Fall in Household Savings

Why in news?

Household sector's savings in financial assets has shown a sharp decline to 5.1% of GDP in 2022-23.

What is household savings?

- Household savings refer to money left after the household pays taxes and spends on the consumption of goods and services.
- **Components-** Household savings has three components
  - **Financial assets**- Currency, bank deposits, pension, insurance, equity and related products.
  - **Physical assets-** Investment in fixed assets of construction
  - **Gold and silver ornaments**
- **Significance** It is vital for the *economy's long-term growth* as it is the primary source of domestic loanable funds, besides savings from business and public sectors.
- The money moving from the household to the business sector can be used to fund capital investment thus *increasing the productive capacity of business sectors.*

Household savings rate = (Household savings/Personal disposable income) x 100%

Factors influencing Household Savings
• **Income**- High-income households usually allocate more income to savings than consumption. Because they cannot fulfill the most desirable items, low-income households consume more than they save. • **Interest rate**- High real interest rates make savings more attractive. The high nominal interest rate will be useless if inflation is also high. When it is lower than the inflation rate, the actual returns cannot offset the decline in the purchasing power of money. Hence, households are reluctant to save. • **Future income expectation**- Households increase consumption rather than saving when they are optimistic about their future income. It commonly occurs during economic expansion. • **Wealth-**Increased asset value encourages households to consume more. As the assets value rise, households find reaching their wealth accumulation target without saving more. • **Tax-**Higher personal taxes reduce disposable income, hence decreasing money allocation for consumption and saving

Why household savings is important?

- **Supply source-**They are the supply source of domestic funds for capital investment.

- **Profit-**Households save their money into various types of assets, such as deposits, stocks, and bonds. In return, they receive interest income, dividends, or capital gains.
- **Increase production**- Companies require money to purchase new equipment and other capital assets, they raise funds by issuing bonds etc.,
- **Financial market**- Supply-demand of the money takes place in the financial market. As the household invests in the corporate bonds, money flowing to the business sector. Now, with money, companies can invest and increase their productive capacity.
- **Investment in capital assets**- It is essential for economic growth. It is a key driver in increasing the productive capacity of the economy. Higher production capacity leads the economy to produce more goods and services, without causing inflationary pressures.
- **Accumulate wealth-** It allow households to accumulate wealth. In addition to income, wealth is a crucial determinant for consumption. An increase in household consumption drive up aggregate demand stimulates a growing real GDP.
- **Buffer**- By saving, household sacrifice current consumption for future consumption. For this reason, savings allows households to support their well-being.

Status of Household Savings

- **Household financial savings** - The Reserve Bank of India (RBI) data showed that household financial savings were at 5.1% of GDP in FY23, almost a 40-year low.
- **Household Financial liabilities** - The annual financial liabilities of households increased by 5.8% of GDP in FY23, signaling an unusually high reliance on loans for consumption and real estate purchases.
- This rate of increase in financial liabilities was the 2nd highest since India's Independence.
- **Household assets** - Household assets saw a sharp decline from Rs 22.8 trillion in FY21, to Rs 13.76 trillion in FY23.
- **Household debt** - Household debt, as measured by the stock of financial liabilities, remained significantly elevated at 37.6% of GDP in FY23.
- The primary reasons behind the subdued savings and increased borrowing seem to be stagnant or declining incomes for households and small and medium-sized enterprises (SMEs), occurring in the midst of high inflation.

What are the implications of fall in household savings?

- **Choke capital investment** - Indian government depends on household savings to finance its capital investments in physical assets such as infrastructure, machinery, and equipment.
- A dip in the savings could choke major sources of funds for the government's capital investments.
- **Dependence on foreign capital** – Dip in household savings would lead to more dependence on foreign capital to fund the growth.
- **Impact on investment cycle** - Households are leveraging themselves by borrowing

funds. This directly impacts the investment cycle, given that private consumption demand accounts for 60% of the country's GDP.

- **Increase in debts** - As borrowing goes up, future income gets tied up for the repayment of debt, leading to fewer investments.
- **Rising inequality** - The rise in financial liabilities with falling asset levels could be a sign of rising inequality.

References

1. Business Line- How serious is the fall in household savings
2. Business Line- Dynamic shift in household savings

