

## **EFFECT OF DEMONETIZATION ON INDIAN REAL ESTATE SECTOR**

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### **ABSTRACT**

Demonetization is the process of removing a currency from general usage or circulation. It is the act of stripping a currency unit of its status as legal tender. Demonetization occurs whenever there is a change of national currency. The current form or forms of money is pulled from circulation to be replaced with new notes or coins. Sometimes, a country completely replaces the old currency with the new currency. The currency was demonetized first time in 1946 and the second time in 1978. The currency is demonetized for the third time by the present Modi government on Nov. 2016. This step is taken by the government for the betterment of the economy and the country as it is targeted towards dealing with the problems of black money, corruption and terrorism. It is very important to evaluate the short run as well as the long-term impacts of demonetization on the Indian economy. The paper addresses the effects of demonetization on the Indian Real Estate Sector.

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### **INTRODUCTION**

**Demonetization** is withdrawal of a particular form of currency from circulation or market. Since 9 November 2016, the ₹500 and ₹1,000 banknotes had been declared invalid in order to stop the rising practice of fake notes and black money. This is the third demonetization exercise which is undertaken by the Modi government. In the last few years, the government has initiated a number of key reforms in the real estate sector like **Real Estate Regulation Act (RERA)**, **GST**, **REITs and Benami Transactions (Prohibition) Amendment Act, 2016**, besides reforms related to FDI, to bring in transparency in the system. But with this step of demonetization, the real-estate sector will become more efficient, evolved, fair and transparent in the long-term.

### **GENERAL IMPACT OF DEMONETIZATION**

The demonetization measures have had significant and immediate impact on the state of the Indian economy. These measures are also expected to result in long-term impact on certain industries and sectors.

- ❖ These measures have resulted in a significant decrease in liquidity in the short term, which will gradually increase with the introduction and circulation of the new currency

notes. As a result of increased deposits with banks, the bank deposit base has increased significantly. This, in turn, is expected to enhance the liquidity position of banks, which can be used for lending purposes.

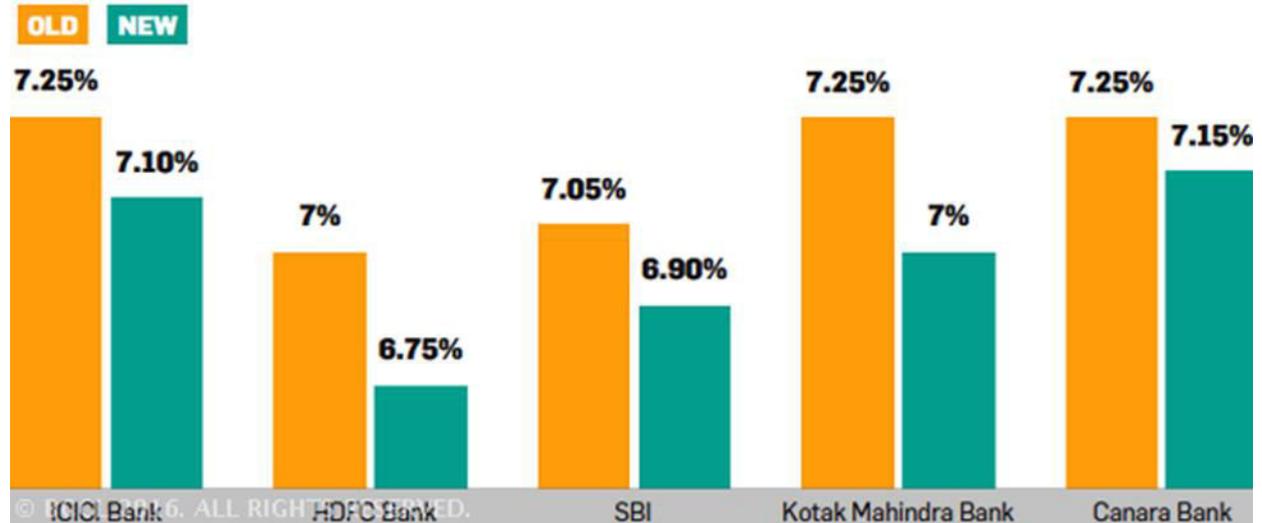
- ❖ Due to decrease in liquidity in the economy, alternative payment methods, such as e-wallets, online transactions using e-banking, debit and credit card usage have increased significantly and there is a shift towards an efficient cashless infrastructure.
- ❖ Reduced liquidity has also caused a sharp decline in the availability of disposable income, affecting the spending and consumption patterns of the people in the economy in the short term.
- ❖ These trends are expected to affect India's GDP growth rates adversely in the fiscal year ending March 31, 2017.
- ❖ While demonetization has left less cash in the hands of consumers, it is also expected to have a longer term deflationary impact on the economy. It will bring about a slowdown in purchases of items such as white goods, jewellery, high-end retail and of course, real estate.
- ❖ The sudden decline in money supply and simultaneous increase in bank deposits is going to adversely impact consumption demand in the economy in the short term.
- ❖ Banks are expected to lend money at a better rate of interest, following an increase in their deposits by demonetization drive. So, instead of investing the money in bonds or fixed deposits, people would prefer to invest their money in property in the coming days.

## **DEMONETIZATION AND RESIDENTIAL PROPERTY.**

Due to demonetization, people can expect property prices to come down which would provide an opportunity for them to buy their own houses.

- **Home loan rates will be liberal** due to demonetization, as a large amount of cash in circulation will be brought in the banking system through low-cost current account and saving account deposits. Due to this, lending rates are likely to come down further.
- **Fixed deposit rates have decreased across banks** due to increased liquidity, which in turn will lower the lending rates for the people, thus, increasing their purchasing power to buy the residential property.

The following figure depicts the old and new fixed deposit rates of different banks which has decreased over the period of time.



- **The primary sale of the houses will go up** with the demonetization move after some time, as the banks will lend more money to the actual buyers.
- Lower land costs in emerging areas and smaller cities will eventually **result in lower cost of budget housing**, as developers will pass on the benefit of these savings to their customers.
- The luxury and high-end segments of residential real estate will also see a major impact from this exercise of demonetization because a lot of payments are done in cash. The demonetization move is likely to **result in luxury property prices dropping** by as much as 25-30%.
- **The primary market** - the market formed by projects undertaken by reputed and credible developers in the cities - **will remain more or less unaffected**. This is because buyers into such projects take the home loans/finance route to buy their homes and such transactions are done through legal channels. Therefore, there will not be any major impact on sales in this segment.

## IMPACT OF DEMONETIZATION ON REAL-ESTATE

It is too early to accurately find out the impact of demonetization, but its impact on the real estate sector is immediately visible. The real estate sector will definitely be affected by the demonetization exercise, as it has traditionally seen a very high involvement of black money and cash transactions.

1. The current step of demonetization will make it extremely difficult for any buyer to pay in cash. The seller will also not accept such money. This will automatically **bring down the prices of property**.
2. Demonetization will lead to **correction of real-estate prices in the market** where investment was done through black money.
3. Real-estate sector in India constitutes about 11 per cent of the GDP and accounts for more than 50 per cent of the current black money market. Freeing of this money will give a **rise in GDP**.
4. Due to **Urban Land Ceiling Act, coupled with foreign investments and tax holidays, people** had opportunities to buy properties in bulk and then sell it at higher prices leading to property inflation. This would not be practiced in future.
5. No registration records were maintained even for larger properties. Demonetization will change the scenario. From now onwards, the investments would be legal.
6. Decreased liquidity sources is expected to significantly weaken the demand for resale properties.
7. Luxury property rates are expected to decrease as a result of fewer purchasers with significant liquidity.
8. Cash transactions are most common in secondary sales and resale transactions are expected to decline.
9. A decline in resale property rates is also expected to adversely affect the real estate investors that intend to make investment in new projects. In turn, this is expected to affect the primary market as funding new projects become more challenging, and is also expected to affect industries related to the real estate, infrastructure and construction sectors, such as the steel and cement industries.
10. Large institutionalized real estate developers are however, not expected to be directly affected by such demonetization measures. Since infrastructure development projects are typically partly funded by the government, these measures are not expected to impact such projects directly.
11. However, the unorganized and middle real estate developers that were predominantly dependent on cash funding, are expected to increasingly rely on institutional investors for funding the projects.

12. With black money suddenly being wiped out of the market, a lot of investors who have been investing in projects with the black money and raising prices to book profits will be eliminated from the system.

## **FUTURE OF REAL ESTATE SECTOR**

On the whole, the move of demonetization is very good for the Indian real estate sector. The Indian real estate sector will now become more transparent, credible and attractive to all kinds of investors, especially institutional investors. The real estate market is expected to stabilize with the increase in bank deposits, gradual stabilization in banking operations and resultant lower cost of funds. The government has taken this initiative to make the Indian business environment more attractive for both domestic as well as foreign investments. For end-users and investors, the current time is extremely favourable to make their investments in real estate. The salaried class which uses home loans to purchase properties will not face any problems at all because of the demonetization move. Those who invest in residential real estate now can expect satisfactory long-term capital appreciation. In the long term, we will see a much more sustainable, strong and healthy real estate market emerging in India