Demonetisation

November 3, 2017
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India in 2014

GDP growth at 6.1%; economy struggling with multiple weaknesses

High inflation limited the spending capacity

Twin deficit stress; fiscal deficit target missed

‘Ease of doing business’ (EoDB) rank deteriorating

India listed among the ‘fragile five’

Country outlook downgraded

SME contribution to GDP at 37%, of the overall GDP growth of 6.1%

Source: Reserve Bank of India (RBI); World Bank

*CAD: Current account deficit
**FD: Fiscal deficit
Developments since then...

A gradual turnaround story has been seen 2014 onwards

Pillars of Govt. initiatives to address structural issues

- Development
- Employment
- Corruption

Major reforms introduced

- FDI: USD 105 bn+ over 3 FYs
- Infra: Projects worth USD 59 bn
- Transparency in resource allocation
- Fiscal consolidation: Subsidy bill cut
- Inclusion: 300 mn beneficiaries under PMJDY*
- DBT**: Saved USD 8.8 bn in subsidy transfer

Source: Government of India

Indian economy in 2016

- Inflation (Aug’16)
  - CPI: 5.1%
  - WPI: 3.7%
- GDP (FY16): 7.9%
  - CAD: 1.1%
  - FD: 3.9%
- Outlook upgraded to ‘stable’
- Ranked 130 in EoDB, poised to rise

Source: Government of India, RBI, World Bank

*PMJDY: Prime Minister’s Jan Dhan Yojana
**DBT: Direct Benefits Transfer
CPI: Consumer Price Index; WPI: Wholesale Price Index
SME initiatives

- **Start up**
  - Aimed at promoting bank financing for start-ups to boost entrepreneurship and encourage jobs creation
  - There are currently 50+ schemes

- **TReDS* Program**
  - Online channel for financing of trade receivables of MSMEs through multiple financiers

- **Udhyog Aadhar**
  - Online platform for registration of on-going MSMEs
  - To avail benefits i.e. tax benefits, bank loans at concessional rates and subsidies

*SME contribution to GDP increased to 45%, of the overall GDP growth of 7.1%*

Source: Confederation of Indian Industry

*TReDS: Trade Receivables Discounting Systems*
2016 – An eventful year globally

Multiple shockwaves globally with Brexit, US Presidential elections catching experts unawares

In this context, demonetisation caused major shock and awe at the domestic and international stage
Demonetisation

The move
- Executed on midnight of Nov. 9, 2016
- Largest denomination notes (INR 500 & 1,000) de-legalised

Scale
- Legal status of currency worth USD 237 bn withdrawn
- More than 86% of currency in circulation on date

Rationale
- Curb the following:
  - Terror financing
  - Black money
  - Counterfeiting

Source: Government of India, RBI
Tracing the timeline

- **Nov. 08, 2016**: PM Modi announced the move
- **Nov. 10, 2016**: Banks start replacing old currency
- **Dec. 31, 2016**: End of window for replacement of old notes
- **Mar. 31, 2017**: Extended window for Indians abroad
- **Jun. 30, 2017**: Final window for NRIs only
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Banks

Handled queues for exchange of old notes

Witnessed a surge in deposit base in the short term

Recalibrated ATMs to dispense new notes

Impacted by higher delinquency in retail portfolio
Companies & SMEs

Challenges faced
- No cash to handle operations
- Inability to retain workforce
- Drop in sales hit cash inflow

Impact on business
- Disrupted unorganized, rural MSMEs*
- 30%-60% decline in employment
- 20%-40% revenue loss
- Sowing season disrupted

Unorganised SME and rural sectors more impacted than organized sectors

*MSMEs: Micro, Small and Medium Enterprises
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Impact

- Increase in formal financial savings
- Decrease in interest rates

Impetus to digital payments

Liquidity boost

Change in mind set

Digitisation

Formalisation

Increased tax compliance
Liquidity boost

Deposit base in USD bn

- Only 40% of incremental deposits were expected to be retained
- Actual figure is around 65%

Impact on key banking parameters

- CASA share in deposits increased by 4.1% points to 39.3%
- Median term deposit rate declined by 38bps by Feb-17
- 1-year median MCLR* fell by 70bps

Source: RBI

*MCLR: Marginal cost-of-funds-based lending rate
Digitisation (1/2)

Increase in digital channel activity post demonetisation

- POS – 100%*
- Credit card usage – 30%**
- Debit card usage – 140%**
- Digital payment – 55%***
- E-commerce card txn. – 284%****

source: RBI

Channels like BHIM and UPI introduced and promoted to widen digital transaction net

*August 2016 – August 2017;  
**March 2017 data, yoy growth  
***November 2016 over October 2016  
****November 2016 over October 2016
Digitisation (2/2)

Digital transactions

- Mobile internet users to double by 2026
- Digital transactions as a percentage to PCE* to increase 4x to 36% by 2027
- Government targeting of 25 billion digital transactions over FY18

*PCE: Personal Consumption Expenditure

Source: RBI, National Payments Corporation of India, Morgan Stanley Research
Formalisation

**Increase in tax volume and tax base**

<table>
<thead>
<tr>
<th>Year</th>
<th>Total tax collections</th>
<th>Income tax base</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014-15</td>
<td>191.4 USD bn</td>
<td>29.1 No. in million</td>
</tr>
<tr>
<td>2015-16</td>
<td>223.8 USD bn</td>
<td>34.1 No. in million</td>
</tr>
<tr>
<td>2016-17</td>
<td>263.1 USD bn</td>
<td>43.3 No. in million</td>
</tr>
</tbody>
</table>

- Tax-to-GDP ratio has risen from 14% in FY15 to 17% in FY17
- Tax base has doubled to 4% of population in three years

**Direct tax collection up 19%; tax registration up 25%**

**Closure of shell companies: 200,000+ firms deregistered**

**Close to a million individuals being investigated by IT department**

Source: Government of India
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Reforms continue...

- On July 01, 2017 Government introduced the biggest indirect tax reform in India – the Goods and Service Tax (GST)

- GST has subsumed 17 distinct central and state taxes

- GST is expected to
  - Reduce leakages and tax evasions
  - Create a transparent indirect tax regime
  - Boost GDP by 0.80% in 5 years
  - Ensure greater compliance, revenue

USD 14bn realized as GST revenues in July, surpassing expectations
Recovery begins...

Despite positive indicators from GST, June quarter GDP figure of 5.7% was a shocker!

To initiate recovery, Government has announced:
- USD 108 bn further infrastructure investment
- USD 32.5 bn infused into PSBs to support credit offtake
- Series of measures to increase flow of credit and guarantee payment cycle to small businesses and exporters
Improving economic indicators

High frequency data seem to indicate...

- Comm. vehicle sale up 25% for Sep., highest since Nov. 2011
- Trade deficit fell 30% since Nov.; 26% growth in exports
- IIP rebounds to 4.3% growth for Aug. v/s 4% in Aug. 2016
- Credit growth at 7.5% y-o-y for Sep. 15, highest for 2017

Source: RBI, Central Statistics Office, Society of Indian Automobile Manufacturers

...an end to the short term disruptions, despite decline in GDP
Looking forward

Government’s 3-point agenda

- Development
- Consistent reforms
- Attracting FDI

Supported with favourable demographics, will amplify India’s expansion

India to become the world's fastest-growing large economy over the next 10 years

Indian economy to rise from its current 7th position to the 3rd largest economy by 2027 with USD 6 trillion GDP

Source: Morgan Stanley research
Thank you