What does the decline in household financial savings imply?

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The household financial savings data recently published in the latest issue of the Reserve Bank of India (RBI) bulletin created quite a stir. It indicated that the net household financial savings rate had declined to only 5.1 per cent of GDP in 2022-23, the lowest in decades. Some analysts interpreted this as a symptom of rising indebtedness among households. Others interpreted the data as a worrying indication of a declining savings rate, noting that India's high growth in the first decade of this century had been enabled by the high savings rate in that period. To calm market sentiments, the Finance Ministry found it necessary to issue a clarification that the decline in the financial savings rate is not a symptom of any distress in the household sector but merely a reflection of changing household preferences in the composition of their asset portfolio.

To understand what is really going on, it is necessary to look closely at the data. As shown in the table, there was a decline of over 2 per cent of GDP in net household financial savings (net financial assets) to 5.1 per cent in 2022-23 on top of a 4.3 per cent decline from the pandemic year peak of 11.5 per cent in 2020-21 to 7.2 per cent in 2021-22. This is not just a symptom of post pandemic volatility, because the net financial savings rate in 2022-23 is also 3 per cent lower than the 8.1 per cent recorded in 2019-20, the last pre-pandemic normal year. This decline in the net financial savings rate is almost entirely attributable to a rise of approximately 2 per cent of GDP in financial liabilities in 2022-23 compared to 2021-22 as well as compared to 2019-20. Hence, we then need to look at the composition of financial liabilities of households and see how that has changed.

Banks loans are by far the largest component, accounting for over 75 per cent of household borrowing. Borrowing from non-bank finance companies (NBFCs) are a distant second, followed by housing finance and insurance. However, between 2020-21 and 2022-23 there was a large decline in the share of household borrowing from banks, declining from over 86 per cent in 2021-22 to about 77 per cent in 2022-23. The share of housing finance also declined. However, there was a sharp increase in the share of borrowing from NBFCs, which rose from 2.4 per cent in 2022-23 to 15.2 per cent in 2022-23, a more than six-fold increase in a single year (see table, component percentages may not add up to 100 due to rounding off and excluded minor components).

So the decline in net household financial savings is primarily a reflection of the increase in financial liabilities of the household sector. This, in turn, is a reflection of the shift in household borrowing from banks, and to a lesser extent housing finance, to NBFCs. We also know that while growth of bank credit has been robust, much of the enhanced credit flow has gone to NBFCs, real estate and personal loans, not industry. The non-performing asset ratios of commercial banks, in both the private sector and the public sector, have also improved a great deal. Bringing together these pieces of the puzzle, it would appear that

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there is a high demand for loans in the household sector. However, banks have adhered to stringent lending norms, leaving many unsatisfied borrowers in the household sector who have not qualified for bank loans. These less credit worthy borrowers have turned to the NBFCs, whose lending norms are less stringent. The NBFCs have borrowed heavily from the banks as intermediaries, and on-lent to the household sector.

Thus, the banks have cleaned up their balance sheets and shifted risk to the NBFCs, but the risk exposure of the financial sector as a whole is no less. Indeed, it is higher since the indebtedness of the household sector has gone up. However, undertaking a robust assessment of the financial health of the household sector is very challenging because the available data lumps together two completely different groups of economic agents. On one side you have the business households, the micro, small and medium enterprises whom we call the unorganized sector. On the other side, there are the non-business households. The two groups are subject to very different types of constraints, risks, opportunities and incentives. Thus, any assessment of the financial health of the household sector without data disaggregated at least for these two broad groups is unavoidably speculative.

That being said, the decline in the household financial savings rate – even compared to 2019-20, the last pre-pandemic normal year – does not reflect a current decline in either the household savings rate or the domestic savings rate. At 19.7 per cent and 30.2 per cent respectively, both rates were a little higher in 2021-22 than in 2019-20. A savings rate of 30.2 per cent is also higher than in most emerging market and developing economies. But it is lower than the savings rates achieved in most years during the past two decades, especially compared to several years during the first decade of this century when the savings rate had risen to 35-36 per cent. Sustaining high growth rates of 7-8 per cent would not be possible unless the economy gets back to these high rates of savings.