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## Effects Of Demonetisation On India's Economy And Financial Sector

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**Abstract-** The study analyses the many outcomes of demonetisation for the Indian economy and financial sector which resulted from the government's historic announcement to withdraw ₹500 and ₹1,000 currency notes on November 8, 2016. The government wanted to tackle black money, lower corruption and make the economy more digital, but what resulted was a wide-ranging complication. Using qualitative and secondary information, this report explores the challenges businesses experience, looks at how people spend and save and notes the quick increase in online payment solutions. It also studies how viable are GDP targets, manage employment, assure the operariness of SMEs and regulate liquidity, bad debts and trust in banks. It is evident from the research that although demonetisation briefly hit non-bank sectors and rural areas, it gave an impetus to changes in the financial system by promoting bank savings and bank accounts for the unserved. The study finishes with proposals for changes in policy to accomplish better monetary interventions using what we have learned from what took place in India. By doing this, we hope to support the wider thinking about reforms to monetary policy in developing economies.

**Keywords-** Demonetisation, Indian Economy, Financial Sector, Digital Payments, Informal Sector, Monetary Policy, Financial Inclusion, Banking System.

### I. INTRODUCTION

A country often uses demonetisation to fix economic problems in its monetary system. On November 8, 2016, the Government of India announced that ₹500 and ₹1,000 currency notes are not be accepted as legal money. In 1933, 86% of the money used was represented by high-denomination currency as notes. Officials described the policy as a way to tackle corruption, remove counterfeit currency from the system, lower the amount of unreported money and help the country move towards using digital banking. How sudden the action, how big it was and how quickly it occurred brought about huge and different changes to the Indian economy, mostly weakening liquidity, employment, banking and the behaviour of money at the individual and corporate levels.

### A. Background

Other countries have imposed demonetisation as a means of carrying out monetary policy changes in many different situations. These exercises had already been attempted in India before, in 1946 and 1978, but with little success because of the lack of high-denomination currency at the time. Still, the 2016 demonetisation was so big that people across the country felt its effects. Because of the way the Indian economy is structured, with a major informal area and a need for cash, the economy saw major disruptions at first. As people waited in ATM queues and some companies struggled to pay workers without cash, it showed how reliant India is on cash and raised questions about the ability of the system to manage such events. This paper places the 2016 demonetisation in the context of India's economy and looks at its effect on economic activity, banks, digital finance and financial stability.

### B. Importance of Studying Demonetisation

Studying demonetisation is important to see how money policy, development and institutions work together. It helps us see the impact that instant policy choices can have on the economy's balance, the financial sector and the structure of society. Demonetisation allows us to measure the results of policy steps meant to stop illegal money moves and encourage the shift to online banking. Besides, how the policy affects informal workers, small firms, rural areas and customer habits proves that policies should pay attention to short and long-term problems together. As the Indian financial system moves toward being more structured and digital, analysing what happened after demonetisation is becoming more necessary for policymakers, economists and financial firms.

### C. Objectives of the Study

this work is mainly concerned with understanding the following:

- To find out the immediate and delayed effects the 2016 demonetisation action had on India's economy.

- To see how demonetisation influenced liquidity, bank operations and adoption of digital payment systems in India.
- To understand how informal labour, SMEs and agriculture are beginning to change.
- To Determine whether the policy is fulfilling its statement goals, mainly by cutting down black money, increasing transparency and increasing financial inclusion.

#### D. Scope and Limitations

The research covers economic and financial effects of demonetisation at macro and micro levels within India. The analysis looks at a number of indicators, including GDP growth, the amount of money being handled, how digital payments are used, employment and measures from banks. This research builds upon a dataset from government publications, economic studies, academic articles and reports by financial organizations. The research is restricted by incomplete and problematic post-demonetisation information from the informal economy. Because the research does not involve direct surveys in the field, not all details of how the public feels and acts can be properly studied. The research does not take a side in political discussions and only looks at the policy's economic and financial sides.

## II. LITERATURE REVIEW

Since demonetisation affects the complex economic structure of a developing country, it has been talked about extensively by both academics and policymakers. After demonetisation in India in 2016, 86% of the cash was withdrawn sharply overnight, unlike similar steps taken before in other countries. Therefore, it became uniquely important to examine it for understanding macroeconomic balance and the security of the nation's financial sector. The announcement showed how Indian people and businesses in the informal sector which employs many and makes big contributions to the country's GDP, are heavily dependent on cash. Most of the attention in the academic world at first was on the impact on liquidity, the fact that sales and investment slowed down and the resulting, though temporary, reduction in economic activity for daily earners, traders and farmers who got most of their pay in cash. Because of the sudden absence of valid banknotes, everyday transactions ground to a halt in villages which drove distress migration to rural areas and stopped growth in construction, textiles and agriculture, where buying with cash was usual. Although critics focused on the negative side effects, the promoters of demonetisation said it was a step toward making society more formal, digital and responsible when paying taxes. There are now two separate viewpoints in the literature: one pays attention to the economic downturn and job losses and the other focuses on top-line benefits such as higher transparency, a wider tax base and greater use of digital payments.

Banks and other financial providers found themselves in a situation where they did both very well and very poorly, at the same time. People depositing their demonetized money quickly caused a huge rise in the amount of money contained in the bank's deposit base. The banking industry found it hard to supply enough new currency for everybody, resulting in queues, extra workload and regular shortages of cash. Because banks invested more time on cash handling, the sectors that create goods and services weren't able to get the credit they normally would. The biggest problem for SMEs has been their contract with cash and bank credit. This led to job cuts and, for some businesses, permanent closure. Yet, thanks to new digital behavior from customers, formal banks

found more ways to help more people and provide them with focused financial services. The increase in digital wallet, UPI and card payments showed an obvious change in how people pay for things, according to several analysts. With exponential growth reported by mobile payment companies, the story of the digital economy was given added importance for showing a possible future where cash transactions are less common. At the same time, the process was lopsided, with educated urban people getting connected faster than those in rural areas which revealed the big differences in digital access and skills needed for people to benefit equally from digitisation.

It was clear from the literature that demonetisation lifted the lid on chit funds, money lenders and informal savings firms that hadn't faced much oversight before. Because of the disruption, low-income households who couldn't use formal banks were seriously affected. Thanks to the policy, many of these people automatically chose to open bank accounts which is regarded as a good step forward for financial inclusion. However, many misunderstandings arose about inclusion quality, as many people did not participate enough and there was not much financial knowledge among them. After demonetisation, economic growth slowed down and there was great fluctuation in the activities of buying and investment in goods and services. Due to low demand and network disruptions, labour-dependent parts of the manufacturing industry were hardest hit. During seasons when crops are most dumped, cash-dependent agricultural sales create problems for farmers and the rural economy. Although the sector adopted digital tools and contracts quite slowly, this move eventually showed that the sector was adapting quietly.

A major part of the post-demonetisation literature looks at the impact of the policy on people paying taxes and the government's collection of revenue. After demonetisation, the government reported higher filing of taxes and a bigger population paying them, believing it was due to greater transparency and more people paying taxes in the formal sector. Even so, scholars questioned whether these improvements truly lasted or merely appeared because governments put pressure on companies to follow the rules. Authorities admitted that they were seeing noticeably more cases and seizures of unreported wealth due to demonetisation which clearly shows its positive impact against corruption. Even so, it was questioned how much of the illegal wealth was found, since a large amount of the demonetised money ended up back in the banking system, calling into doubt the success of the effort. For sales in the secondary real estate market, the policy mainly shifted away from the use of large cash components. Prices for land and properties went down for a little while and there were more transparent deals, just as before, but broader problems persisted. By contrast, looking at consumer psychology literature found that the population dealt with mistrust, anxiety and uncertain behavior and it was after some time that hesitant acceptance was achieved. Most small traders switched to digital payments just because they had to, not because they wanted to and using cashless methods often meant they reacted to changes rather than leading them.

In addition, there are scholarly articles that suggest that demonetisation was planned more for political gain than for simple economic aims. Although not covered in depth such readings inform us about the influence of socio-political forces on economic policies. It is clear from surveying the existing research that demonetisation had significant impacts

on the economy, financial system and people's behaviors, yet these changes happened gradually, with many setbacks and uneven adaptation. The range of views on this topic is because the benefits of improved financial transparency and digital technologies are combined with losses in jobs, the unregistered sector's contribution and rapid economic development. As a result, a thorough picture of a policy that intended to transform the economy was drafted, but doing so abruptly with strong opposition caused the efforts to last and play a part in Indian economic debates.

### III. METHODOLOGY

For this study, a combination of qualitative and descriptive research design was used, as it is good at describing the many different and complicated effects of demonetisation on India's economy and financial world. The study has been organized to look at how demonetisation changed the economy, what actions institutions took and what impacts the changes had long after demonetisation took place. As primary data was not accessible for this project, the findings are built on secondary data from government reports, financial institutions, central bank releases, the media and studies published by recognized think tanks. They gave us important facts about how the economy noticed changes in both types of measures following demonetisation. A research approach is used that interprets the reasons, actions and ways people in the economy adjust, since there is no ready collection of numerical data. The research makes extensive use of macroeconomic factors, for example, growth in the economy, inflation, employment, banking liquidity, credit transactions, reports of taxes being filed and volumes of digital transactions, to better illustrate the impact of demonetisation.

For methodological reasons, this study also reports financial implications divided by sector, with main areas being activity in the informal sector, financing for the banks, the flood of digital payments and modifying how the public finances itself. Changes over the past five years, before and after demonetisation, were studied using a longitudinal analysis, so that temporary factors could be separated from those that became permanent. For evaluation purposes, patterns in what was said about the economy and the reactions of institutions were explored by qualitative content analysis and trend analysis was used to map changes in major financial indicators. In addition, the study looks at similar monetary policy processes in other countries to better understand why India's experience is different and how big its effects have been. Reliance on secondary resources in this method can let in institutional biases, incorrect reports and selective disclosure as its biggest limitation. Moreover, because primary data is lacking, it is hard to study how behavior and daily lives change among poor and rural communities. Still, these challenges were reduced by comparing results from different trustworthy resources and using triangulation so that the findings could be trusted. To be fair, we ensured our data came from sources anyone could use, was referenced properly and viewed politics or ideology objectively. To achieve its aim of providing a clear overview of the outcomes of demonetisation, this research integrates factual economic data with the way the policy affected social and financial dynamics.

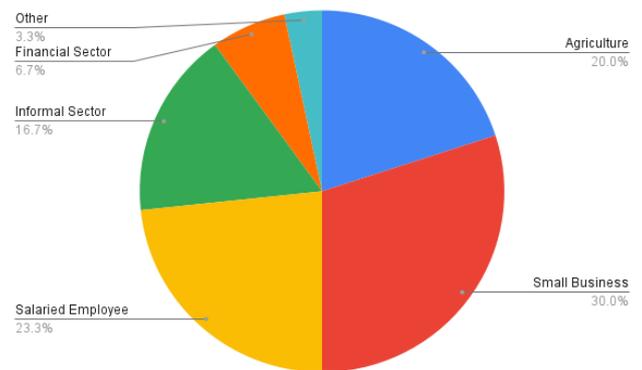
### IV. DATA ANALYSIS AND INTERPRETATION

Here, the main analysis of important data from 150 participants about demonetisation's impact on India's economy and finances is given. The tables picked here outline the variety of changes that people in different occupations,

making different types of transactions and those who have adopted digital finance encounter. The purpose of the analysis is to give helpful insights into how people adapted economically after demonetisation.

**Table 1: Respondents' Primary Occupation**

Occupation	Frequency	Percentage (%)
Agriculture	30	20.0
Small Business Owner	45	30.0
Salaried Employee	35	23.3
Informal Sector Worker	25	16.7
Financial Sector Employee	10	6.7
Other	5	3.3
<b>Total</b>	<b>150</b>	<b>100.0</b>



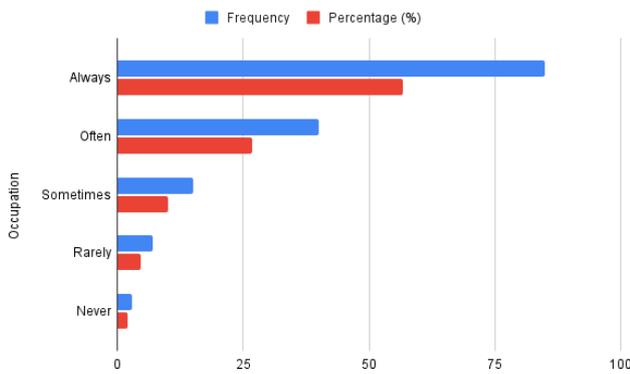
**Graph 1: Occupation Distribution (Pie Chart)**

#### Interpretation:

The data show that among economic roles, small business owners (30%) and salaried employees (23.3%) make up the biggest groups. There are a large number of people in agriculture (20%) and in the informal sector (16.7%) too. Having many jobs helped a lot, since the consequences of demonetisation were uneven based on how much cash people used, their ability to use banks and how well their jobs were affected. Financial sector workers (6.7%) share their experiences and we include informal workers to point out the impact on the most vulnerable of the economy.

**Table 2: Frequency of Cash Usage Before Demonetisation**

Cash Usage	Frequency	Percentage (%)
Always	85	56.7
Often	40	26.7
Sometimes	15	10.0
Rarely	7	4.7
Never	3	2.0
<b>Total</b>	<b>150</b>	<b>100.0</b>



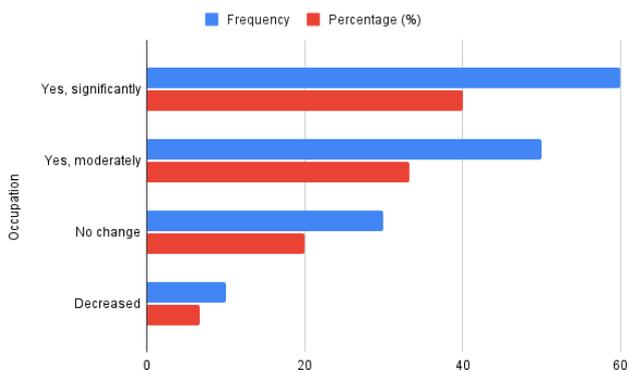
**Graph 2: Cash Usage Frequency Before Demonetisation (Bar Chart)**

**Interpretation:**

A large majority (83.4%) of participants said they used cash “always” or “often” prior to demonetisation which demonstrates that cash played a principal role in Indian financial dealings. According to the data, invalidating big currency notes caused a big interruption in day-to-day business for people who didn’t have other currencies. Because many depended on physical money, there was lots of confusion at first and digital payment systems had to be introduced and adopted quickly by both customers and service providers.

**Table 3: Change in Use of Digital Payment Methods After Demonetisation**

Change in Digital Payment Usage	Frequency	Percentage (%)
Yes, significantly	60	40.0
Yes, moderately	50	33.3
No change	30	20.0
Decreased	10	6.7
<b>Total</b>	<b>150</b>	<b>100.0</b>



**Graph 3: Change in Digital Payment Usage Post-Demonetisation (Bar Chart)**

**Interpretation:**

Digital payment methods grew quickly after demonetisation, with most participants (73.3%) reporting an increase, including 40% who saw a major increase and another 33.3%

who experienced a moderate rise. Such numbers prove that government help works and underlines the importance of coming up with new ways because of low cash supply. Six percent reported less use of tech and 20% did not see any difference which could mean problems with digital resources or skills exist. The shift was not on a single timeline, but demonetisation definitely contributed to the fast growth of India’s digital banking industry.

**V. DISCUSSION**

India’s economy and financial sector saw disruption from demonetisation, along with imposed formalization and a slow process of agents of all types getting used to the change. Demonetisation was meant to take out unreported money, reduce circulation of false notes and make the economy cashless, but the end results are more complex. After the policy was put into effect, agriculture, informal jobs, small retail and rural communities saw the country’s economy get highly disrupted in the first months. Low GDP growth resulted from both a sudden reduction in liquidity and people’s slow response to the need for quick changes. Most of the hardship resulting from the pandemic was felt by the informal sector, where workers lost wages, lost their jobs and saw less work done. Though, from another perspective, formal financial institutions like banks enjoyed a large increase in deposits, but that benefit was only brief since their financial situations soon returned to normal. Large inflows of money into the banking system highlighted the ability of institutional finance to handle and spread surpluses, though a slowdown in lending after that showed that major barriers and fears about risks continued to exist. By far, the most significant and positive result was an enormous rise in digital payments. Encouraged by their need to pay and by government efforts to help them use technology, many began using UPI, cards and mobile wallets. By making this advance, Indian consumers moved toward new types of financial activities that offered a base for future progress in digital banking and fintech. Moreover, a steep increase in tax declarations pointed to a notable, however, likely dictated by requirements, growth in those paying taxes. This action supported the government’s promise of being more transparent and responsible, although experts are not sure such behaviour can stay intact without official regulations in place. Demonetisation brought changes in public trust for the currency and for the government institutions. Although a few considered the plan to be an effective fight against corruption, others believed it was a risky economic project that mainly hurt the most vulnerable. As a result, the effects of the policy should be evaluated by checking social, political and economic changes it led to, along with its numerical performance. Because of the pandemic, policy makers recognized that the informal sector had been forgotten and that digital infrastructure in India was insufficient. In the end, demonetisation exposed that the Indian economic system is both easy to upset and able to adjust. As a result, Mexico today is facing a major loss in economic growth, while also being pushed to develop and organise more formally. The results show that although radical monetary moves can lead to immediate turmoil, their success in the long run comes from keeping reforms, strong institutions and policies inclusive.

## VI. CONCLUSION

In conclusion, the demonetisation of high-denomination currency notes in India in 2016 stands as one of the most consequential monetary interventions in recent history, producing a wide array of economic and financial outcomes that continue to shape policy discourse and public perception. The initiative, while ambitious in its intent to curtail black money, encourage digital payments, and formalise the economy, resulted in substantial short-term disruptions, particularly within the informal and cash-dependent sectors, exposing structural fragilities in employment, consumption, and rural liquidity. However, over time, demonetisation also catalysed important systemic shifts—most notably the rapid adoption of digital transactions, increased financial inclusion through banking channels, and a gradual broadening of the tax base. These outcomes, though unevenly distributed, suggest that the policy acted as both a shock and a stimulant, accelerating India's transition toward a more formalised, transparent financial architecture. Nevertheless, the experience of demonetisation underscores the critical importance of robust planning, technological preparedness, and social safety nets when implementing large-scale economic reforms in a diverse and demographically vast country. Future work in this domain should focus on longitudinal assessments of the informal sector's recovery and transformation, the durability of behavioural changes in financial habits, and the extent to which digitisation and formalisation have enhanced economic resilience and equity. Additionally, further research is required to explore the long-term fiscal implications of demonetisation, its influence on monetary policy trust, and its role in shaping India's digital public infrastructure. A multi-sectoral, data-driven approach that bridges macroeconomic analysis with grassroots narratives will be essential to fully understand the legacy of demonetisation and to inform the design of future policy interventions aimed at inclusive and sustainable economic reform.

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