MAINTAINING ADEQUATE DOMESTIC SAVINGS IS ESSENTIAL TO SOUND MACROECONOMIC MANAGEMENT

Relevant for: Indian Economy | Topic: Issues relating to Mobilization of resources incl. Savings, Borrowings & External Resources

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Empirical evidence shows that developing economies have a positive long-term correlation between savings and growth. In a fast-growing economy like India, investments generally outpace domestic savings, and the gap gets funded by foreign savings. This shows up as current account deficit. Maintaining adequate domestic savings, therefore, is essential to sound macroeconomic management — more so in today’s challenging global environment.

Unfortunately, Indians have been saving less. Worse, our rate of savings has fallen sharply. The overall savings rate (households, public sector and private sector), or the proportion of gross domestic savings in the GDP, plunged to 30.5 per cent in fiscal 2018 from a peak of 36.8 per cent in fiscal 2008, rising marginally in the interim. It has been downhill since fiscal 2012. The external shock of the global financial crisis led to a sharp slowdown in public savings in fiscal 2009, with the government resorting to fiscal stimulus. The savings rate recovered marginally in the next three years, only to lose momentum thereafter. This could compound India’s problem of slowing growth.

Understanding the granular trends in the savings rate helps us pinpoint solutions. The largest savers in the economy, household savings, (the government and the corporate sector being the other two categories) fell from 23.1 per cent as a per cent of the GDP in fiscal 2010 to 17.2 per cent in fiscal 2018. As a result, its share in gross savings fell from 68.2 per cent to 56.3 per cent. Household savings in physical form (largely in real estate and also referred to as physical savings), declined from 15.9 per cent to 10.3 per cent. Financial savings declined too, from 7.4 per cent to 6.6 per cent. That’s a major source of concern because households have been traditionally net suppliers of funds to the private corporate sector as well as the public sector. This means that excess of household sector savings over their investments is used to fund the saving-investment gap of the other two sectors. That level of financial savings is just about enough to finance the combined fiscal deficit of the Centre and the states. A continuation of this trend will shrink the pool of savings available to facilitate private investments. Put another way, it could lead to a “crowding out” of private investments.

What explains the decline in household savings? A part of the answer lies in the consumption trend. National accounts data shows that over the past few years, private consumption as a percentage of the GDP has risen — in a reversal of the trend seen till the early 2000s. From around 65 per cent at the beginning of 2000s, private consumption as a percentage of the GDP fell to 55 per cent towards the end of that decade. It has rebounded since then to 59.4 per cent in fiscal 2019.

Given favourable demographics, households are becoming consumption-centric, and their

financial liabilities have been rising, as evidenced in retail credit, which, at 17 per cent annually, is the fastest-growing loans segment in the past five years. Pertinently, this has happened in tandem with a moderation in household disposable incomes. This fall in household savings rate is also corroborated by a sharp fall in household saving elasticity (the proportional change in savings to a change in income) since the beginning of this decade.

So what are the reasons for the fall in the household savings rate? Franco Modigliani's life cycle hypothesis says a youthful population typically tends to consume more than they earn. Individuals seek to smoothen their consumption over the course of a lifetime — borrowing in times of low-income (initial working years) and saving during periods of higher income. In India, about 70 per cent of the working age population falls in the 20-40 years category. On the other hand, savings of government corporations (departmental and non-departmental enterprises) are largely offset by government dis-saving (as it runs a revenue deficit), which keeps the overall public savings rate low.

But the private corporate sector savings bucked this trend, surging to 11.6 per cent of the GDP in fiscal 2018 from 7.4 per cent about a decade ago. Part of this is the result of a change in the base year to 2011-12, which led to physical assets of quasi-corporations being excluded from households and included in private corporations. So while private corporate savings surged, household savings declined commensurately. Yet, the rise in private corporate savings is in line with evolving global trends in savings after the global financial crisis. According to research, "Whereas in the early 1980s most of global investment was funded by household saving, nowadays nearly two-thirds of global investment is funded by corporate saving."

In India too, rising corporate savings could be channeled for financing private corporate investment when the opportunity arises. Beyond these domestic sources, an increase in private sector investment will need to be financed by foreign savings, which carries its own set of risks beyond a point. It is noteworthy that the expansion of the Indian economy before the global financial crisis coincided with a significant lift in both savings and investments. With the election-related uncertainty behind us, a softer monetary policy stance, and the government's resolve to push growth up, investments are likely to increase in the future. But if savings do not rise commensurately, India's current account deficit could come under stress. Clearly, it's time to reignite the virtuous cycle of high savings, investment, and growth so that the country returns to the high-growth trajectory of the past. Pushing up household financial savings would require greater efforts towards financial inclusion, and possibly, incentives for saving. These must be complemented by productivity-enhancing reforms that encourage private sector investments.

(This article first appeared in the July 26, 2019, print edition under the title The savings dilemma. Joshi is chief economist, and Verma is senior economist at CRISIL)

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