HOUSEHOLD SAVINGS - GS III MAINS

Q. Evaluate the trend of household savings in India and its implications on economic stability, considering the decline in net financial savings and the rise in household debt. (15 marks, 250 words)

News: *On the fall in household savings*

What's in the news?

- The sharp reduction in Household Net Financial Savings and the rise in Household Debt burden are a cause for concern for growth and economic stability.

Household Financial Savings:

- Household financial savings refer to currency, bank deposits, debt securities, mutual- funds, pension funds, insurance, and investments in small savings schemes.
- The total of these savings is referred to as gross household financial savings.

Household Debt:

- Household debt is **all household liabilities** (including non-profit institutions serving households) that require payments of interest or principal by households to creditors at a fixed date in the future.
    - **Debt** is calculated as the sum of the following liability categories - loans (primarily mortgage loans and consumer credit) and other accounts payable.

Current Status:

- Household savings in India have **declined**, with the net financial savings to GDP ratio hitting a four-decade low.
- **Net financial savings** have significantly **decreased**, with the gross financial savings to GDP ratio falling from 7.3% to 5.3% in 2022-23.
- **Physical savings** have slightly **increased**, with the household physical investment to GDP ratio moving from 12.6% to 12.9% during the same period.
- **Household debt has risen sharply**, especially noticeable in the spike in the household borrowing to income ratio in 2022-23.
- **Interest payments have increased**, contributing to higher household debt and affecting overall net financial savings despite stable consumption rates.

Reasons Behind the Lower Financial Savings:

- **Increased borrowing** or reduced gross financial savings are the primary drivers of lower net financial savings.
- Lower net financial savings due to increased borrowing for consumption or investment can stimulate aggregate demand and output.

- **Higher interest rates** can lead to increased interest payments by households, reducing their net financial savings.

Implication of Higher Debt Burden on the Indian Market:

1. Debt Repayment and Financial Fragility:

- Household debt sustainability depends on the gap between the interest rate and income growth rate.
- Suppose households fail to meet their debt repayment commitments. In that case, it reduces the income of the financial sector and deteriorates their balance sheets, which in turn can have a cascading effect on the macroeconomy.

2. Scheduled Commercial Banks Lending vs. Growth Rate of GNS:

- The weighted average lending rate registered a sharp rise in the last two years, particularly due to the tight monetary policy stance of the RBI and the sharp rise in the call money rate during this period.

3. Impact on Consumption Demand:

- Reducing household wealth can lead to lower consumption expenditure as households may attempt to preserve their wealth by increasing their savings.

4. Reduced Higher Household Debt:

- Higher household debt can also reduce consumption expenditure in at least two ways.
- If higher household leverage is perceived as an indicator of higher default risk, then it may induce banks to indulge in credit rationing and reduce credit disbursement. The consequent reduction in credit disbursement can adversely affect consumption.
- Higher debt can reduce consumption expenditure by increasing the interest burden, not to mention the effect of higher interest rates on consumption expenditure.

5. Low Household Financial Wealth:

- Recent trends in the Indian economy indicate a decline in household financial wealth relative to GDP, alongside an increase in household leverage (debt to net worth ratio).
- The financial wealth/net worth of the household is the difference between the stock of financial assets and liabilities.

Macroeconomic Implication:

1. Implications of the Procyclical Leverage:

- Given that both the flow indicator of liabilities to disposable income and the debt to net worth show an increasing trend, where households are vulnerable.

2. Fall in the Household Savings:

- The policy mantra of higher interest rates to counter inflation by reducing macroeconomic output and employment can leave households with an increasing level of debt in their balance sheets and potentially push the households into a debt trap.
- The implications of high-interest rates on debt burden can hurt the consumption of the households and consequently aggregate demand.

Measures Needs to be Taken:

1. Promote Sustainable Borrowing:

- Policymakers need to address the growing vulnerabilities of households by implementing measures to promote sustainable borrowing practices and reduce reliance on debt.

2. Prioritizes Production and Employment:

- The policies aimed at fostering a more balanced economy that prioritizes production and employment alongside financial activities may be necessary to ensure long-term economic stability and growth.

The change in the composition of the asset side of the household balance sheet towards financial assets indicates some degree of financialization of the economy which moves from a production-based economy to a monetary or financial exchange-based economy making the 5 trillion dollar economy both jobless and fragile.