Does the Savings Decline Drive Growth?*

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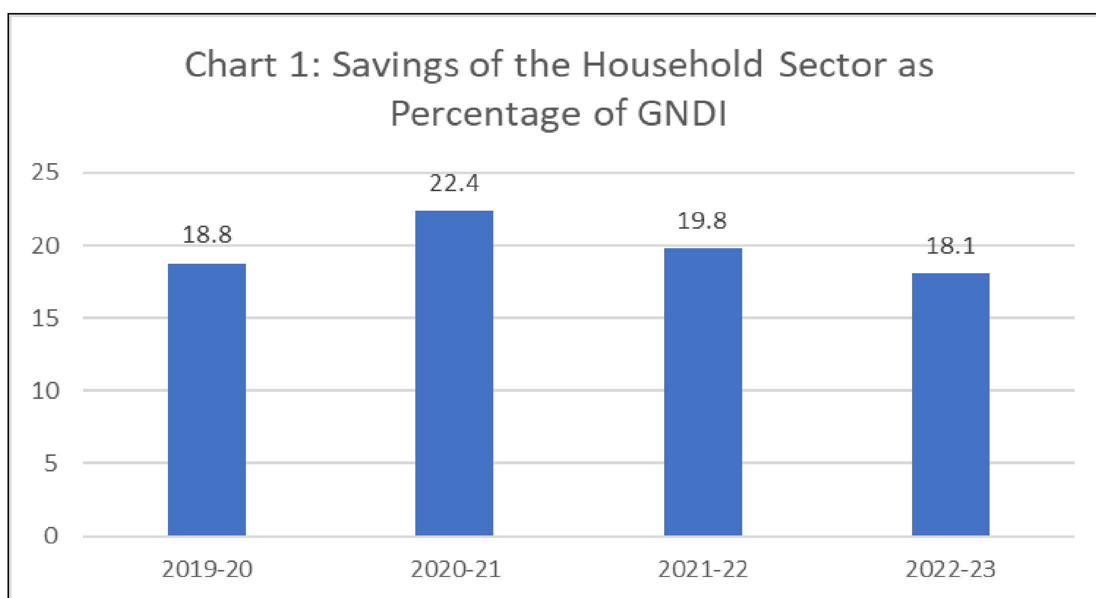
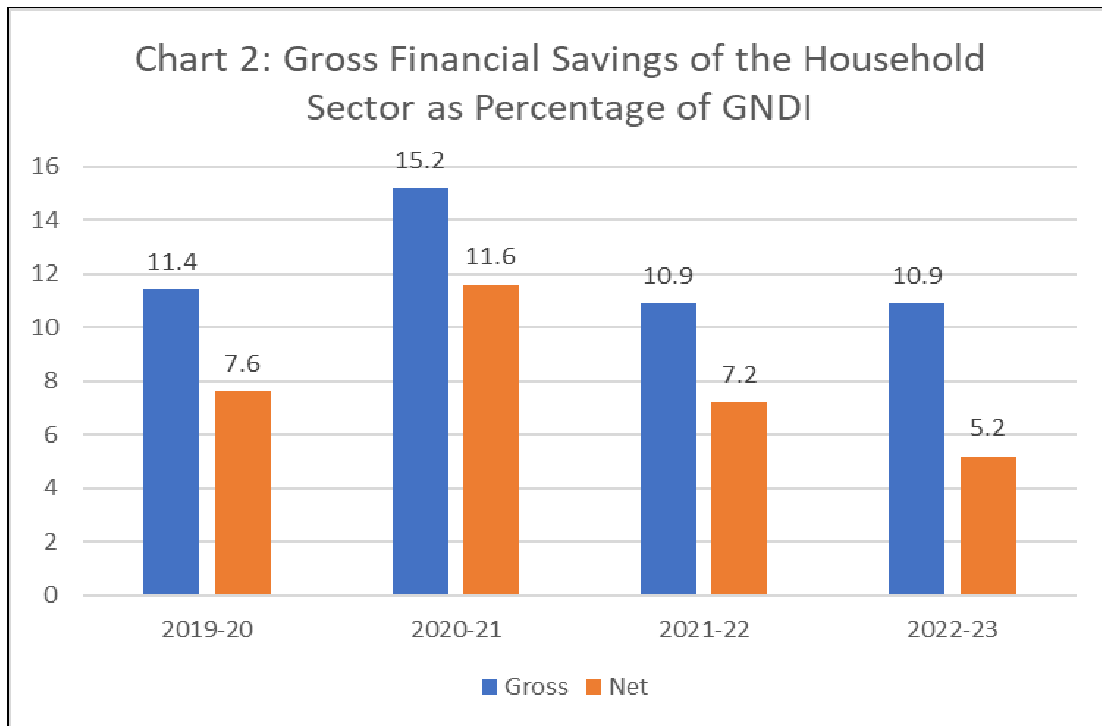
For some time now, there has been much discussion of and concern expressed about a decline in the net financial savings of the household sector in India. Overall household savings as a percentage of gross national disposable income (GNDI) rose from 18.8 per cent in 2019-20 to 22.4 per cent in pandemic year 2020-21 (Chart 1). That rise is understandable because opportunities and avenues for spending were severely restricted due to the pandemic and the accompanying sudden and prolonged lockdown. So, the fact that following the pandemic that saving rate fell to 19.8 per cent in 2021-22 and 18.1 per cent in 2022-23 should not give cause for alarm, since the last figure is not very much lower than that observed prior to the pandemic.



Gross financial savings of the household sector reflected a similar trend, rising from 11.4 to 15.2 per cent of GNDI in the pandemic year, and then falling to 10.9 per cent (Chart 2). The real cause for concern, if any, is the trend in net financial savings, which is the difference been gross financial savings and the accumulation of financial liabilities during the year. Net financial savings, having jumped from 7.6 per cent of GNDI in 2019-20 to 11.6 per cent in the pandemic year, fell to 7.2 per cent and 5.2 per cent in the subsequent two years (Chart 2), bringing the figure down to a long time low.

The arithmetic implicit in these numbers does indicate that the decline in net financial savings is essentially the result of an increase in their financial liabilities by incremental sums that neutralise a large volume of gross financial savings. Other data from the RBI indicate that the share of retail loans in total lending by the banks has risen, with items like loans for housing, purchases of automobiles and even borrowing to finance education registering significant increases. Personal loans advanced by the scheduled commercial banks rose by 21 per cent in financial year 2022-23 and 28 per cent in 2023-24, way ahead of the rise in nominal incomes.



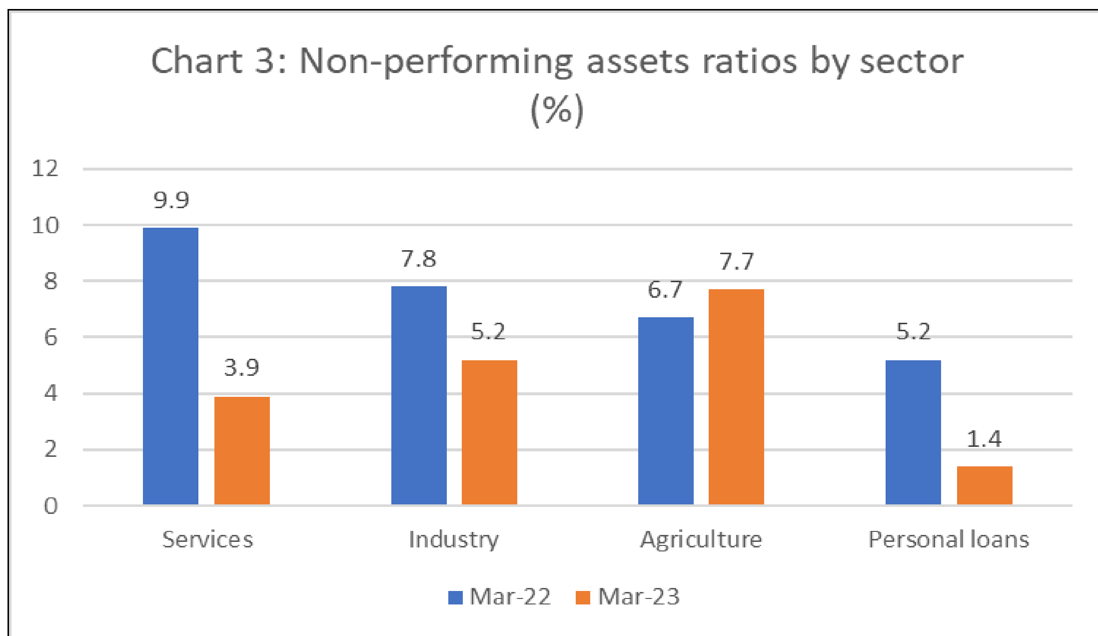
There are reasons why there has been a surge in retail lending post the pandemic. On the one hand, India has regained its position as a favoured destination for inflows of foreign finance capital seeking high yields from equity and bond purchases. The large volumes of liquidity infused into the system as a result of that capital inflow soon found its way into banks, which needed to keep the money accumulating as deposits moving. During the high growth years after 2004, lending driven by this supply side pressure went largely into infrastructure projects in areas like power generation and distribution, roads, ports, and civil aviation. There were obvious maturity and liquidity mismatches between the kind of capital that banks mobilised (which were relatively shorter-term deposits associated with expectations of high liquidity), and the long term character of the more illiquid lending that the exposure to infrastructure involved. But banks chose to take that route, partly because of the need to expand lending, and also because of pressure from the government, which owned most of these banks and was keen on raising infrastructural investment in private and public-private partnership projects.

It turned out that many of these projects failed to take off, or were delayed, or could not earn the expected returns, resulting in large scale defaults. The spike in non-performing assets and the push by the RBI under Governor Raghuram Rajan to recognise these bad loans more transparently, led to provisioning and losses and subsequent recapitalisation of the banks. That experience forced the banks to turn more cautious on lending to infrastructure.

The pressure to expand lending driven by the liquidity infused by international capital flows persisted and increased in the years after the pandemic. In response, the banks diversified away from lending to infrastructure into lending to the retail sector. This led to a boom in lending for housing, automobile and durables purchases, and education, besides an increase in credit card receivables. Besides lending directly for these purposes, banks also lent to non-bank financial companies, which then lent to retail borrowers.

The supply side push into these areas meant that the universe of retail borrowers had to expand substantially. Many who were earlier excluded from access to large retail loans with low deposit margins, found themselves eligible and were only too happy to exploit the opportunity.

The danger in this is that it brings in weaker borrowers in whose case the probability of default is higher. But the numbers provide some basis for bank confidence in such lending. The ratio of non-performing loans to advances is lower for retail loans (Chart 3), being low in lending for housing and automobile and durable purchases, with only educational loans showing relatively high ratios. This has encouraged banks to continue with this strategy, leading to the decline in net financial savings noted earlier.



This trend has implications for India's growth trajectory as well. One puzzling feature of that trajectory has been the absence of clarity with respect to the drivers of India's relatively high growth, even after discounting for some overestimation of GDP growth rates resulting from changes in the methods of estimation. India is by no means a successful exporter, except for software and IT-enabled services. So net exports cannot be the main driver of that growth. The government is focused, even if not always successfully, on reining in its fiscal deficit or debt financed spending. So, the stimulus from that government spending is also limited.

Despite this, if growth has been high in a number of years since 2003 it is mainly because of debt financed spending by the private sector. Initially, this was dominantly bank-debt financed spending by the corporate sector, especially corporates making a bid for profits from infrastructural investments supported by the state. The enforced end to that growth strategy has been partly compensated for by an increase in bank debt-financed spending by the household sector. In what may seem to be a paradox, the lower net financial savings thus appears to be a cause of the recent growth.

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