Rise in Net Financial Assets

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Why in News

According to the Reserve Bank of India's recent **Quarterly Estimates of Households' Financial Assets and Liabilities,** net financial assets of Indian households rose to 7.7% of the **Gross Domestic Product (GDP)** in the Financial Year (FY) 2019-20.

Key Points

- **Net Financial Assets:**
    - **Net Financial Assets** are the difference between **Gross Financial Assets (GFA)** (deposits and investments) and **Financial Liabilities** (borrowings).
        - The net financial assets jumped from Rs. 13.73 lakh crore in FY 2018-19 (7.2 % of GDP) to Rs. 15.62 lakh crore (7.7% of the GDP) in FY 2019-20.
        - The GFA rose marginally from Rs. 21.23 lakh crore in FY 2018-19 to Rs. 21.63 lakh crore in FY 2019-20.
        - The **financial liabilities witnessed a sharp decline** from Rs. 7.5 lakh crore to Rs. 6.01 lakh crore in the same period, thereby contributing to the rise in net financial assets.
    - In the first quarter of FY 2020-21, RBI also expects a **spike in net financial assets of households** on account of a **sharp drop in lockdown induced consumption.**

        Studies show households tend to save more during a slowdown and income uncertainty.
- **Decline in Borrowing:**
    - The rise in net financial assets was **accompanied by decline in bank borrowings by households.**
    - The decline in bank borrowing by households **is a reflection of slowdown in the economy and risk aversion of banks.**

        The economic slowdown may be because income levels of individuals are either going down or not increasing.

- **Savings:**
  - In value terms GFA has increased marginally from Rs. 21.23 lakh crore in FY 2018-19 to Rs 21.63 lakh crore FY 2019-20.
  - The overall savings have not grown in proportion. However, the **household savings in bank deposits as a percent of GDP declined** to 3.4% in FY 2019-20 compared to FY 2018-19 where it stood at 3.8%.
    - The decline in household savings is because banks reduced their interest rates following sharp cut in repo rate by the RBI over the last 18-months.
      - A repo rate is the rate at which RBI lends to commercial banks.
      - Between January 2019 and March 2020, RBI cut the repo rate by 210 basis points from 6.5% to 4.4%. In May, 2020 RBI reduced it further to 4%.
    - **Small saving instruments** that continued to offer higher rates than bank deposits witnessed a higher deployment of household savings as their share as percent of GDP increased from 1.1% to 1.3% in the same period.
  - Savings into life insurance funds and mutual funds as a percent of GDP also declined from 2.2% in FY 2018-19 to 1.9% in FY 2019-20.
- **Issues Involved:**

  There is a possibility that households may use their savings due to lags in the pickup of economic activity post Covid-19 lockdown.
    - This may cause the financial surplus (savings) of households to decrease in coming days.
    - This may decrease the investment, which may further add to the economic slowdown.

Way Forward

- The government must remove the issues emerged post Covid-19 lockdown, which will lead to increase in economic activity.
- The government can also consider to provide cash in hand to the public to increase the demand, which will lead to increase in production.

Source: IE