

CASH IN CIRCULATION NOW MORE THAN PRE-DEMONETISATION LEVEL

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Public Finance, Taxation & Black Money incl. Government Budgeting

MUMBAI: Currency in circulation touched a new high of Rs 20.65 lakh crore on January 18, 2019, way above the pre-demonetisation high of Rs 17.97 lakh crore. The increase in currency usage points to a recovery in 'informality' in the economy as the government goes easy on goods and services tax compliance and businesses continue using cash, according to Pranjul Bhandari, chief economist, India, HSBC.

The acceleration of CIC since late-2017 has resulted in leakage of liquidity from the banking system, said Bhandari, who has previously served at the IMF, finance ministry and Planning Commission. The introduction of GST was expected to improve tax compliance but is taking time, she said in a research report.

She said the [informal sector](#), which had weakened significantly following [demonetisation](#) has, with the progress of remonetisation, inched up.

However, Soumya Kanti Ghosh, chief economist, [SBI](#) group, told TOI, "It is a matter of debate whether currency in circulation implies more cash usage. This is because there has been a decline in velocity of money implying that fewer cash transactions are being made." In the past, economists have noted how CIC goes up ahead of major elections. Former governor [Raghuram Rajan](#), too, had attributed the surge in currency in April 2016 to state elections. "Around election time, cash with the public does normally increase.... You can guess as to reasons why, we can also guess," he had said.

Bhandari says this is not the case now. "We tested for some other drivers of cash as well, for instance, poll-related increase in cash use, and found it to be insignificant." Bankers say money not coming back into the banking system is one of the reasons why they are unable to meet deposit growth targets. Deposit growth during FY19 (up to January 18, 2019) at 4.9% has not been keeping pace with credit surge, which has grown 8.2% during the same period, making it difficult for banks to cut interest rates.

"Traditionally, currency in circulation has been positively correlated with rural demand. However, that relationship may have broken down in FY19. Nearly 70% of rural India, whose main source of income is wages, was not doing too well. And yet, CIC accelerated. We attribute this to the recovery in the informal sector," said Bhandari. When currency in circulation surpassed predemonetisation levels, government officials said the increase was below trend growth and as a ratio of [GDP](#), it was still lower. The [CIC-to-GDP](#) ratio was 11.9% on the eve of demonetisation.

After touching a low of 8.8% in March 2017, it jumped to 10.9% in March 2018, and a likely 11.4% by March 2019. "We expect the CIC-to-GDP ratio to inch up further to 11.6% by March 2020, implying some increase but not an acceleration in currency leakage," said Bhandari.

Incidentally, high CIC-to-GDP ratio was one of the reasons cited by the government for demonetisation. Bhandari attributes the rise of 'informal' economy to teething issues with the GST regime. She says this is expected to get addressed next year, arresting the increase in

informality and blunting the acceleration in the CIC-to-GDP ratio. "However, if rural demand rises over the year, that could lead to a rise in CIC," she adds.

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