The Suno India Show

Indian Economy Explained: How COVID-19 shrunk household saving

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A year into the pandemic, the household savings has been dwindling. According to the estimates by The Reserve Bank of India, household financial savings were at 8.2 percent of Gross Domestic Product or GDP in the third quarter i.e. July, August and September of 2020-21. In the first quarter - January to March--the household savings stood at 21 percent of the GDP. The second quarter, between April and June 2020, the household savings were recorded at 10.4 percent.

Experts attributed the fall in savings to job losses and salary cuts. Severe depletion in household incomes have forced people to withdraw from their retirement funds. By May 31, 2021, the Employee Provident Fund Organization had settled over 76.31 lakh claims under the Covid-19 advance scheme amounting to over ₹18,698.15 crore.

The uncertainty of income has also adversely affected consumer sentiment, experts say. Up to 30% of people have shifted to buying only essential commodities as per a report by McKinsey. Alternatively, investments in mutual funds have increased to 1.2% of the GDP as opposed to the 0.2-0.3% average in the period between 2018 and 2020.

Hi I am Kunika Balhotra, Research and Communications Officer for Suno India and your host for this episode of Indian Economy Explained.

To make sense of these statistics and to gather a clearer picture of the reasons behind these patterns of household savings and debt, I spoke to Professor Biswajit Nag.

Professor Nag is the Head of Economics Division at the Indian Institute of Foreign Trade. He also served in the Poverty and Development Division of the United Nations Economic and Social Commission for Asia and the Pacific.

Host: To start off, Could you tell us about the role of household savings in the Indian economy and also if you could explain the ways in which an average Indian household manage their savings?

Professor Biswajit Nag: So, we look into the data. A country's savings are divided into three parts, one is definitely household savings, and then there is public sector savings and the private sectors Okay. Now, what happened over the time India savings rate started going down okay.

And this was mostly after 2008 after the subprime crisis and in 2011-12 it was around 23.6% of GDP and it came down in 2018-19 around 18% of our GDP. So, that means, the Indian household is not able to save much okay, over time, right. So, the GDP is increasing, though, our GDP growth rate has come down in recent past, but that means savings came down faster than that, okay, from 23.6% to 18.2%, in 18-19 was say it was just before the pandemic, okay. Now, during the pandemic a lot of abnormal things happen. So, one is definitely people are concerned about their health as a lot of people lost jobs, many people who are having almost 50% of incomes, rural and migrant workers also suffered. So, overall there is an erosion of income. So when there is a significant drop in income, then and also the expectation also plays an important role here that you know, how fast their income will come back to the normal level. So your savings and consumption behavior is definitely a function of that. So, during the COVID, as a normal household, what they will think about, they'll think they will be concerned about health issues, about the education of their kids, about the possible inflation, possible uncertainty in general. So, people will start, you know, saving more, or rather, people reduce the consumption, provided your income level remains at the same level. Okay, but if your income also goes down, then actually how people will behave, it's a matter of research, okay? Because a lot of people might be deferring their purchase of durable goods, or maybe they will reduce their exposure to loans and all those things. But anyway, people would like to have a plain simple life without tourists, without having food in restaurants or going out. So, a lot of costs will also go down. So, apparently, it looks like that in 2020, I have that data from RBI. That you know, there was a rise of savings because private consumptions declined 26.7% in quarter one of 2021 Okay. And as a result of that, there is a rising shift of household savings. Now, looking at the RBI report, it looks like that the savings behaviour has also changed, how people are actually saving. So, it looks like 53% of the savings are mostly bank deposits, there is a significant rise in life insurance. And also an interesting thing close to 7% is mutual funds. So, people have started exploring the stock markets and putting money in the insurance sector. Okay, it was if I go back to traditional economic theories, Keynes at some point of time said that you know, monetization of the economy is very important. All savings should be in the financial form. If the savings are in financial form, then those savings can be translated into investment, perhaps we have reached that level that now the Indian economy is a very, very, you know, monetized economy, even at the rural level that people are having bank accounts. So if they have additional money, they will put the money in the banks. So, that's the thing I can say, in general, that is the way basically the savings behavior has changed.

Host: What are the common ways in which the investments or savings are significantly depleted? And what are the ways in which COVID waves have affected household saving?

Prof. Biswajit Nag: You know, household savings dipped significantly, one of the main reasons for that, that the real income of the people actually didn't rise much. So it is a global phenomenon. There are a lot of research on the US economy, that the labor share in GDP, that is the total wages over the GDP, that value is, you know, had a secular decline over the years, okay. So, that's an interesting thing, the labor productivity is increasing, but the labor is not rewarded sufficiently. So my income should have risen much higher than what I'm getting, okay. So, productivity has increased, but wages have not increased significantly, this is mostly because of technological change. And now, because of COVID, more automations more artificial intelligence and all those things. So, labor productivity will rise significantly, the labor requirement will go down sufficiently. So there is a structural change in the labor market. Okay. And, in my understanding this might lead to a very high level of inequality, because you will find out that highly skilled workers will be paid a very high level, and there'll be a large number of people who will be struggling for regular jobs. So people may be working, but it should be mostly a contract for a few months, or maybe it is self employment, where the income regularity will be always in question. Now, if a large number of people or a large section of the society, they're not having regular income, or a regular job, or they are self employed, for which there is expected fluctuation, their consumption behavior will also change, because they weren't very much concerned about their future. So as a result of that, you know, there will be a tendency for more savings. But at the same time, there is another force which will not allow them to save more. As you can see, the health expenditures are increasing, expenditures on education are increasing, it's not anymore.For example, when in our childhood, there was one single phone at home. Okay, and the total phone bill as a percentage of my parents income was a small amount. Now, today, you can understand in a family, there are so many phones, you have internet connections. So your total, in our communications bill as a percentage of your income must have increased significantly, health expenses have increased significantly, education expenses, typically, people have become more mobile. So what happened, just imagine that my income is not regular, it's very volatile. So I have a tendency to save more, because I really do not know about the future. But at the same time, certain things are not allowing me to save more, because these expenditures are necessary expenditures now. So traditionally, we are looking at food inflation, but perhaps now we need to look into the inflation from a different perspective. Recently, you know, there's a report from SBI, where actually, they've said that you know, in, in consumer price index, the weightage for health expenditure needs to be changed and if you change it and We are expecting in 2021 the health expenditures percentage of your income will rise significantly and there will be an inflationary impact of the health expenditures on top of it petroleum prices and energy prices. If those prices go up, definitely with an irregular income, there will be a kind of a depletion of the savings. So, this is a global phenomena, but in India, because we are poor, the large sections of the people have relatively low income, so, the situation is much more grave.

Host: So, as you all already mentioned about the SBI report, could you tell me how the second wave of COVID in the country led to a sharp increase in healthcare spending. So, how will this increased spending on healthcare impact the economy?

Prof Biswajit Nag: Because we are discussing from the household's perspective, let us look at it from that perspective. Okay, see, if you divide the rural sector and the urban sector, as you know, in a country, then the rural sector, the health infrastructures are not adequate. So, as the health infrastructure is not adequate, people are actually having an additional expense. You need to travel to the cities you need to stay there for suppose for an MRI or CT scan there is a structural change, because now, better instruments are available. And as a result is an overall rise of expenditure. So, poor people's health expenditure as a percentage of his or her income will go up substantially, as you mean that they are not mostly covered by health insurance. Now, in urban areas, even now, India doesn't have a very high percentage of health insurance numbers. Actually, you can check it. Now, if you look at our perspective, the health expenditure will be significantly higher. Because now people will spend money for prevention and also detections, also regular health checkups. So, it will be a part of our yearly kind of additional expenses, which earlier people were averting. So from that perspective, health becomes a very crucial thing, and I personally feel that's why because the health market as a whole will expand. So, we feel that as the demand is rising, the price must go down, okay. But, you know, it may not happen, because the market is not completely transparent or the market is not completely competitive.

Host: Also sir we have seen a sharp increase in petrol and diesel prices, could you explain how this rising inflation will affect households and their savings?

Professor Biswajit Nag: Yeah, this is standard logic because you know, energy and petroleum especially is part of daily life and immediately pay not effect. But eventually, definitely it is going to have an effect on the overall budget because this has direct impact those who are having cars, or those who are traveling by bus, of course, there's a direct impact, but at that same time, there has been a direct impact because transportation sectors will be will be costly. So, it will see if this trend continues for some more time, for even for vegetables, you will see there'll be a rise of at least five rupees per kg of every product, eventually, in the coming months, then we will see the basic groceries price will go up slowly, slowly. So after six months, you will be able to realize that that the amount that you are paying for buying the things are much higher than what you were doing six months back, you'll not be able to separate it out that whether it is because of our petroleum price hike or something else, but definitely we know that there will be an indirect impact of this.

Host: You already talked about the RBI data. So, according to that data, the financial liabilities of households have fallen to rupees two lakh 40,418 crore in December from two lakh 54,912 crore in September 2020. Could you explain to us what this means? And what are some ground level reasons that might have led to this?

Prof. Biswajit Nag: Uncertainty has increased so, people wanted to reduce their expenditure, okay. And also like to defer their purchase, suppose you want to buy a durable goods, so, because there's uncertainty, so, you will delay the purchase, right, I suppose you want to buy house real estate, so you'd like to later purchase because there's uncertainty and you are uncertain about your future income as well and future expenditure pattern also, because we are very much worried about health expenditure. So, they're not taking loans from the financial institutions, and also for some time financial institutions, also a bit reluctant because they were right now going through a kind of a bad patch, a lot of corrections happening in the bank sectors, because of high end deals. So they are very cautious about whether to provide a loan or not, despite the rate of interest coming down, banks may be flushing funds, but they are very much concerned. So, it is a two sided story from the consumer side, it is the lack of, you know, confidence, and which reduces the exposure as well as deferring alone. And banks are also a bit conscious. So that, you know, during this time they're giving loans for the person who has no future income, which will actually having a proper return in the right time. So there is less. Yeah, I just want to add in so one thing is that that means, you know, so, so people are having basically more savings as a first point to mention. So that one is going to the stock market buying mutual funds or in the insurance sector.

Host: So could you briefly talk about some of the relief measures that have been announced by the government to elevate the financial burden of households, especially the schemes like Pradhan Mantri Jhan Dhan Yojna where the government claims to transfer money directly into women's accounts?

Prof. Biswajit Nag: It's an interesting question. Now, definitely money has been transferred, our money is going to be transferred. But that doesn't mean that people are going to spend, the government wants this money to be spent. Right. But you know, if I get the money, my income level goes up, I'm uncertain about the future and my confidence about the market is down. So I will try to save it for the rainy days okay. Or I will invest that money in some places where I actually get a higher return. So, this is basically a puzzle because no government wants to provide money to our direct benefits to hand out to people, but it may not actually convert to as an expenditure. So consumer sentiment is very important in this case. The recent report says I think RBI is also going for a next round of consumer sentiment study that in the month of June, there's a slight rise of consumer sentiment, okay. Because consumer sentiment in change is the expectations and the expectations are having a huge impact on the consumption pattern of people. Okay, so. so, the government's policy needs to be on two sided one, definitely, cash transfer is required. But at the same time, you need to make the consumption. So that means there'll be less inflation. Some of the things in which the government is investing should be affordable. Like you know, for example, Like education sector, most of the classes are going on online. But you can understand India is a very large country and significant rural areas where the internet infrastructure is weak. Even if there's infrastructure, the speed of the internet will be, you know, awful. Say it's not possible that the schools or the students are having the same infrastructure as it is in the big city. So, I'm not finding a very good, you know, kind of policy by which rural young students can actually bring them to the school virtually. So, you require a huge investment for that. So, that is to buy tabs and to bring in infrastructures in the schools and to equip teachers. So, once you start investing in such cases, so, people start buying those those things, maybe they in a subsidized price or whatever it is, so, you can just push the education sector, I mean, the early education sector in the school level, you know, at least you know, which can have an impact on the consumption as well. So, like that, education is definitely a part of the overall consumption. It doesn't mean only the food proteins and you know, communication on public education is like a huge expense. So, that's the way actually can increase the confidence of people also, you need to create lots of jobs, Okay, at this moment, the job creation is possible, you know, in the health sector, because it is expanding like anything, even in tier two tier three cities, you know, a lot of you know, paramedical a worker's health service providers are there. So, through that, actually, you can increase the employment possibilities and that will actually maybe have an impact on the consumption. So, consumption can go back to the same old, but it might take some time.

Host: Also sir finally, could you share possible ways to boost the declining household savings?

Prof. Biswajit Nag: I just mentioned that, you know, one most important thing is confidence, okay. And second thing is controlling inflation including, you know, Petrol prices. So, that you know, suppose my income is 100 and during the pandemic, my income has not increased from 100 to 110 but if the petroleum prices go up, it will definitely lead into my consumption. So, my savings will go down. So, to have two things together one, how to increase the income second, how to reduce the overall consumption expenditure, right. So, in the right places, subsidies and incentives are required. So that now people have more money in hand. So, this is basically at an our ground level, this exercise you can do at the macro level, when countries growth will come back to a normal path. And that will pull up the confidence that will increase people's income. Okay. So, you need to have a very good macroeconomic policy, how to take the Indian economy back to the track so, to reduce the decline, as I said, on one hand, you have to generate employment, so that more income is there. And the second one is basically controlling the cost of goods and services. And you need to know at this moment, energy prices going up, health costs going up, education costs going up as they are right now, consider getting the larger share in your way to distributions in the consumer price index. So you need to now give importance to this particular Because, you know, the Indian economy has moved from a low level to a middle level income now, a lower middle income country now. So, that means those things become very much necessary and we need to keep focused on that. Lastly, as I said sometime in this discussion, labor productivity is going up and labor is not being rewarded properly. So, this is a global phenomenon and this might erode the savings as well. Because in the future people will spend a lot for education and skill development for higher education to become costlier. So, everyone in the middle class will try to get educated to get the jobs, but the salary will not go up that much. Or maybe the real income is not that bad. So, that is a situation which is very much worrying globally.

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