

SEPTEMBER 24, 2018
ISSUE NO: 49, FY19

CURRENCY IN CIRCULATION EXPANSION SLOWING DOWN

The currency in circulation (CIC) which was increasing exponentially as expected post demonetisation, flattened since May'18. CIC increased from Rs 9.0 trillion in Jan'17 to Rs 19.5 trillion as of Sep'18 (14th Sep). However, since the starting of May'18, it has been in the range of Rs 19.0-19.6 trillion. We believe it could be a combination of several factors.

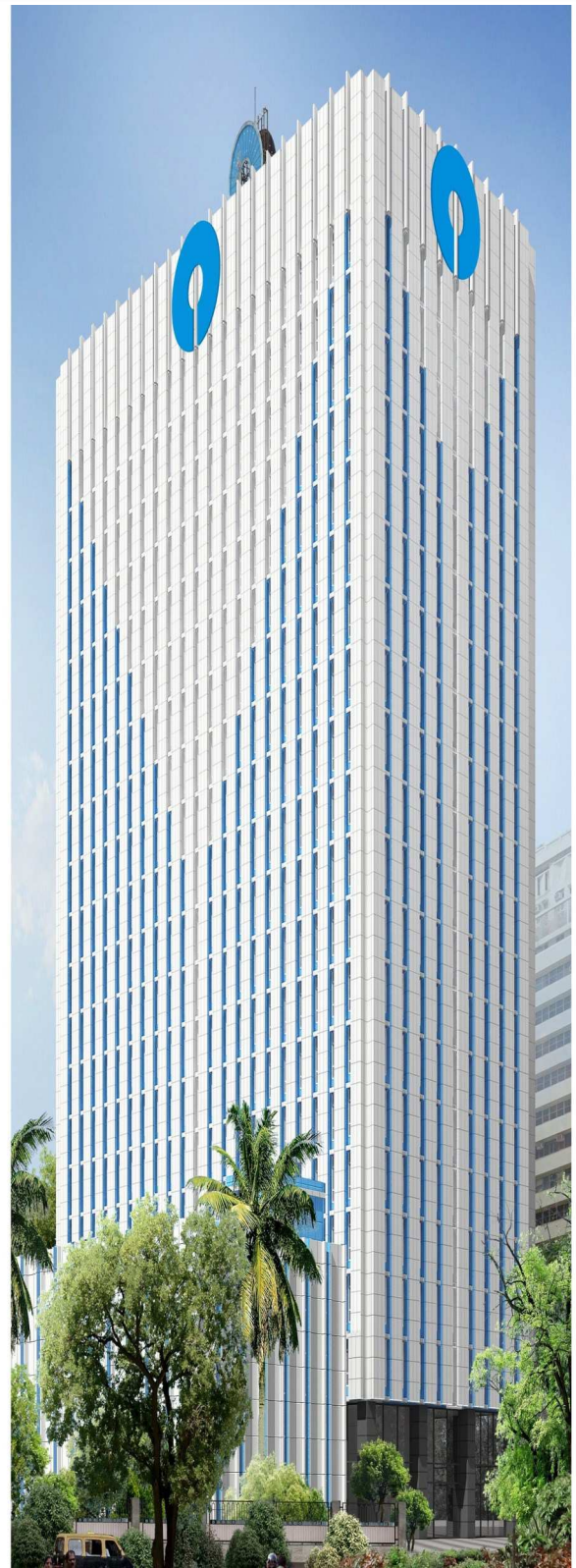
Such a decline in CIC is indeed a seasonal phenomenon but this time it seems the decline is more than just seasonal. When we observe the weekly data for the last 10 years, we have found a pattern in CIC decline in the last fortnight of July every year. However the decline is more pronounced in 2018 (almost Rs 150 billion more than the average of 2009-2016). RBI in its 2016-17 Annual Report has also quoted "*currency in circulation (CIC) rose sharply in Q1 but fell back in Q2, reflecting the usual seasonality*".

First, the decline in CIC in the last fortnight of every July is partly explained by the low cash demand from agriculture sector. The demand for currency increases post-monsoon as the harvesting begins in October followed by Rabi sowing, eventually giving rise to cash requirement.

Second, the festive season also brings along its natural demand, which gets accentuated with buying of gold, automobiles, etc. increasing the demand for currency.

Intriguingly, the decline in CIC this fiscal has continued beyond August and it seems there may be other reasons behind it. One possible reason could be people may be cutting back discretionary spending with the recent spurt in fuel prices, mostly in rural areas. The other could be to the extent RBI is selling dollars directly from its foreign exchange reserves to designated dealers / banks thereby withdrawing rupee resources in return, thus reducing money/currency in circulation. However, such intervention, since taking place between banks, should not have major impact on systemic liquidity. The other reason, though insignificant, could also be RBI replacing soiled notes.

Whatever is the reason for such trend, this implies that bank deposit growth will at least not face pressure in the interregnum with less of a currency leakage as of now!



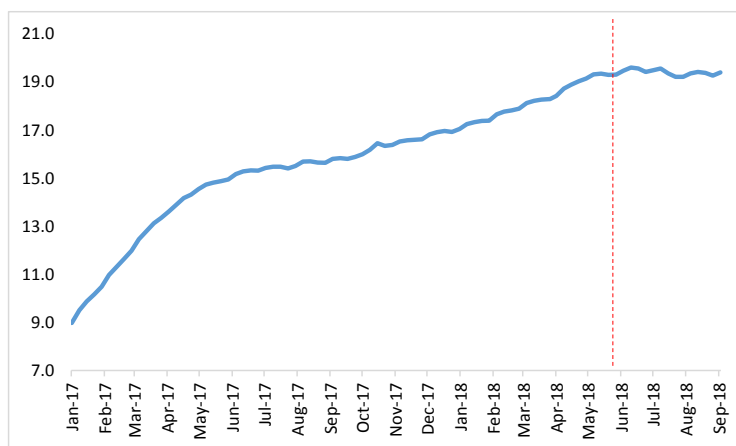
WHY CURRENCY IN CIRCULATION IS DECLINING?

- ◆ The currency in circulation (CIC) which was increasing exponentially as expected post demonetisation, flattened since May'18. CIC increased from Rs 9.0 trillion in Jan'17 to Rs 19.5 trillion as of Sep'18 (14th Sep). However, since the starting of May'18, it has been in the range of Rs 19.0-19.6 trillion. There are certain reasons for this slow growth in CIC since May'18.

SEASONALITY

- ◆ After Jan'17, the first major weekly decline in CIC was observed on 20th Jul'18 when it fell by around Rs 200 billion. In the next week also CIC declined by more than Rs 140 billion. When we observe the weekly data for the last 10 years, we have found a pattern in CIC decline in the last fortnight of July every year. However the decline is more pronounced in 2018 (almost Rs 150 billion more than the average of 2009-2016). RBI in its 2016-17 Annual Report has also quoted "currency in circulation (CIC) rose sharply in Q1 but fell back in Q2, reflecting the usual seasonality".
- ◆ The decline in CIC in the last fortnight of every July is partly explained by the low cash demand from agriculture sector. The demand for currency will increase post-monsoon as the harvesting begins in October followed by Rabi sowing, eventually giving rise to cash requirement. The harvest requires labour wages distribution, hiring of equipment's and Rabi sowing leads to overall requirement of money for purchase of seeds, fertilisers etc.
- ◆ The festive season also brings along its natural demand, which gets accentuated with buying of gold, automobiles, etc. increasing the demand for currency. It remains to be seen whether the recent spurt in fuel prices may result in cut in discretionary spending by households. Our estimates suggest that inflation of discretionary items in rural basket is declining at a faster pace in recent times. Whether it is because of a demand decline remains to be seen.

Graph 1: Currency in Circulation (in Rs Trillion)



Source: RBI; SBI Research

Weekly Change in Currency in Circulation (Rs Bn)			
Year	27th July	20th July	Total
2018	-141	-203	-344
2017	-68	0	-68
2016	-125	-151	-275
2015	-126	-145	-271
2014	-125	-61	-186
2013	-127	-81	-208
2012	-110	-100	-210
2011	-87	-69	-156
2010	-76	-63	-140
2009	-52	-57	-109
Average (2009-2016)			-194

Source: RBI; SBI Research

RBI INTERVENTION

- ◆ This apart, to manage the rupee volatility, RBI has been selling dollars. The RBI could sell dollars directly from its foreign exchange reserves to designated dealers / banks thereby withdrawing rupee resources in return, thus reducing money/currency in circulation. However, in most cases, such intervention may be between banks thus having no impact on systemic liquidity.
- ◆ The good thing is that as there is no leakage of currency, the bank deposit growth will not be hit.

ABOUT US

The Economic Research Department (ERD) in SBI Corporate Centre is the successor to the Economic and Statistical Research Department (E&SRD). The latter came into being in 1956, immediately after the State Bank of India was formed, with the objective of “tendering technical advice to the management on economic and financial problems in which the Bank has interest and which required expert analysis”.

After the first reorganization of the Bank, when specialized departments like Management Science, Management Information Systems, Planning and Market Segment Departments took over the statistical work of E&SRD, the Department was renamed as ERD.

However, with the ERD team now taking on multidimensional functionalities in the area of risk management, corporate analytics, strategy and so on, who knows, the time may have come to rename it again!

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