



# Savings, driver of growth



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The onus is on the Government to control fiscal spending to incentivise savings.

Four years after the worst financial crisis in recent times, the economic situation in India continues to slip.

A couple of months ago, India posted the lowest GDP growth of 5.3 per cent since the 2008 crisis and are most likely to achieve a 5-5.5 per cent growth for the whole year - a far cry from the 7.3 per cent growth expected at the start of the financial year. Barely 18 months ago, we were growing at 8.4 per cent.

A fair question at this point is whether India is experiencing a temporary hiccup or something more fundamental and lasting.

A good starting point is to evaluate the drivers behind the 9-9.5 per cent growth in the 2003-2007 period. India faced a significant investment boom in the above-mentioned period when investment or gross capital formation in-

creased sharply from 22 per cent of GDP in FY02 to almost 38 per cent of GDP in FY08.

To put this growth in context, the real gross capital formation grew at a 15.4 per cent rate in FY06-FY08 or, in other words, investment growth was responsible for almost 50 per cent of the 9.5 per cent GDP growth in the FY06-FY08 period.

On the other hand, real gross capital formation has grown at only 0.1 per cent in the last three quarters. No wonder our GDP growth has slowed!

### INVESTMENT DRIVERS

Investments grew not only because of a number of demand-driven factors including robust corporate profits, capacity expansion to meet domestic demand and infrastructure development, especially power projects, but also because of a number of supply-side measures such as increased infra lending by the banking sector and a sharp acceleration in India's saving rate from 23 per cent of GDP in FY02 to 37 per cent of GDP in FY08.

Given India is still a low-middle income country (with <\$2000 income per capita) with significant infrastructure needs, the demand drivers for capital formation are still strong. But the supply-side or capital available for investment is showing some disturbing trends.

India is not different from other emerging economies in that most capital development is internally financed

through domestic savings. Most emerging markets had savings rates higher than investment rates or close to 80-90 per cent of the investment rate in 2010.

Domestic savings have declined from 37 per cent of GDP in FY08 to 32 per cent of GDP in FY11.

In a capital-deficient nation like India, it's not difficult to see how a high investment rate and better infrastructure is critical in making sure that India's potential growth rate remains high.

One can almost think of our saving rate as a driver of future growth and productivity levels.

### SAVINGS TRENDS

Analysing the savings trends for the last 10 years, it's evident that household savings (as per cent of GDP) have been largely unchanged at 22-23 per cent since FY00. On the other hand, both public and corporate savings have hit their 10-year highs in FY08 and have fallen since then.

Not surprisingly, a drop in public savings from 5 per cent of GDP in FY08 to 1.7 per cent of GDP in FY11 is the primary cause for the 5 per cent drop in aggregate savings rate. The increase in the fiscal deficit from 2.5 per cent in FY08 to 4.9 per cent in FY11 explains a big portion of the drop in public savings.

While private corporate savings have also dropped from 9.4 per cent in FY08 to 7.9 per cent in FY11, the drop is much less severe than the drop in public savings. Even though the household savings rate has remained unchanged over the last 10 years, the recently released RBI's FY12 annual report has highlighted a disturbing trend in the composition of household savings.

The more productive component of household savings, namely, financial savings, which are in turn provided to users of capital and, thus, have a multiplier impact, have dropped to 1990 levels of 7.8 per cent of GDP from 12.2 per cent of GDP in 2010.

The drop in net financial savings is largely a result of an absolute decline in small-savings and equity mutual funds and lower growth in household's holding of currency and life insurance funds.

A look at the composition of financial savings over the years shows that in FY10, shares, debentures, equity MFs and life insurance products gave bank deposits serious competition.

In FY12, post regulatory changes and the external market, shares, mutual funds, insurance and debentures are de-growing while bank deposits have increased their share of financial savings.

Persistence of high inflation, with average inflation of 9 per cent in 2011-2012, and thus low real rates on small-savings and deposits seems to have incentivised household savings into real assets such as gold and real estate.

Moreover, lacklustre equity market returns and regulatory changes in the last two years have resulted in a weak appetite for equity funds and ULIPs.

### HOW TO INCREASE SAVINGS

As discussed above, high government deficit is a big driver of the fall in savings rate and, thus, it is imperative that the Centre re-ign in spending and stops crowding out private investment.

Moreover, policy-makers need to ensure that savers can earn adequate real returns in "productive" financial savings rather than turning to "non-productive" real assets such as gold.

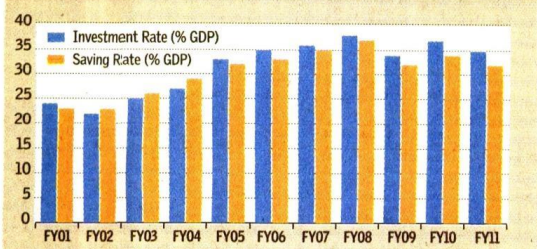
And, finally, we need an environment where financial savings are accessed and put into assets which, post-tax, have the potential to beat inflation longer term, so that not only will we have our population being able to meet their future financial needs, but we will be able to channelise savings into the sectors that need money to grow.

The bottomline is, if we allow our investment rate to fall, we risk impairing our long-term potential growth rate.

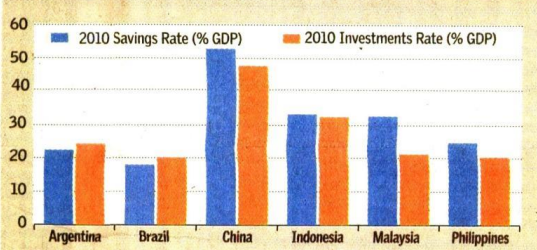
A high savings rate is an important pre-requisite to return to the high growth era of 8 per cent-plus GDP growth. The onus is on the Government to control fiscal spending and tame inflation to incentivise savings. It would be a shame if we convert the current cyclical slowdown into something more structural.

(The author is Chief Executive - Financial Services, Aditya Birla Group. The views are personal.)

Investment and savings keep pace



High savings ratio in emerging economies



Household savings steady

