HOUSEHOLD SAVINGS AND DEBT IN INDIA - GS III MAINS

Q. The fall in household net financial savings to GDP ratio highlights deeper structural issues within the Indian economy. Discuss (10 marks, 150 words)

News: *Rising debt strains household savings*

What's in the news?

- The drastic fall in the household net financial savings to GDP ratio during 2022-23, attributed to a higher borrowing to GDP ratio, has sparked a significant debate.

Key takeaways:

- While the Chief Economic Advisor (CEA) to the Government of India views this trend as a shift in the composition of household savings towards **higher physical savings**, there are counter arguments that the interpretation is inconsistent with broader economic trends and highlights structural shifts in the Indian economy.

Changes in Savings Pattern:

- The **household savings to GDP ratio** includes net financial savings, physical savings, and savings in gold and ornaments.

Data from 2022-23:

- **Net financial savings to GDP ratio declined by 2.5 percentage points.**
- **Physical savings to GDP ratio increased by only 0.3 percentage points.**
- **Household borrowing to GDP ratio increased by 2 percentage points.**
- **Gold savings to GDP ratio remained unchanged.**
- **Overall household savings to GDP ratio declined by 1.7 percentage points.**

Reasons for Decline of Household Savings:

1. Decline in Net Financial Savings:

- The main issue is the significant decline in household net financial savings to GDP, which fell by 2.5 percentage points during 2022-23.
- This shows households are saving less in financial forms like bank deposits or stocks.

2. Increase in Household Debt:

- According to the CEA, households are incurring greater borrowing or reducing their net financial savings not out of distress but to finance higher physical savings.
- This means that households are taking on more debt to invest in physical assets like real estate, durable goods, or infrastructure, which they believe will provide better returns or value over time.

- Alongside the decrease in savings, there was a rise in the household borrowing to GDP ratio by 2 percentage points, indicating that households are taking on more debt.

3. Mismatched Compensation:

- Although there was a slight increase in physical savings (up by 0.3 percentage points), it did not offset the reduction in financial savings, leading to an overall drop in the household savings to GDP ratio by 1.7 percentage points.

4. Post-COVID Economic Impact:

- Households are taking on more debt not just to invest in physical assets but also to manage higher interest payments, which reflects financial distress

5. Fisher Dynamics:

- In the post-COVID period, India has experienced a sharp rise in the ratio between nominal debt and nominal income, largely because income growth has not kept pace with rising interest rates.

Challenges of Indian Economy with respect to Household Savings:

1. Growing Debt Burden:

- The gap between lending rates and income growth is increasing. This raises the debt-income ratio, leading to higher interest payments for households.

2. Reduced Consumption:

- Higher debt prompts households to cut back on spending. The consumption to GDP ratio dropped in 2023-24, showing this trend.

Government's Interpretation:

1. Shift in Savings Composition:

- The government, represented by the Chief Economic Advisor (CEA), interprets the trend as a shift in savings from financial assets to physical investments, suggesting households are not actually saving less but changing where they save.

2. Increase in Total Savings:

- Despite the decline in net financial savings, the CEA points out that the nominal value of total household savings has increased, indicating growth in the overall savings pool during 2022-23.

Measures Needs to be Taken:

To address these challenges, policymakers may need to set additional macroeconomic targets focused on stimulating and supporting household income growth.

1. Reducing Debt Burden:

- The first challenge is to decrease the gap between interest rates and income growth to prevent further increases in household debt burdens.

2. Maintaining Demand:

- The second challenge is to prevent a reduction in aggregate demand.
- High debt and interest payment commitments can lead households to cut back on consumption, which could slow economic growth.
- This could help reduce financial distress and support sustained economic growth.

The debate around the fall in household net financial savings to GDP ratio highlights deeper structural issues within the Indian economy. It is essential to address the rising debt-income ratio and the resultant financial distress faced by households. Policymakers must focus on reducing the interest rate and income growth gap and supporting household income growth to ensure sustainable economic development.