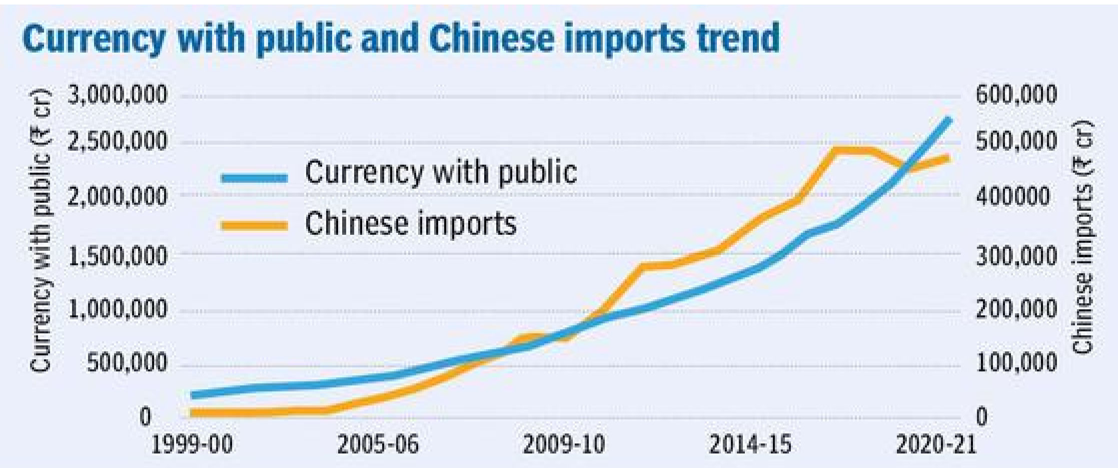
# The Paradox of High Cash Intensity

## What is the issue?

The high level of illegal Chinese imports and a dysfunctional trade credit system are keeping cash usage high.

## What is the trend of cash intensity in the country?

- The cash intensity of the economy heightened since early 2000s, accelerated in the last two or three years and peaked during FY 2021.
- The decadal average ratio of currency with public (CwP) to GDP steadily increased from 8.2% in 1980s to 10.6% during FY2010s.
- It reached a high of 14.5% in FY2021 despite large decline in GDP and multi-fold increase in digital payments.
- The trend continued with ratio at 13% during FY2022, despite month-on-month jump in e-payments.
- The decadal average share of currency in households' financial assets increased from 8.8 % in 1990s to 12.4% in 2010s.
- CwP to demand deposits ratio reached record high during 2010s.
- This is not explained by the currency demand models nor by transient events like elections, festivals or precautionary holding by public.
- This trend indicates counter-intuitive developments which are not ideally aligned with RBI's currency demand forecasting models.



Note : Demonetisation year of FY 2017 not considered

## Why the currency demand forecasting is distorted?

> *Trade credit is an agreement made between two businesses where the customer can make purchases on the account without making cash payment upfront.*

- **Dysfunctional trade credit**- Demonetisation resulted in conversion of notes into bank deposits of high denomination notes accounting about 87% of total value of currency in circulation.
- However, post-demonetisation saw accelerated growth in CwP.
- Accelerated currency growth is also attributable to economic uncertainty arising from demonetisation, GST and the Covid.
- Negative trade credit conditions spur a strong preference for cash sales and reduce currency and trade credit velocity amplifying cash holdings by firms.
- The preference for cash and liquidity holdback by firms can be traced to cash and trade credit flow uncertainties triggered by a dysfunctional trade credit network having spillover effects on banking.
- **Financing Chinese imports**- The other missing variable is the need for cash to finance under-invoiced/illegal portion of imports from China which appear to have steadily surged, since early 2000s.
- These imports appear to be too massive to nullify decline in currency demand due to financial deepening and erupt in digital payments.
- In absence of data on concealed imports and given the fact of our consumption and industrial structure being overdependent on Chinese import, we can assume that concealed imports grew at perhaps the same rate as growth in value of official imports.
- Chinese imports increased 49% between January and November 2021, despite lower private consumption, low capacity utilisation and strained ties with China.
- This perhaps explains the continuation of high cash intensity in FY2022.

*The RBI's Financial Stability Report of July 2021 shows a steady increase in cash holdings by a sample of 1,360 listed private non-financial companies.*

## What is the way ahead?

- Stringent measures are required to remove concealed Chinese imports, a longstanding cause of growth in currency demand and sluggish industrial development.
- A trade credit intervention is required to mitigate disorderly developments in the financial system, and for pro-growth monetary measures to succeed.

**References**


1. https://www.thehindubusinessline.com/opinion/the-paradox-of-high-cash-intensity/article65214085.ece
2. https://cleartax.in/g/terms/trade-credit