SBI Research

Withdrawal of Rs 2000 Note: How it could result in a bank deposit boost, repayment of loans boost, consumption boost, RBI retail CBDC boost and a possible GDP boost

19-June-2023

Executive Summary….1

- On 19th May 2023, RBI decided to withdraw the Rs 2000 denomination banknotes from circulation as a part of currency management w.e.f. 22nd May

- In value term, the share of 2000 denomination notes (Rs 3.62 lakh crore) was at 10.8% as on Mar’23

- Basis the RBI Governor’s statement (on 08 June), around 1.8 lakh crore of Rs 2000-rupee notes have come back to the system. Of this, around 85% /Rs 1.5 lakh crores have come as deposits and the rest are exchanged for other smaller denominations

- In accounting terms, as the RBI generates liabilities / currency in circulation, it must be matched by creation of assets / Open Market Operations of purchase /sale of Government securities of the same magnitude…thus, it is most likely that the entire amount will come back into the system….However, the seasonally adjusted decline in currency in circulation during the same period is only around Rs 90,000 crore…..

- Even as Rs 1.5 lakh crore of Rs 2000-rupee notes has been deposited at the banks …This implies that the amount spent / exchanged by people over the counter is ~ Rs 60,000 crore (Rs 1.5 lakh crores net of Rs 90,000 crore decline in currency in circulation ~Rs 60,000 crores) …this could also result in a bank deposit boost, repayment of loans boost, consumption boost, RBI retail CBDC boost and a possible GDP boost…

    - Our objective in this exercise is to fathom these entire dynamics of withdrawal of Rs 3.62 lakh crore in the form of Rs 2000 denomination note

Executive Summary….2

- The ‘precision strike’ by RBI hits the right notes on multiple counts, taking pressure off substantially from near war-like quest for deposits from banking system while also smoothening the bias for higher interest rates going forward. Additionally, the move effectively anchors the surge in incremental C/D ratio, nearing pre-pandemic levels, by filling the coffers and keeping banks ready to meet funding needs from diverse sectors

- The short-term rates (CPs) should ease from upper crest, in alignment with smoothening of benchmark yields while CDs raising by banks to fund the credit/investment demands should also find a rational footing

- With overseas markets remaining choppy (further consolidation of mid and small size banks in AEs looks certain going ahead with elevated Fed rates distorting the flimsy equilibrium of yesteryears), Indian banks should get more elbow room to meet the demands from corporates to fund their expansion plans through a mix of credit facilities

- Deposit in the banking system through corporates is witnessing smart traction, majorly through Bulk Deposits, as better returns with liquidity and safety has made bank deposits a favourite alternative for corporates from diverse strata including PSUs and NBFCs

- RBI’s retail CBDC project (E-RUPI) should be an ultimate beneficiary of this tactical move as it transitions from a beta-testing phase in the CUG (Close User Group) to hit the streets (going by the preparedness of stakeholder banks to on-board select merchants and retail individuals in the real-time payment landscape through their dedicated apps). The absence of higher denomination note should propel faster adoption of E-RUPI for merchant transactions, concurrent with physical fiat currency

- We expect Q1 FY24 GDP growth at ~ 8.1% with an upward bias due to the impact of Rs 2000 note withdrawal event…this reinforces our projection that FY24 GDP could be higher than 6.5%, basis the RBI estimate

Anatomy of Withdrawal of Rs 2000 Denomination…Based on our understanding till now…

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Total Withdrawal
Rs 3.62 lakh crore

Bank Deposit (85%)
Rs 3.08 lakh crore

Counter Exchange (15%)
Rs 54,000 crore

In Savings Account (30%)
Rs 92,000 crore

In Current Account (40%)
Rs 1.23 lakh crore

In Loan Account (30%)
Rs 92,000 crore

Withdrawal from Savings Account
60%

Immediate Increase in Consumption
Rs 55,000 crore

Consumption boost in long run
Rs 1.83 lakh crore through the marginal propensity to consumption multiplier

Q1 FY24 GDP growth at ~ 8.1% with an upward bias

Currency Composition shows Rs 2000-rupee note was 9% of total value as on March'23

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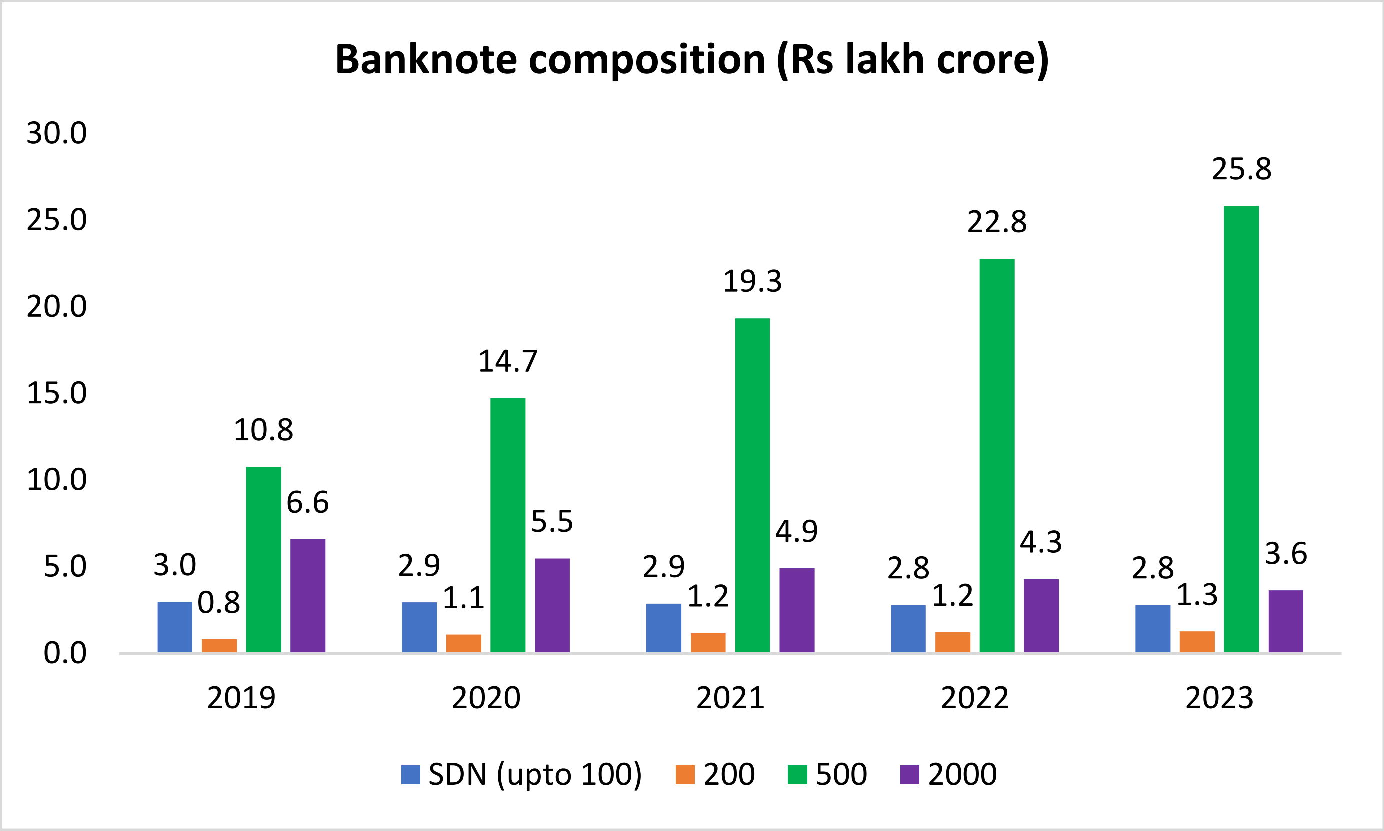
- The 2000 denomination note which the RBI had stopped printing since 2018 reduced to 1.8 billion pieces as on Mar'23, from 2.1 billion pieces in Mar'22
- In value term, the share of 2000 denomination notes (Rs 3.62 lakh crore) was at 10.8% as on Mar'23, while the share of small denomination notes came down further to 8.3% by end Mar'23 from 9.0% a year earlier

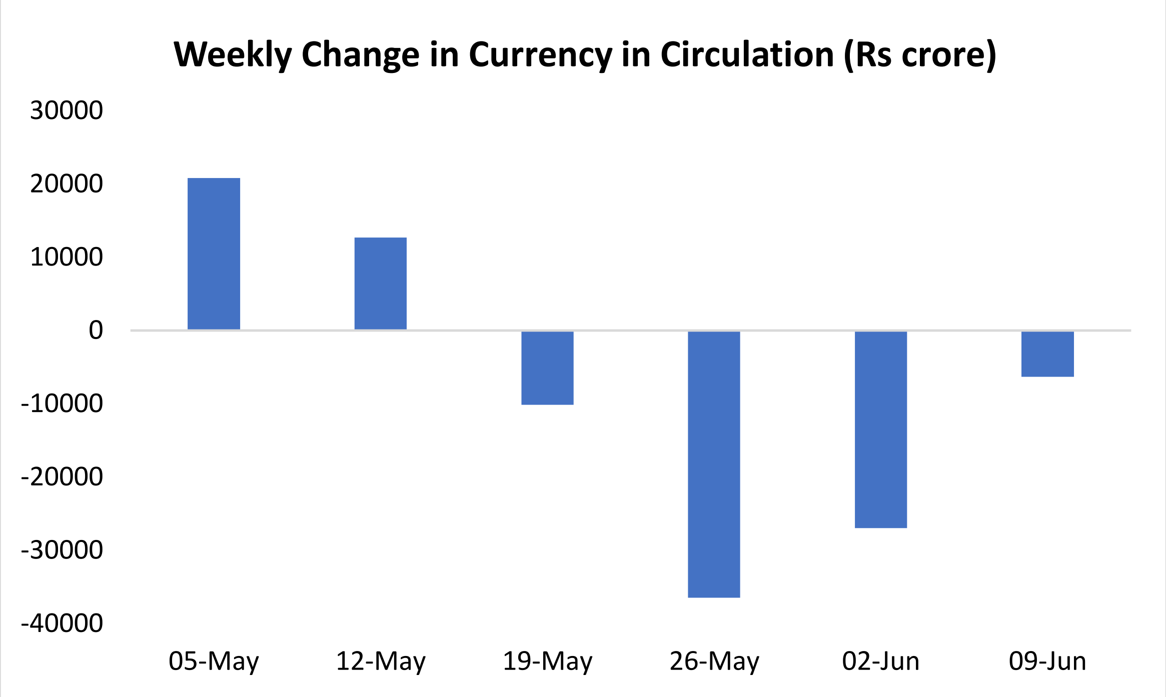


Ideally, the lower is the decline in currency in circulation, compared to Rs 2000 notes returning, it implies the residual gap is being exchanged / spent ….decline in currency in circulation much lower than Rs 2000 notes deposited in bank accounts

- The currency in circulation has declined less when compared to Rs 2000 notes deposits in banks (85% of Rs 1.8 lakh crore ~Rs 1.5 lakh crore). It has declined from Rs 34.78 lakh crore as on 19 May'23 to Rs 34.08 lakh crore as on 9 Jun'23, a decline of only around Rs 70,000 crore

- During the same period in the last two years, the CIC has increased by an average of Rs 19,000 crore. Thus, CIC would have increased by this amount this year as well which in turn implies that **CIC has actually declined by Rs 89,000 crore (Rs 70,000 crore + Rs 19000 crore)** which is still much lower than Rs 1.5 lakh crore deposited Rs 2000 notes

- Had the entire Rs 1.5 lakh crore/ 85% of Rs 1.8 lakh crore were deposited and not exchanged, the CIC should have declined even more. Currency notes with public represents a liability of the RBI and assets for the people



Impact on Deposits, Credit (Loan Repayment) and Consumption

Deposit

- Though some amount would be withdrawn following the deposit, but going by the current trends, CASA deposits are likely to increase (Rs 1.5 lakh crore) due to this measure. ASCB data shows that there has been an increase in total deposits of Rs 3.3 lakh crore (81% increase of which is in term deposits) during **the fortnight ended 2 Jun'23**. However, there is some seasonality in the data. The average increase in deposits during the same fortnight in the last two years was around Rs 1.5 lakh crore. Thus, taking that also into account, banks may have received additional deposits of around Rs 1.8 lakh crore during the fortnight this year. It seems Corporates, flush with in-hand liquidity, are parking the additional funds with Banks. This is also substantiated by the fact that some of the sectors which reported improved cash and bank balance as of Mar'23 as compared to Mar'22 includes Refinery, Oil & Gas, Power, Chemicals etc. are believed to be more active in parking of funds with banks that ranges from 30-45 days to 1 year!

Credit

- On credit front, as per our assessment, 30% of deposits (or Rs 92,000 crore) might go for loan payment (in CC/OD and in term loan accounts also). Interestingly, despite repayments getting frontloaded, credit growth continues to remain quite strong

Consumption

- One of the major benefits of withdrawal of Rs 2000 note might be the immediate uptick in consumption demand. As per our estimate consumption demand may be frontloaded by Rs 55,000 crore

Consumption boost of Rs 55,000 crore…likely benefits to Real Estate, Jewellery and Consumer Durables

- With the bank note remaining a legal tender, unlike demonetization, consumption could see a boost. Though, RBI asked customers to deposit or exchange the Rs 2000 notes, but it is expected that high-value amounts could move to high-value spends such as gold/jewellery, high-end consumer durables like AC, mobile phones etc, and real estate
  - **Petrol pumps**: Cash transactions have sharply risen at petrol pumps and cash-paying customers are using Rs 2,000 notes. The All-India Petroleum Dealers Association (AIPDA) has said that the digital payments, which used to be ~40% of daily sales at pumps, have dropped to ~10% while cash sales have increased dramatically
  - **Cash on delivery**: People have also started ordering items online with the cash-on-delivery option. It is reported that nearly 75% of Zomato’s users opting for cash-on-delivery have been paying with Rs 2,000 notes. Ecommerce, food and online grocery segments are likely to witness an increase in customers opting for cash on delivery.
  - **Temples**: Expected to increase in donations through Rs 2000 notes in temples and other religious institutions
  - **Sundry purchases**: Such as consumer durables, boutique furniture, etc.

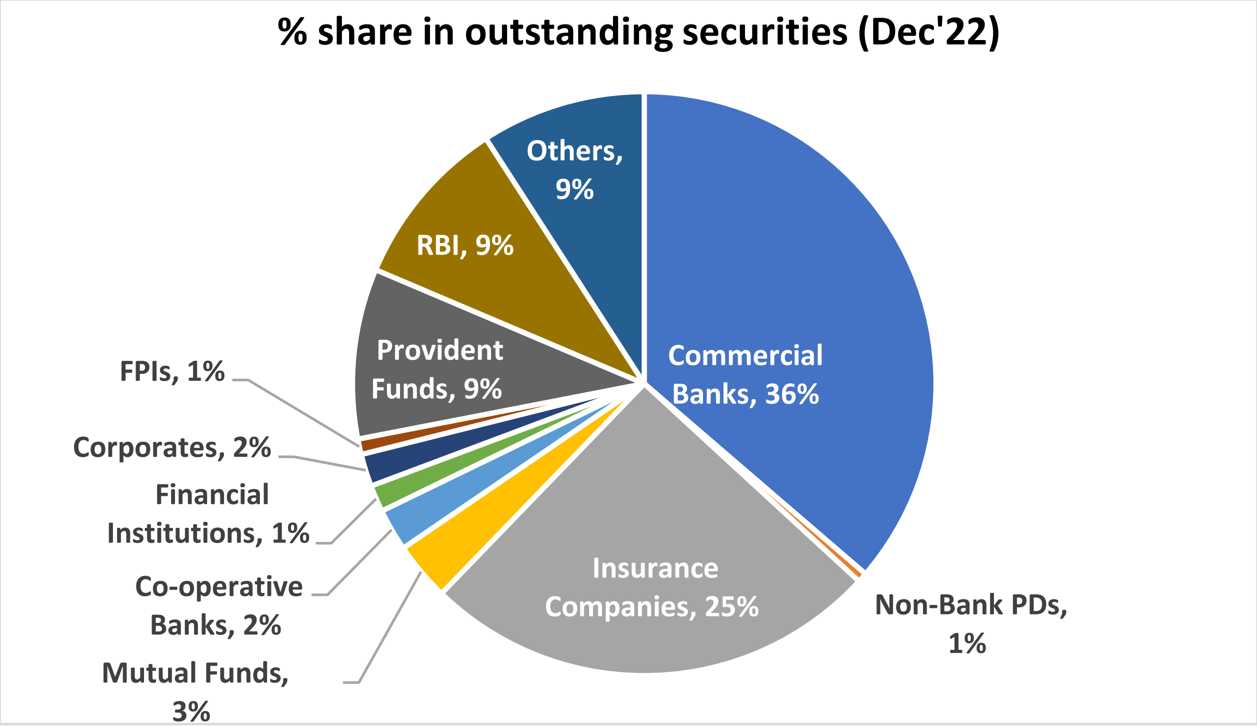
Impact of Consumption on Q1 FY24 GDP …Q1 GDP might be higher than RBI estimates of 8%

- Around Rs 55,000 crore could be withdrawn by public from ~Rs 92,000 crore saving bank deposits to be made cumulatively through Rs 2000 notes. This should give consumption boost along with increasing the velocity of money

- Considering the MPC of this Rs 55,000 crore at 0.7, we believe that the Private Final Consumption Expenditure (PFCE) might increase by Rs 1.83 lakh crore through the multiplier effect. Considering that ratio of PFCE to GDP at constant prices is around 58%, we may expect Q1 FY24 GDP growth at ~ 8.1% with an upward bias due to the impact of this Rs 2000 note withdrawal event…this reinforces our projection that FY24 GDP could be higher than 6.5%, per the RBI estimate

Not much impact on liquidity- but given that loan repayments are also happening & loans ultimately create deposits.. Bank Deposits could still expand at a healthy rate… RBI OMO purchase requirements could be thus lower than consensus…

- There will not be much impact on the liquidity owing to withdrawal of Rs 2000 notes, as the amount deposited with the banks would be withdrawn in smaller denominations later
- But the interesting thing is that some amount would also come in loan account and **loans create client deposits and balances** as every loan given out by any bank lands up in a client banking account within the banking system. Lending does however result in a very small secondary impact on banking liquidity surpluses as the deposits created by lending require CRR maintenance
- The total supply of the securities including G-sec, SDL and T-bills is around Rs 17.65 lakh crore. Assuming 11.5% of deposit growth and actual SLR investments of 28%, there will be demand of Rs 6.0 lakh crore from banks. Furthermore, taking into account the share of other entities in total outstanding securities, total demand would be around Rs 15.6 lakh crore. if we consider that loans will also create additional deposits the need for OMO would be still be lower than market consensus upto Rs 2.5 lakh crore



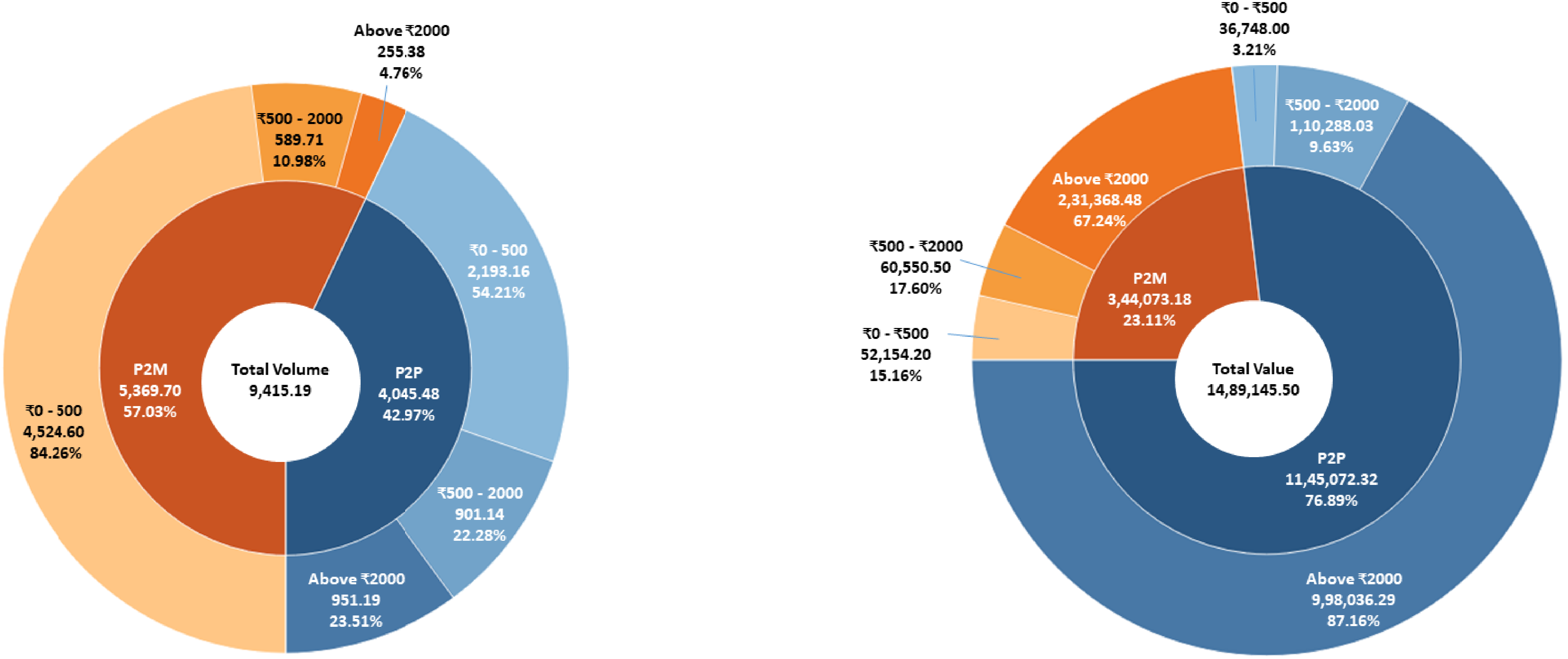
Is UPI the new Rs 2000?

Data trends suggest so….

How UPI has changed the Payment Landscape…67% of UPI transactions in value in Person-to-Merchant Segment more than 2000 & 87% in Person-to-Person category….

UPI: Transactions (by Volume in Mn) for May'23

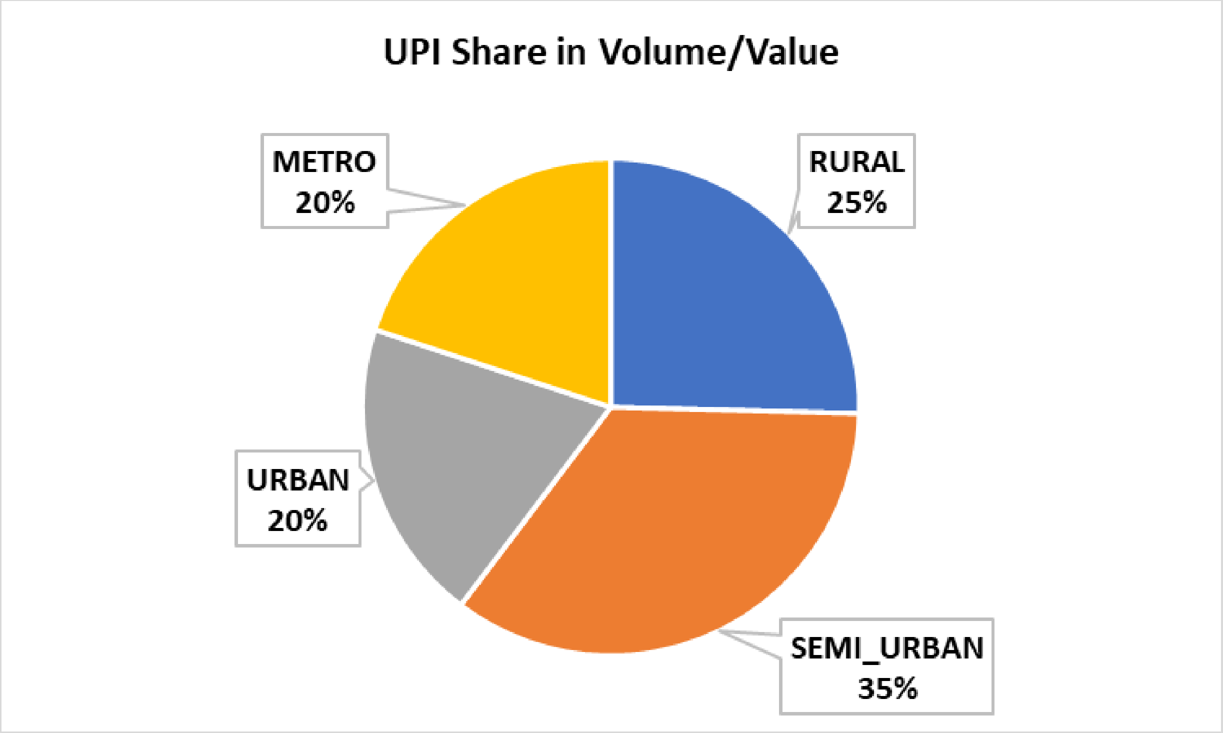
UPI: Transactions (by Value in Crores) for May'23



Source: NPCI

Rural & Semi-urban Areas are leading the surge in UPI transactions

- Against the popular perception that UPI is popular in metro areas only, Semi-Urban areas are accounting for one-third of the share in value/volume
- Top 15 states accounted for almost 90% of share in value/volume The average ticket size of these 15 states ranges between Rs 1600 to Rs 2200
- District-wise analysis indicate that the top 100 districts of India accounted for ~45% share in UPI value/volume
- Thus, UPI has effectively replaced much of the currency in circulation



Share of 15 Major States in UPI Value/Volume Terms & Average Ticket Size

Share	State	Avg Ticket Size (Rs)
8-12%	AP, Maharashtra, Telangana, Karnataka	2000-2200
5-8%	UP, Rajasthan, TN, Bihar, WB	1800-2000
2-5%	Odisha, Kerala, MP, Gujarat, Assam, Haryana	1600-1800

Source: SBI Research

Contact Details:
Dr. Soumya Kanti Ghosh
Group Chief Economic Adviser
State Bank of India, Corporate Centre
Nariman Point, Mumbai - 400021
Email: soumya.ghosh@sbi.co.in
gcea.erd@sbi.co.in
Phone:022-22742440
:@kantisoumya