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**DEMONETISATION AND ITS EFFECTS ON BANKING SECTOR**- Theertha. K & Sruthi. S<sup>1</sup>**ABSTRACT**

Demonetization is a step taken by our Indian government on 8<sup>th</sup> November 2016 which creates negative as well as positive impacts among various sectors in the country. Until now, currency has been demonetized thrice in India. It has been used as a tool to fight against corruption, black money, nonpayment of taxes, counterfeiting currencies and terrorism but it has affected the liquidity. The highly impacted period was during the month of November and December of 2016. Approximately, 86% of the currency which was in circulation was withdrawn. The impacts were also in the banking sector as it is the centre for channeling the legal tender money for the needs of the society and a core of the economy.

This paper focuses on the influence of demonetization over banking operations. This paper also discusses the negative as well as positive impacts they have caused.

Banking sectors have also experienced greater impacts caused by the demonetization. There was an increase in currency deposits in current and savings accounts which created excess liquidity conditions. Many of them have used PMYDY accounts during this demonetization period. This also causes a great impact in e-banking. The reduction in fixed deposit rates has created a strong competitor for banks i.e. mutual funds. People in rural areas have suffered so much due to demonetization. Demonetization disturbed the bank operations and the employees of the bank had stressful work. Though it had negative and positive impacts, the currency in circulation is lower than the pre demonetization period. Experts are of the opinion that this decision of the government had helped to control black money to some extent and the path to digitization was smoothed and it's time to achieve a cashless society.

**KEYWORDS:** Banks, Demonetization, liquidity, impacts, black money, cashless economy.

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## 1. INTRODUCTION

Demonetisation was a significant step taken by the Indian government on 8<sup>th</sup> November 2016. Denominations of '1000' and '500' (specified bank notes) worth 15.4 trillion which constitutes around 86.9% of the total currency value in circulation were demonetised. Prior 2016, the first demonetization was taken place in 1946 which seized the currency notes of '1000' and '10,000' from circulation and these notes were reintroduced in 1954. In 1978, the second demonetization bans the currency notes of '1,000', '5,000' and '10,000' from circulation. The above two demonetization didn't have greater effect on people but the recent demonetisation have greater impact and influence in all the sectors. Banking sector was not an exception to this. Banking sector is an essential sector in an economy which channelizes the circulation of money for the functioning of different sectors. In post demonetization, there was severe shortage of currency so banks were unable to meet the currency demand of their customers and also Reserve Bank of India had been falling short of printing new notes on a timely basis, prompting to empty ATMs and swarmed banks for quite a long time and amounting to mismanagement of the monetary economic system at the most elevated level. Day to day activities of the bank were affected and the demonetization had a greater influence on the management of liquidity and employees. Also, majority of the banks couldn't discharge other banking services while doing the process of exchanging the banned currency notes.

## 2. DEMONETISATION

### 2.1 MEANING

Demonetization is the act of withdrawing the status of a currency unit as legal tender.<sup>2</sup> In simple words, demonetisation is the process by which the demonetised notes are stopped from acknowledging as legal currency for any sort of transaction. The demonetized currency notes are replaced with the new currency notes. In 2016, the '500' and '1000' currency notes were replaced with new '500' and '2000' currency notes.

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<sup>2</sup><https://www.investopedia.com/terms/d/demonetization.asp#:~:text=Demonetization%20is%20the%20act%20of,wit h%20new%20notes%20or%20coins.>

The SC observed that “The Preamble of the Demonetization Act makes it obvious that where the availability of high denomination bank notes facilitate illicit transfer of money for financial transactions and which are harmful to the national economy or which serve illegal purposes, the Reserve Bank of India can demonetize high denomination bank notes in public interest”.<sup>3</sup>

## 2.2 REASONS FOR DEMONETIZATION

### 1. Black Money:

Demonetisation was a striking and progressive activity taken by the administration of India to curb the black money and one that will have a profound effect on the parallel economy in the nation. By this move, a person who has black money can be identified. A couple of organizations like property dealers, foreign currency, jewellers, and private money lenders generally hold tremendous measures of unaccounted cash in form of currency notes. Such unaccounted currency had made an parallel economy in the nation. Those illegal currencies reached the bank accounts through direct or indirect channels.

### 2. Fake currency rackets:

Stripping the highest currency will have a major impact on the fake currency syndicates, thus puts an end to the terror funding. The fake currencies with criminals have been left in futile and new currency notes with high security; makes the counterfeit impossible. Demonetisation was an attack aimed at the fake currency circulating in the economy.

### 3. Online transactions:

The motto was to energize the cashless/digital economy. Increase in cash-less or less-cash transactions will result in more disclosure of income which will increase the direct tax collections. If the cash transaction reduced then the alternate forms of payment will be in

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<sup>3</sup>JayantilalRatanchand Shah vs. Reserve Bank of India & Others JT 1996 (7), 681 1996 SCALE (5)741

demand. The demand of E - mode of payment like online transaction, E-wallets, E-banking, usage of debit and credit cards etc. will certainly increased.

#### 4. To hit Maoists:

This progression really brought in cash with Maoists useless. As revealed, Maoists had stored over Rs.7000 crores with them at Baster in Chhattisgarh. All those notes are currently only bits of papers.

#### 5. Ascend in GDP:

In spite of the fact that demonetisation has adversely affected sectors such as property, real estate, construction, and general household utilization , it is believed that the long term advantages of GDP growth will exceed the momentary temporary effect. In the financial year (2018-19), the GDP development had been headed towards 9%.<sup>4</sup>

### 3. BANKING

A bank is a financial institution authorized to receive deposits and make advances. It may also offer financial services.

#### 3.1 INFLUENCES OF DEMONETIZATION:

- Increase in Deposits:

The deposits had increased in the bank due to Demonetization. Unaccounted money in the form of Rs.500 and Rs.1000 were streaming to the Banks and the deposits sizes have also been increased. It aided the banks to get the deposits and increase their deposits. The banks have extended the loans and advances by Rupees 1,008 billion. The gradual credit deposit ratio for the period was just 18.2%. The commercial banks have deployed the additional deposits mobilised in liquid asset.

- Fall in cost of funds:

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<sup>4</sup>[http://dx.doi.org/10.18843/ijms/v5i2\(7\)/04](http://dx.doi.org/10.18843/ijms/v5i2(7)/04)



The deposits have been increased over the past few months. It drove the banks to keep a significant part of deposits in the cash deposits. PSU Banks have a major share of over 70% of the deposits and biggest gainers of the ascent in deposits, prompting to lower cost of funds. Surplus liquidity conditions have aided to facilitate the transmission of monetary policy to market interest rates. Several banks have decreased their domestic term deposit rates and lending rates in post demonetisation. During Nov 2016 – Feb 2017, SCBs medium term deposit rates have declined by 38 bps, while banks' weighted average term deposit rate have declined by 24 bps up to Jan 2017. Combined with the sharp increase in low cost CASA deposits, the overall cost of borrowings decreased which allows the banks to reduce their lending rates.

- Demand for Government Banks:

Under reverse repo option, the banks have started lending the excess deposits to the RBI after the sharp ascend in deposits on post demonetization especially the PSU banks who have deployed surplus funds in government bonds. The profit on bond investment is likely to add 15 - 20 % increase in the banks' earnings.

- Sagginess in Lending:

Even post demonetisation, the lending growth of the banks is significantly less and its impacts are upon the public deposits. With an intention to help the needy people, the banks have lent the money with a low interest rates but it was contracted after few months.<sup>5</sup>

### 3.2 PRADHAN MANTRI JAN DHAN ACCOUNT (PMJDY):

PMJDY is a national mission for financial inclusion to ensure access to financial services which was launched in 2014. During demonetization, these accounts had come into attention when the deposits witnessed a meteoric rise. Since demonetization, 23.3 million accounts were opened under PMJDY and from them 80% were with public sector banks. Among the newly opened PMJDY accounts, 53.6 per cent were in urban areas and 46.4 per cent in rural areas. The total

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<sup>5</sup> <https://iasscore.in/topical-analysis/impact-of-demonetization-on-banking-sector>

balance in this account has been increased from Rs. 456 billion as on November 9, 2016 to Rs. 746 billion as on December 7, 2016 which is an increase of 63.6%. There were reports stating that these accounts were used to convert black money into white so the government issued warning regarding the misuse of such accounts.<sup>6</sup>

### 3.3 DIGITAL BANKING:

Post demonetisation, people had no other choice other than switching to do transactions by means of electronic channels instead of standing in long queues and the RBI had also restricted the withdrawal amount. It leads us to cashless economy which was as expected by the government. There are various modes of digital transaction in India. They are

#### 1. Debit card swipes at post point of sale (POS) Terminals:

Generally, a POS terminal has as its core a Personal computer, which is furnished with application-explicit programs and Input and output devices for the specific environment in which it will serve.

In the financial year 2017, debit card transactions had been increased by 109%. Since November 2016, the use of debit card at point of sale devices increased to 83%. As per the report of RBI, such transactions were increased from 23.47 Crore to 42.87 Crore.<sup>7</sup>

#### 2. E- wallet:

Through this mode, the payments can be done through mobile number or QR code. This mode of payment plays a major role and become popular in post demonetisation. As per the report of RBI, the transaction through this mode has been increased by 163% from Oct 2016 - Dec 2016.

#### 3. UPI:

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<sup>6</sup><https://economictimes.indiatimes.com/industry/banking/finance/banking/deposits-in-jan-dhan-accounts-cross-rs-80000-crore/articleshow/63865987.cms?from=mdr>

<sup>7</sup><https://www.livemint.com/politics/policy/demonetization-3rd-anniversary-how-digital-payments-picked-up-post-note-ban-11573199358135.html>

Through UPI, all account holders can use their smart phones to send and receive money and the only essential is to enter his/her account information. It experienced phenomenal growth following three years of post demonetization.

The transactions through UPI reached 1 billion mark in October within 3 years since its initiation.<sup>8</sup>

#### 4. Aadhar pay:

This app came into existence especially for merchants and shop keepers. Through this app, the merchant can get the amount from the customer's Aadhar linked account after the customer has given his/her finger print for authentication.

#### 5. Immediate Payment Service (IMPS):

Through this, one can make instant interbank electronic fund transfer via mobile phones. Since November 2016, IMPS has witnessed over five-fold jump and 20.10 Crore transactions have taken place till August 2019.

#### 6. National Electronic Funds Transfer (NEFT):

It is a nation-wide payment system where anyone can electronically transact fund from any bank branch to a person having account in any other bank. Since demonetisation, 22.12 crore transactions have taken place in august for business which constitutes 80% of the total transaction.

#### 7. The Bharat Interface for Money (BHIM) APP:

This is an initiative step taken by the government in order to enable fast, secure and reliable cashless payments via mobile phone. It was a good start for BHIM but post demonetisation, BHIM had faced a downfall due to its offers and unfriendliness.<sup>9</sup>

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<sup>8</sup><https://www.entrepreneur.com/article/342061#:~:text=Push%20to%20Digital%20Payments,October%202016%20and%20December%202016.>

### 3.3.1 BENEFITS AND CHALLENGES OF CASHLESS ECONOMY:

- Benefits:
  - Instances of tax avoidance will be reduced.
  - Prevents counterfeiting and saves the cost of printing notes.
  - Generation of black money will be curbed
  - Speedy and satisfaction of operation for customers
  - No abuse of welfare programs as the money is directly transacted.
  
- Challenges:
  - Circulation of cash is at a high level in India.
  - 95% of the transactions are taken place in cash mode. Wages of the daily workers are made in cash and that would be a useful mode for them.
  - 92% of the ATM cards are used only for cash withdrawals and not for online transactions.
  - Limited availability of POS (point of sale) terminal.
  - Most of the rural people have low literacy rate and don't have knowledge about it. Even the internet connection is poor in those rural areas.

### 3.4 DEMONETISATION CRIPPLED BANK LENDING:

In the second half of 2016-17, the growth of bank credits decreased due to demonetisation. As per RBI's data, the annual credit growth of bank had been decreased from 12.1% (30 -Sept-2016) to 5.4% (31 -Mar-2017). The growth in rural loans has been decreased from 12.9% to 2.5% in March 2017. The lending to rural India was majorly affected but other parts also dropped off in credit growth. The growth rate of bank credit in semi-urban India, urban India and metropolitan India was declined from 11.9%, 11.2% and 12.3% to 6.4%, 6.1% and 5.5%, respectively during 2016-2017. Overall growth of bank credit has been fallen from 12.2% to 5.4% which is less than the half credit growth rate.

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<sup>9</sup><https://www.livemint.com/money/personal-finance/why-bhim-is-losing-to-other-apps-in-upi-race-1556007428797.html>

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SBI and its associates credit growth had declined from 13.7% to 7.8% during that period. Even the credit growth of private banks' had also reduced from 18.8% to 10.1%. This clearly depicts that every banking sector had been affected.<sup>10</sup>

#### 4. POSITIVE AND NEGATIVE IMPACTS

This demonetisation has its own negative and positive impacts on the banking sector.

##### 4.1 POSITIVE IMPACT:

1. Free flow of deposits: Post demonetisation, deposits have been increased in banks which can be invested for enhancing the banks' liquidity and profitability.
2. Improved digital Interface: Enhancement in digital equipment to execute bank transactions had evaded cash loss for various reasons like robbery, misappropriations and dacoits.
3. People's excess at Bank: Cash is an inert asset which does not yield any income except if kept in a bank. So, demonetisation made the people to keep their excess money in a bank to gain some sort of income.
4. Enhancement of Customers: Demonetisation has impacted the people to execute transactions with banks. It even made the non-income persons to open new accounts. So, it increased the amount of bank account holders which will increase the deposit corpus.

##### 4.2 NEGATIVE IMPACTS:

Similarly there were some negative impacts and they are

1. Cash Reserve Ratio: 100% CRR on incremental deposits implied that banks had not procured any interest on Rs. 3 Lakh crore of deposits for almost a fortnight.
2. Waived off ATM Charges: During banned note transactions, ATM charges were deferred off and banks incurred a loss of Rs. 20 in every exchange they made.
3. Waived off Merchant Discount Rate: Banks have incurred a loss of 1% discount charges from merchants on utilizing of each card exchange.

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<sup>10</sup><https://www.livemint.com/Opinion/j6FWY6uYX5sGxcqW4WR1dN/How-demonetisation-crippled-bank-lending.html>

4. Non Selling of Loans: Banks were concentrated on exchanging currency notes and they couldn't sell any loan products. This made banks to control their lending activities.

5. Diminished SMEs's Sale and influence on NPAs: During demonetization, some SME business did see their sales drop (50-80%) and could default in their installments to banks. This drove the banks to consider it as NPA and affected its level in banks.

6. Stress on Employees: Bank Employees were put under pressure and overtime working conditions. It leads them in depression and imbalanced life style. In some cases, the employers have even committed suicide due to the presser placed upon them.<sup>11</sup>

## 5. POST DEMONETISATION CASES

- **Cbi v. Rama Nand Gupta**<sup>12</sup>

They were charged for making false records which is contrary to the original physical vouchers filled by the depositors. Those three officials unauthorisedly and illegally exchanged Rs 10,51,000 Specified Bank Notes with legal tenders. The complaint was filed by the deputy circle head of one of the branches of Punjab National Bank on on April 5, 2017. The Special CBI Judge Raj Kumar Chauhan convicted and stated that the accused persons conspired to commit criminal breach of trust and falsification of bank records by making fictitious and false entries. District court held that the accused persons were guilty under the 120B read with section 409,471,477A of IPC and section 13(2) read with section section 13(1)(d) of the prevention of corruption Act,1988 and convicted them for 4 years of imprisonment with fine of 4 lakhs.

- **Axis bank demonetised notes case**

The ED had filed its first money laundering case after demonetization against the officials of axis bank and others for illegal conversion of scrapped currency notes based on the FIR filed by the delhi police which seized for about 3.70 crore demonetised notes in 2016.

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<sup>11</sup><http://ijcrt.org/papers/IJCRT1704373.pdf>

<sup>12</sup> 23 August, 2019.

Investigation revealed that on announcement of demonetisation policy, the accused officials used shell companies for illegal exchange of demonetised currency.

The ED said that the accused persons collect the demonetised money from the people and deposited in the shell companys' account and the deposited amount was further send to different accounts of bullion traders who made them into gold. The accused bank official had got illegally 15% from the amount deposited. The employees were removed from the bank and charged under the special prevention of money laundry Act.

- **Madhuri Das Narain Das v. CIT<sup>13</sup>**

Assessee's books demonstrates a cash balance of above Rs.38,000 as on the immediate day preceding the date of demonetisation. As there was no material before the Tribunal, it could not have determined that only 22 out of 28 high denomination notes denoted cash balance and the six were established from undisclosed sources.

Allahabad HC had reversed ITAT order. In the current case, assessee cashed 28 high denomination notes of Rs.1,000 each after issuance of High Denomination Bank Notes (Demonetisation) Ordinance, 1946. when the question has been asked based on the sourced, he stated that he had a closing balance and those 28 denominations have come out from that. On appeal Tribunal partly upheld it by saying that those 6 notes of Rs.1000 were not considered from the cash balance. On further appeal to High Court, It held that finding of Tribunal was based upon surmises and conjectures and cannot be upheld HC based on the Kanpur Steel Co. v. CIT case.

## 6. SUGGESTION & CONCLUSION

The Demonetisation has caused positive as well as negative impacts on the banking sectors. It is a tool used by the government to control corruption and black money. The sudden announcement created a chaos and discomfort but temporarily. Banks are the major sector influenced by the demonetisation. Though it affected the banking operations, it helped the

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<sup>13</sup>[1968] 67 ITR 368 (ALL)(HC)

economy to reach growth and development through banks. The major part is that the cyber crimes have been increased tremendously post demonetisation. Separate laws should be regulated regarding that. Everyone should be educated about the online transactions. Even now, some banks are not providing swiping machines, they should start providing. The cash circulation seems to be reduced post demonetisation which will control the black money and corruption to some extent.

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