cash collections, had to be restructured due to the cash crunch.
   * Some institutions attempted to switch to digital payments, but the infrastructure and financial literacy among borrowers posed challenges.

Given these factors, the study aims to assess the extent to which demonetisation disrupted microfinance operations and whether it contributed to a structural shift in the sector’s financial model.

**Research Gap:**

While various studies have analyzed demonetisation’s macroeconomic effects, fewer have explored its sector-specific impacts, particularly in microfinance. The existing literature primarily focuses on:

* The broader economic effects of demonetisation, including GDP growth, inflation, and banking liquidity.
* Theoretical discussions on demonetisation’s intent versus its outcomes.
* The shift towards digital banking and electronic transactions at a national level.

However, the following critical gaps remain unaddressed:

1. **Sector-Specific Impact on Microfinance:**
   * Most studies discuss demonetisation’s impact on formal banking institutions, but there is limited empirical data on how MFIs, which operate on the fringes of the formal economy, coped with the policy.
   * This study fills the gap by examining how MFIs managed cash shortages, loan defaults, and borrower distress during the immediate aftermath of demonetisation.
2. **Financial Vulnerability of Borrowers:**
   * The sudden disappearance of cash disproportionately affected those without alternative financial resources.
   * There is a lack of comprehensive research on how demonetisation impacted borrowers who rely on daily cash earnings to sustain their livelihoods.
3. **Transition to Digital Transactions:**
   * While demonetisation aimed to accelerate digital financial inclusion, the extent to which MFI borrowers were able to transition to cashless transactions remains underexplored.
   * This study investigates whether microfinance clients adopted digital payment methods or whether the policy led to financial exclusion due to inadequate digital infrastructure and financial literacy.
4. **Policy Implications for Future Economic Shocks:**
   * The study contributes to policy discussions on how future monetary policies should be designed to minimize disruptions in cash-dependent financial sectors.
   * It provides insights into the need for preemptive measures, such as phased cash withdrawal strategies or better integration of microfinance into formal banking channels, to mitigate economic shocks.

By addressing these research gaps, the paper by Dr. V.R. Palanivelu and S. Narmada provides a deeper understanding of the unintended consequences of demonetisation on microfinance, contributing to broader financial policy debates.

**9.“Efficacy of Demonetisation in Eliminating Black Money”: An Analysis of Indian Demonetisation November 2016" by T.P. Ghosh. The paper reviews demonetization's effectiveness in curbing black money through data mining, tax collection improvements, and public perception.**

**Impact of Demonetisation on Black Money and the Indian Economy**

The Indian government’s demonetisation moves on November 8, 2016, aimed at eliminating black money and counterfeit currency, stirred significant economic debate. While the expectation was that a substantial proportion of black money would not return to the formal banking system, nearly 98.96% of the banned currency eventually did, raising concerns over the efficacy of the strategy. This study assesses demonetisation’s impact on tax compliance, corruption, economic growth, and currency circulation.

**Review of Literature** Existing research presents a multifaceted perspective on demonetisation’s effectiveness. Ghosh (2017) highlights that demonetisation failed in terms of direct cash seizure but was instrumental in uncovering black money through data analytics and Operation Clean Money. The RBI (2017) observed a significant rise in tax filings and financial transparency post-demonetisation. Transparency International (2017) reported that despite these efforts, India’s corruption ranking showed marginal improvement. Other studies indicate a temporary economic slowdown, especially in the informal sector, with the GDP growth rate dropping from 7.6% in 2015-16 to 6.1% in 2016-17. However, improved financial inclusion and increased digital transactions were positive long-term effects.

**Need for the Study** While demonetisation was a bold policy move; its mixed outcomes necessitate further analysis. Although initial liquidity shocks and economic distress were widely documented, long-term structural shifts in tax compliance, corruption levels, and financial formalisation remain underexplored. Additionally, the interplay between demonetisation and other fiscal policies, such as the Goods and Services Tax (GST), requires scrutiny to assess its overall impact on economic growth and capital flow.

**Research Gaps**

* **Long-Term Financial Implications:** While immediate economic disruptions are well-documented, the sustained impact on tax revenue, banking sector liquidity, and investment patterns needs deeper examination.
* **Sector-Specific Effects:** Limited studies differentiate between the effects on cash-dependent industries (such as agriculture and small enterprises) versus digitally adaptive sectors (like fintech and e-commerce).
* **Public Perception and Compliance:** Understanding behavioural changes among taxpayers, informal sector participants, and small businesses in response to demonetisation remains crucial.
* **Effectiveness Against Corruption:** The correlation between demonetisation and changes in India’s corruption perception index is ambiguous and requires further empirical validation.

By addressing these gaps, this study aims to provide policymakers and financial analysts with a clearer understanding of demonetisation’s broader economic implications and guide future monetary interventions.

**10.“Efficacy of Demonetisation in Influencing GDP Growth”**

This study examines the impact of demonetisation on GDP growth, highlighting liquidity constraints, sectoral disruptions, and long-term economic effects. While industrial and agricultural output initially declined (Krishna, 2018), financial inclusion and digital transactions improved (RBI, 2017). GDP rebounded to 7.2% in 2017-18, showing gradual recovery.

Demonetisation acted as both a shock and a reform catalyst, increasing tax compliance and business formalisation. However, its interaction with GST needs further analysis to assess long-term economic stability.

**Impact of Demonetisation on GDP Growth in India**

The 2016 demonetisation drive, which rendered 86% of India’s currency invalid overnight, was a historic move aimed at combating black money and encouraging digital transactions. However, its economic consequences, particularly on GDP growth, remain a subject of debate. While the formal banking sector saw an influx of liquidity, the informal sector and cash-reliant industries suffered significant disruptions. This study examines the short- and long-term economic impacts of demonetisation on GDP growth, investment, and key sectors.

**Review of Literature** Existing studies present mixed outcomes of demonetisation. Krishna (2018) suggests that while the liquidity shock slowed GDP growth initially, the economy rebounded as digital transactions and formal banking deposits increased. The Economic Survey (2017) reported a temporary decline in consumption and investment, particularly in agriculture and small businesses. Meanwhile, industrial production data (IIP, 2016) revealed a contraction of 1.9% in October 2016, reflecting the immediate shock to manufacturing and trade. The Asian Development Bank (ADB) also revised India’s GDP growth forecast downward, citing demonetisation’s disruptive impact on employment and demand. However, by 2017-18, GDP growth rebounded to 7.2%, indicating a gradual recovery.

**Need for the Study** The long-term implications of demonetisation remain underexplored. While its immediate effects on liquidity and consumption are well-documented, the structural shifts in savings, digital transactions, and tax compliance need further analysis. Additionally, the interplay between demonetisation and other economic reforms, such as GST, must be assessed to understand its holistic impact on GDP growth. This study aims to provide insights into how demonetisation influenced India’s economic trajectory beyond the initial disruption period.

**Research Gaps**

* **Sector-Specific Impacts:** Most research focuses on aggregate GDP figures, but the varying effects on agriculture, real estate, and manufacturing require deeper examination.
* **Informal Economy:** Limited studies address the long-term integration of cash-dependent workers and businesses into the formal financial system.
* **Monetary and Fiscal Policy Interplay:** The combined impact of demonetisation and policies like GST on investment and tax revenues remains an area for further research.
* **Consumer Behaviour:** The shift from cash to digital payments and its influence on long-term spending habits is still evolving.

By addressing these gaps, this study aims to provide a nuanced understanding of demonetisation’s role in shaping India’s economic landscape and future policy directions.

**11.Impact of Demonetisation on Banking Liquidity**

This study examines demonetisation’s effects on banking liquidity, highlighting deposit surges, interest rate changes, and financial stability. The invalidation of ₹500 and ₹1000 notes initially caused a liquidity shock but later boosted CASA deposits, lowering borrowing costs.

Key Findings Sharma & Gaur (2017) noted increased bank liquidity, enabling lower lending rates. The RBI (2017) implemented CRR adjustments and Market Stabilization Schemes to manage surplus cash. While digital transactions grew, NBFCs and microfinance institutions faced short-term stress.

Implications Demonetisation improved formal financial flows but disrupted cash-based sectors, underscoring the need for adaptive banking policies.

**Impact of Demonetisation on Liquidity in the Banking Sector**

The 2016 demonetisation initiative, which invalidated ₹500 and ₹1000 currency notes overnight, significantly affected liquidity in the banking sector. While aimed at curbing black money and promoting digital transactions, the sudden influx of deposits reshaped banking liquidity dynamics, interest rates, and credit availability. This study examines the immediate and long-term effects of demonetisation on liquidity in the Indian banking sector.

**Review of Literature:** Existing research highlights mixed outcomes. Sharma & Gaur (2017) noted a surge in CASA (Current Account and Savings Account) deposits following demonetisation, with banks experiencing a 5-10% increase in CASA ratios. The Reserve Bank of India (2017) observed a temporary contraction in liquidity due to high cash deposits but later managed surplus liquidity through monetary policies like Cash Reserve Ratio (CRR) adjustments. The Economic Times (2017) reported that interest rates on loans declined due to increased liquidity, leading to more affordable credit. However, non-banking financial companies (NBFCs) and microfinance institutions (MFIs) faced liquidity stress, as cash-dependent borrowers struggled to make timely repayments.

**Need for the Study** :While the initial surge in banking liquidity post-demonetisation is well-documented, its long-term impact on credit availability, lending rates, and financial inclusion remains underexplored. This study aims to analyze how the liquidity boost influenced banking profitability, monetary transmission, and consumer credit behavior in the years following demonetisation.

**Research Gaps:**

* **Long-Term Liquidity Trends:** Most studies focus on short-term liquidity injections, but the persistence of these effects on banking operations needs further analysis.
* **Impact on Loan Growth:** While lending rates declined, the extent to which demonetisation spurred credit growth remains ambiguous.
* **Digital Banking Adoption:** The shift in consumer behavior from cash transactions to digital payments and its influence on long-term banking liquidity is still evolving.
* **Policy Adjustments:** The effectiveness of RBI’s liquidity management tools post-demonetisation, including CRR changes and market stabilization schemes, requires further assessment.

By addressing these gaps, this study aims to provide a comprehensive understanding of demonetisation’s impact on banking sector liquidity, informing future monetary policy decisions.

**12. "Impact of Demonetisation on SMEs in India"**

**Need for the Study:**

SMEs are pivotal to India's economy, contributing significantly to employment and GDP. The 2016 demonetisation initiative, which invalidated high-denomination currency notes, disproportionately affected SMEs due to their reliance on cash transactions. Understanding the ramifications of demonetisation on SMEs is essential to:​

1. **Assess Financial and Operational Impacts:** Evaluating how demonetisation influenced SMEs' revenue, profit margins, and operational efficiency.​
2. **Identify Adaptive Strategies:** Exploring the methods SMEs employed to navigate cash shortages, such as adopting digital payment systems.​
3. **Inform Policy Formulation:** Providing insights to craft policies that bolster SMEs' resilience against similar economic disruptions in the future.​

**Research Gaps:**

Despite various studies examining demonetisation's effects on SMEs, certain areas remain underexplored:​

1. **Long-Term Effects:** While immediate impacts have been documented, there is a lack of research on the enduring consequences of demonetisation on SMEs' sustainability and growth.​
2. **Regional Disparities:** Most studies focus on specific regions, leading to a need for comprehensive analyses that consider regional variations in impact.​
3. **Sector-Specific Analyses:** Limited research delves into how different sectors within the SME category were uniquely affected by demonetisation.​
4. **Psychological Impact:** Few studies examine the psychological stress and mental health challenges faced by SME owners during and after demonetisation.​
5. **Comparative Policy Analysis:** There is a scarcity of research comparing India's demonetisation with similar initiatives globally, which could offer valuable lessons.​

Addressing these gaps would provide a more holistic understanding of demonetisation's impact on SMEs and guide the development of targeted support mechanisms.

**13. "The Great Indian Demonetization" by Amartya Lahiri (2020)**

**Need for Study:**

Demonetization is a major economic reform aimed at addressing issues such as black money, counterfeit currency, and tax evasion while also promoting cashless transactions. In November 2016, the Government of India withdrew ₹500 and ₹1000 currency notes from circulation, removing nearly 86% of the country’s cash overnight. The policy was intended to curb corruption, increase transparency, and encourage the use of digital payments.

Amartya Lahiri’s (2020) research, ***The******Great Indian Demonetization***, critically examines the effectiveness of this policy by analyzing its outcomes over a three-year period. The study investigates whether demonetization met its intended objectives and explores the economic disruptions it caused. Lahiri’s work highlights key economic indicators such as employment rates, GDP growth, digital transactions, and tax revenues. His findings suggest that while the policy had short-term consequences, including a contraction in economic activity and job losses, its long-term success in achieving policy goals remains debatable.

This study is essential for understanding the broader economic implications of demonetization, particularly its impact on financial inclusion, economic formalization, and digital transactions. Given its significance, further research is required to assess the long-term effects of demonetization and its role in shaping future economic policies.

**Research Gaps:**

While Lahiri’s study provides valuable insights into demonetization’s impact, there are still several unexplored areas that require further research:

**1. Long-Term Economic Consequences**

Lahiri’s analysis focuses primarily on the short- and medium-term effects of demonetization, covering a three-year period. However, its long-term consequences on economic stability, financial markets, and overall economic growth remain uncertain. Future research should investigate whether the economy has fully recovered and whether demonetization has resulted in lasting structural changes.

**2. Sector-Wise Impact**

While the study evaluates demonetization from a macroeconomic perspective, it does not provide a detailed analysis of its impact on specific industries. Sectors such as agriculture, small and medium enterprises (SMEs), manufacturing, and retail were affected in different ways. Since many small businesses and informal workers rely heavily on cash transactions, they experienced significant financial strain. A more detailed sectoral study is needed to understand how different industries adapted to the cash crunch and whether they benefited from the shift to digital payments.

**3. Employment and the Informal Sector**

One of the key challenges faced during demonetization was the decline in employment, particularly in the informal economy, which depends largely on cash transactions. While Lahiri mentions a temporary reduction in economic output, there is limited data on how many businesses closed or how many workers lost their jobs permanently. Further research should focus on the long-term employment trends in the informal sector and whether workers successfully transitioned to the formal economy.

**4. Digital Transactions and Financial Inclusion**

A major objective of demonetization was to accelerate the adoption of digital payments. Lahiri’s study indicates an initial rise in electronic transactions following the policy implementation. However, over time, the increase in digital transactions did not sustain its momentum. Additional studies are needed to:

* Analyze why digital payment adoption slowed down after the initial surge.
* Assess whether government initiatives such as Unified Payments Interface (UPI) and fintech innovations contributed to long-term financial inclusion.
* Understand behavioral factors that prevent individuals and businesses from fully transitioning to cashless transactions.

**5. Tax Compliance and Revenue Collection**

One of the key motivations behind demonetization was to improve tax compliance and expand the number of taxpayers. Lahiri’s findings suggest that this goal was not achieved to a significant extent. However, further analysis is required to determine:

* Whether indirect factors, such as stricter financial regulations and tax reforms, had a delayed impact on tax compliance.
* How demonetization influenced small businesses in terms of Goods and Services Tax (GST) compliance and overall tax collections.

**14."An Economic and Public Policy View of Demonetization in India" by Feler Bose(2019)**

**Need for Study:**

Demonetization, implemented in India in 2016, was introduced with the goal of reducing black money, combating corruption, and transitioning towards a digital economy. The sudden withdrawal of ₹500 and ₹1000 notes from circulation had far-reaching economic and policy implications.

Feler Bose’s (2019) study critically examines the rationale behind demonetization by applying public choice theory—a framework that suggests policy decisions are often influenced by political motives rather than purely economic concerns. The study explores how various interest groups, both domestic and international, may have played a role in shaping the policy and evaluates the effectiveness of the move in achieving its intended objectives. Additionally, the research discusses the Austrian school of economic thought, which highlights the limitations of centralized decision-making in economic planning.

Another key aspect of the study is the examination of how demonetization impacted digital transactions and financial inclusion. While the policy encouraged the adoption of electronic payments, the long-term sustainability of this shift remains uncertain. Bose’s study provides valuable insights into these economic and policy dynamics, making it a significant contribution to the broader discussion on financial reforms in India.

**Research gaps:**

Despite the comprehensive analysis presented in Bose’s study, there are several areas that require further research:

**1. Long-Term Economic Consequences**

The study mainly focuses on the immediate aftermath of demonetization. However, its long-term effects on economic growth, employment, and income distribution need further exploration. More research is required to assess whether the economy has fully recovered and if any lasting changes have occurred in the financial sector.

**2. Sector-Specific Impact**

Bose’s research provides a macro-level evaluation of demonetization but does not explore its impact on specific industries. Sectors such as agriculture, small and medium enterprises (SMEs), and the informal economy, which rely heavily on cash transactions, were significantly affected. Future studies should analyze how these industries adapted to the cash crunch and whether they benefited from increased formalization.

**3. Adoption of Digital Transactions**

One of the key objectives of demonetization was to promote cashless transactions. Bose’s study acknowledges the rise in digital payments, but further research is needed to assess whether this transition was sustained in the long run. Key areas of investigation include:

* The extent to which digital transactions became a permanent part of consumer behavior.
* Challenges faced by small businesses and rural populations in adopting digital financial systems.
* The role of government policies in ensuring financial inclusion for all economic classes.

**4. Effectiveness in Reducing Black Money and Corruption**

One of the major goals of demonetization was to eliminate black money and curb corruption. However, Bose’s study does not provide strong empirical evidence to determine whether these objectives were met. Future research should:

* Assess the extent to which unaccounted wealth was uncovered.
* Examine whether corruption levels declined after demonetization.
* Analyze how new methods of tax evasion may have emerged post-demonetization.

**5. Banking Sector and Liquidity Management**

Demonetization led to a surge in bank deposits as people rushed to exchange old currency notes. While Bose’s study acknowledges this, a more in-depth analysis is needed on:

* How banks managed the sudden influx of deposits.
* Whether increased formal savings led to greater lending and economic growth.
* The long-term impact on non-performing assets (NPAs) and credit availability.

**15."Demonetisation and its Discontents" by C. Rammanohar Reddy(2017)**

**Need of Study:**

The demonetization policy announced by the Indian government in 2016 led to the withdrawal of ₹500 and ₹1000 notes from circulation, with the stated goals of curbing black money, eliminating counterfeit currency, and encouraging a shift towards digital payments. This policy had widespread economic implications, both in the short and long term.

C. Rammanohar Reddy’s book, Demonetisation and its Discontents, provides a detailed critique of this decision, analyzing its economic justifications and real-world outcomes. The book explores whether demonetization effectively reduced unaccounted wealth and examines its broader implications on financial inclusion, digital payments, and overall economic stability. Reddy also questions whether the policy achieved its intended goals or merely caused disruptions without delivering substantial long-term benefits. His work is particularly significant as it provides a balanced perspective on both the rationale and consequences of demonetization.

**Research Gaps:**

While Reddy’s book provides an in-depth critique of demonetization, there are several areas where additional research could enhance understanding:

**1. Long-Term Effects on Black Money**

The book primarily discusses the immediate impact of demonetization on black money circulation. However, further research is needed to determine whether demonetization led to a permanent reduction in black money or if individuals and businesses found alternative ways to conceal wealth. A long-term analysis would help in assessing whether the policy had a lasting impact on tax compliance and financial transparency.

**2. Digital Transactions and Financial Inclusion**

One of the key objectives of demonetization was to increase digital transactions and reduce dependence on cash. While the book examines the initial rise in digital payments, it does not provide a long-term assessment of whether this shift was sustained. Future research should focus on:

* The extent to which digital payments became a permanent part of India’s financial system.
* The barriers faced by lower-income groups and rural populations in adopting digital financial services.
* The role of government policies and fintech innovations in sustaining digital financial inclusion.

**3. Industry-Specific Impact**

Reddy provides a **broad economic analysis** of demonetization, but there is limited discussion on how **different industries were affected**. Certain sectors, such as **agriculture, small and medium enterprises (SMEs), and retail**, rely heavily on cash transactions and were disproportionately impacted by the sudden cash shortage. Further research is needed to examine:

* How these sectors **adapted to the cash crunch**.
* Whether demonetization led to **business closures and job losses** in informal industries.
* The long-term structural shifts in industries that previously depended on cash transactions.

**4. Comparative Analysis with Other Countries**

The book primarily focuses on the Indian experience with demonetization. However, several other countries, such as **Zimbabwe (2015), Nigeria (1984), and Venezuela (2016)**, have undertaken similar policies with varying degrees of success. A comparative study could provide:

* **Lessons from international experiences**, highlighting what worked and what did not.
* Insights into the economic conditions required for demonetization to be effective.
* A better understanding of how different policy frameworks affect the **success or failure** of demonetization.

**5. Political Economy of Demonetization**

Reddy critiques the economic rationale behind demonetization, but further research is needed on its political motivations and electoral impact. Future studies could examine:

* Whether demonetization was primarily an economic policy or if it had political objectives.
* The effect of demonetization on voter perception and election outcomes.

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**Chapter 3: Research Methodology**

**Statement of the Problem:**

Demonetisation, implemented by the Indian government on November 8, 2016, aimed to tackle black money, curb counterfeit currency, and promote digital transactions. While it led to increased tax compliance and digital financial adoption, it also caused economic disruptions, especially in cash-dependent sectors. The move significantly impacted GDP growth, employment, liquidity in banking, and financial inclusion. This study seeks to analyse the broader economic effects of demonetisation, addressing both short-term challenges and long-term structural shifts.

**Research Methodology**

**1.Research Design**

This study follows a *mixed-method approach*, utilizing both *quantitative* and *qualitative* research techniques. It is an *exploratory and descriptive* study that analyses secondary data and, where applicable, primary data through surveys and expert opinions.

**2. Data Collection**

***A. Primary Data:***

* Survey Method: Structured questionnaires were used to collect perspectives from individuals, small businesses, and financial institutions.
* Interviews: Insights from economists, financial analysts, and policymakers will be gathered.
* Sampling Technique: Stratified random sampling was used to ensure diverse representation.

***B. Secondary Data:***

* **Sources:**
* Reports from RBI, Economic Survey, NITI Aayog.
* Banking sector reports and fintech data.
* Research papers (EPW, SSRN) and academic studies.
* News reports from sources like The Hindu and Business Standard.
* World Bank and IMF economic assessments.

1. **Data Analysis**

* ***Quantitative Analysis:***
* Statistical tools like regression models and trend analysis.
* Key impact metrics: GDP trends, employment data, banking liquidity, and digital transaction growth.
* ***Qualitative Analysis:***
* Thematic analysis of survey responses and expert opinions.
* Case studies on small businesses, rural economy, and digital finance adoption.

1. **Research Hypothesis**

H1: Demonetisation had a significant short-term negative impact on economic growth.

H2: Demonetisation accelerated India’s transition toward a cashless economy.

1. **Limitations of the Study**

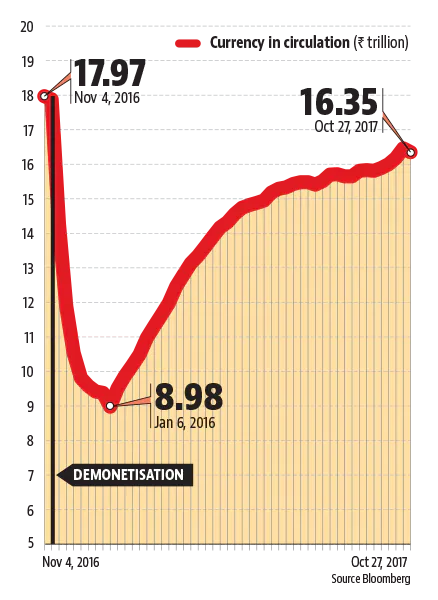
* Dependence on secondary data may affect accuracy.
* Long-term structural changes may be difficult to assess within the study period.
* Sample bias in primary data collection.

1. **Ethical Considerations**

* Ensuring confidentiality of survey respondents.
* Avoiding biased interpretation of data.
* Using credible sources for secondary data.

**Chapter 4**

**Data Analysis and Interpretation**



#### **1. Key Observations from the Graph**

* **Pre-Demonetization Level:**  
   On **November 4, 2016**, the total currency in circulation stood at **₹17.97 trillion**.
* **Sharp Decline Post-Demonetization:**  
   Following the announcement, there was an immediate and steep drop in currency circulation. The lowest point was reached on **January 6, 2017, at ₹8.98 trillion**, indicating a **50% reduction in total cash circulation**.
* **Gradual Recovery:**  
   After hitting the lowest point, the currency in circulation started **recovering steadily**, indicating that new currency notes were being introduced into the system.
* **Currency Levels One Year Later:**  
   By **October 27, 2017**, the currency in circulation had risen back to **₹16.35 trillion**. This shows that cash usage rebounded close to pre-demonetization levels within a year.

#### **2. Analysis & Interpretation**

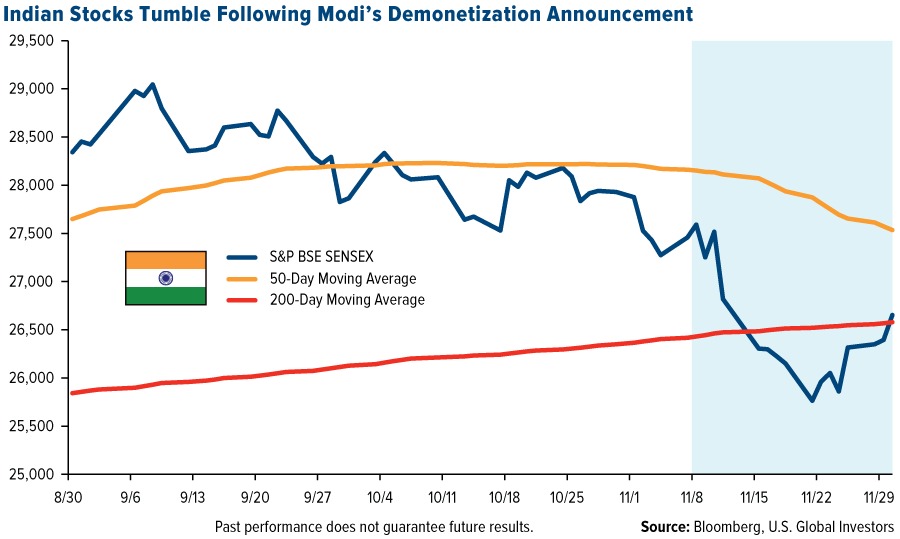
* **Short-Term Impact:**
  + The drastic fall in circulation suggests **liquidity crunch**, causing hardships for individuals and businesses reliant on cash.
  + The economy likely experienced a **temporary slowdown**, as cash transactions play a major role in India’s informal sector.
* **Long-Term Effects:**
  + Although cash circulation dropped initially, its **rapid recovery suggests continued reliance on cash transactions**.
  + This **questions the long-term effectiveness** of demonetization in transitioning towards a cashless economy.
  + A possible increase in banking transactions and digital payments may have occurred, but cash remains dominant.

#### **1. Key Observations from the Graph**

* **Before Demonetization (2013–2016):**
  + Digital transactions were dominated by **card payments**, with prepaid payment instruments playing a minor role.
  + **UPI transactions were almost non-existent** as the system was only launched in **April 2016**.
* **Post-Demonetization Surge (2017 Onwards):**
  + By **November 2017**, UPI transactions became **visible for the first time**, marking a small but significant entry.
  + There was a **steady rise in digital transactions overall**, with card and prepaid payment instruments also growing.
* **Explosive UPI Growth (2019–2021):**
  + The **most notable increase** happened **between November 2019 and August 2021**, where UPI transactions overtook both **cards and prepaid payments**.
  + By **August 2021**, UPI transactions alone accounted for the **majority of digital transactions**, surpassing **₹6 lakh crore**, while card and prepaid payments saw only moderate growth.

#### **3. Analysis & Interpretation**

* **Impact of Demonetization on Digital Payments:**
  + Demonetization acted as a **catalyst** for digital transactions, pushing people to explore **UPI, cards, and prepaid wallets** due to the sudden cash crunch.
  + UPI's user-friendly interface, **zero transaction cost**, and **direct bank linkage** made it a **preferred payment method**.
* **Why Did UPI Dominate?**
  + Unlike cards, **UPI does not require POS machines**, making it easier for **small vendors and individuals** to accept payments.
  + Government policies, such as **incentives for digital transactions** and the **Bharat Interface for Money (BHIM) app**, accelerated UPI adoption.
  + **COVID-19 (2020–2021)** further **boosted UPI transactions**, as contactless digital payments became a necessity.
* **Declining Role of Cards & Prepaid Instruments:**
  + While card transactions grew, their **growth rate was slower** compared to UPI.
  + Prepaid payment instruments (wallets like Paytm, PhonePe, etc.) lost momentum **as UPI provided direct bank transfers** without requiring wallet top-ups.

**1. Key Observations from the Graph**

* **Pre-Demonetization (August–Early November 2016)**
  + The **SENSEX was trending upwards**, reaching **close to 29,000 points** in September.
  + The **50-day moving average** (short-term trend) was relatively stable, showing **minor fluctuations**.
  + The **200-day moving average** (long-term trend) was on a **steady upward slope**, indicating **market stability**.
* **Post-Demonetization Market Reaction (November 8–November 22, 2016)**
  + **Sharp decline:** The **SENSEX dropped significantly**, breaking below the **50-day moving average** and nearing the **200-day moving average**.
  + **Market panic:** The decline suggests **negative investor sentiment**, likely due to uncertainty about liquidity, economic slowdown fears, and potential business disruptions.
  + **The 50-day moving average started declining**, showing a shift in short-term market momentum.
* **Recovery Attempt (November 22–November 29, 2016)**
  + The market **bounced back slightly** toward the end of November, but it remained **below pre-demonetization levels**.
  + The **200-day moving average continued rising**, indicating that while there was a crash, the long-term trend was **not significantly disturbed**.

**2. Analysis & Interpretation**

* **Why Did the Market Drop?**
  + **Liquidity shock:** With 86% of cash removed overnight, businesses relying on cash transactions faced **immediate disruptions**.
  + **Investor panic:** Investors feared **slow economic growth**, a drop in consumer spending, and **lower corporate earnings**.
  + **Foreign investor outflows:** Uncertainty led to **foreign institutional investors (FIIs) selling Indian stocks**, further driving the decline.
* **Why Did the Market Recover?**
  + **Market correction:** After the initial shock, investors **adjusted to the new reality** of demonetization.
  + **Long-term confidence:** The 200-day moving average remaining **stable** suggests that investors still had faith in India's **economic fundamentals**.
  + **Government reassurance:** Policymakers assured the public that demonetization would **boost digital transactions, curb black money, and improve long-term growth**

**Chapter- 5: Conclusion**

Demonetization in India represents a significant monetary policy intervention that aimed to address the persistent issues of black money, counterfeit currency, and corruption within the financial system. From a finance perspective, the move was designed not only as an anti-corruption measure but also as an effort to drive structural reforms towards a more transparent and formalized economy.

In the immediate aftermath, the policy led to liquidity constraints, as evidenced by the short-term cash crunch impacting both organized and unorganized sectors. This disruption affected transaction volumes and temporarily slowed down economic activity, particularly in sectors heavily reliant on cash transactions. The subsequent stress on liquidity management underscored the challenges central banks face when abruptly altering the monetary base.

Conversely, the long-term implications have been more nuanced. Demonetization accelerated the adoption of digital payment systems and fostered a transition toward a less-cash-dependent economy. This shift has had important ramifications for financial inclusion and transparency, enabling more accurate tracking of economic activity and enhancing tax compliance. Moreover, the policy indirectly supported the expansion of the formal banking sector by channelling a significant amount of funds into bank deposits, thereby bolstering liquidity and strengthening credit creation mechanisms. However, the effectiveness of demonetization in curbing black money remains a contentious issue among economists. While it succeeded in destabilizing certain unaccounted channels of wealth, a substantial volume of illicit funds was reportedly transformed into non-cash assets, thereby circumventing the intended financial oversight. This outcome raises important questions regarding the optimal design and execution of such policies in the context of an interconnected financial system.

In conclusion, demonetization serves as a pivotal case study in financial policy, illustrating the complexities and trade-offs inherent in implementing large-scale economic reforms. Its dual impact—manifesting as both an immediate economic slowdown and a long-term push towards digital finance and formalization—provides valuable insights for policymakers. As India continues to refine its financial regulatory framework, the lessons learned from demonetization will be critical in shaping future strategies that balance immediate economic stability with sustainable growth and transparency.

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