A SECTORAL FINANCIAL BALANCES (SFB) ANALYSIS OF THE INDIAN ECONOMY, 2012-13 TO 2021-22: A SHORT NOTE

Student Research Internship Report

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Introduction

In March 2023, the Reserve Bank of India (RBI) released the Flow of Funds statement for the Indian Economy over the last ten fiscal years, i.e., from 2012 to 2022. This document outlined the ever-complex relationship between various economic sectors as well as the flow of monetary funds from each sector to another. Additionally, it also gives the sectoral breakup of the domestic private sector, the government sector, and the foreign sector (which consists of both the private and public sectors).

The 2021-22 report focuses on the impact of post pandemic recovery, which saw nearly a doubling in the fiscal deficit and a significant rise in the savings of the domestic private sector.

Table 1: The SFB Table

Year	S-I	G-T	X-M
2012-13	2.1	-6.9	-4.8
2013-14	5	-6.7	-1.7
2014-15	5.4	-6.7	-1.3
2015-16	5.9	-6.9	-1
2016-17	6.3	-6.9	-0.6
2017-18	4	-5.8	-1.8
2018-19	3.7	-5.8	-2.1
2019-20	6.4	-7.2	-0.9
2020-21	14.2	-13.3	0.9
2021-22	8.5	-9.7	-1.2

Source: Reserve Bank of India - RBI Bulletin

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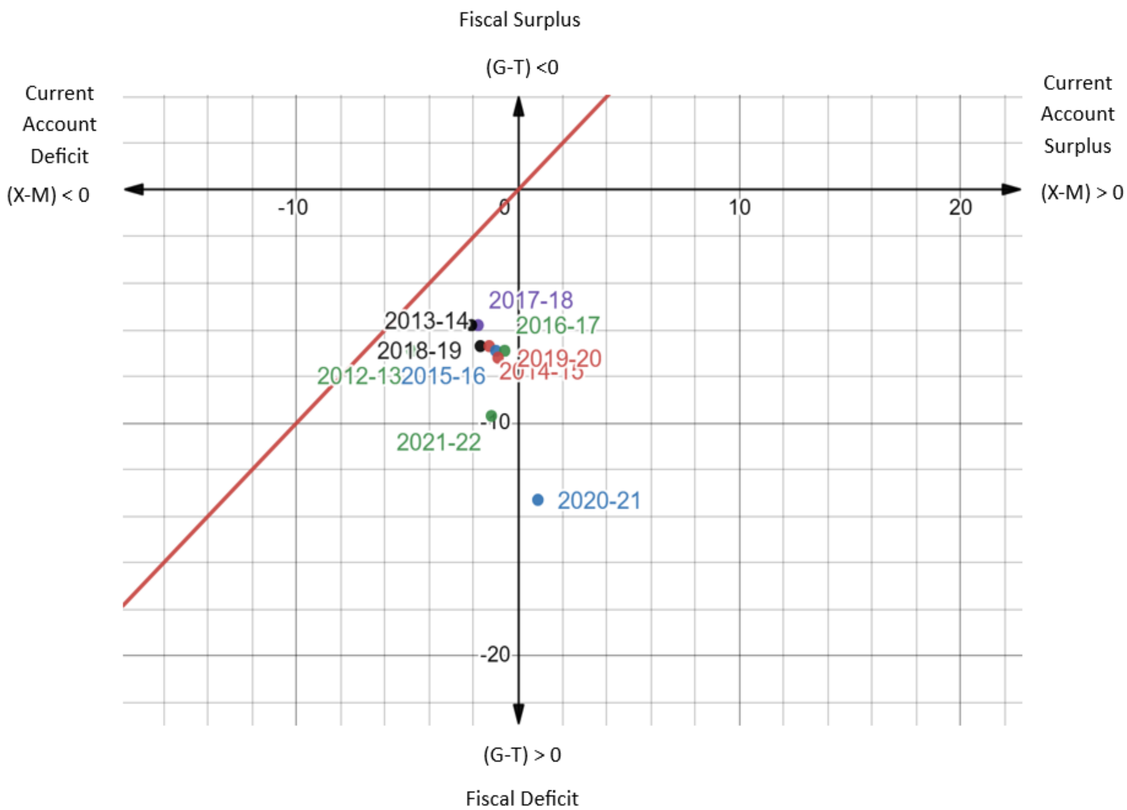

Figure 1: SFB Model
Source: https://www.rbi.org.in/Scripts/BS_ViewBulletin.aspx?Id=21667

SFB Analysis

The Sectoral Financial Balances model or SFB model analyses the sectoral relationships between the domestic private sector, domestic government, and foreign sector.

Between 2012-13 and 2019-20, the domestic private sector as well as the foreign sector was consistently accumulating financial assets as seen in Table 1 with a positive (S – I) and current account deficits respectively. The government was accommodating this desire of these sectors by running a relatively large deficit, i.e., accumulating net financial liabilities.

The Covid-19 pandemic led to a disruption in this trend with a steep rise in the savings of the domestic private sector and contraction of investment spending, triggering the deficit to rise to an unexpected high of 13.3% of GDP. It is interesting to note that the economy saw a small current account surplus in that timespan. However, this surplus was due to the rising savings rates, which reduced the imports at the time, leading to an 'unhealthy' current account surplus caused by a sharp decline in imports rather than a sharp rise in exports.

While this trend has reversed since the end of the pandemic and a return to 'normalcy', Table 1 still shows that the domestic private sector is in a deleveraging mode, which along with the current account deficit, must be accommodated by a large fiscal deficit.

Thought here has been some uptick in investment demand of the domestic private sector, concerns remain over the secular decline in gross fixed capital formation (GFCF) over the period.

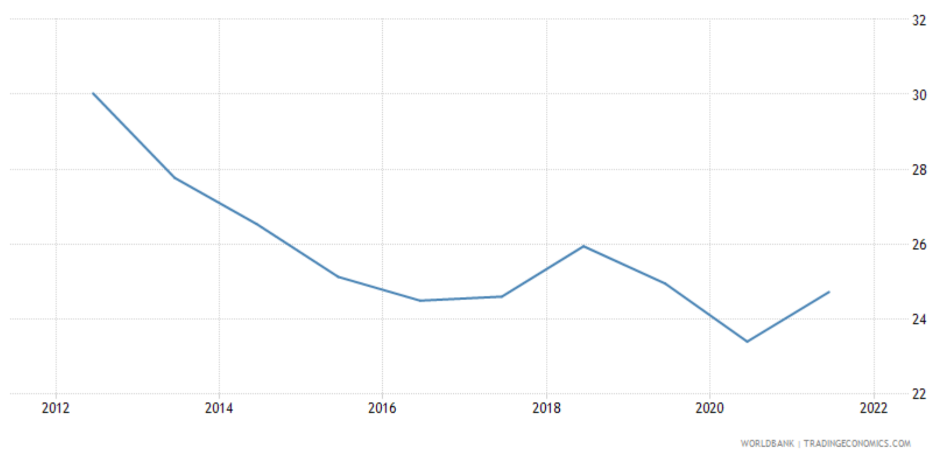

Figure 2: Private sector investment demand, 2012-2021
Source: https://tradingeconomics.com/india/gross-fixed-capital-formation-private-sector-percent-of-gdp-wb-data.html

Policy Implications

One of the key goals of the finance ministry is to ensure the reduction of the fiscal deficit. In the Union budget for the fiscal year 2023-24 Finance Minister Nirmala Sitharaman announced that the government is "*aiming to reach a fiscal deficit level below 4.5% of the GDP by 2025-26, [and that] India has set a target to further narrow the deficit for 2023-24 to 5.9%.*" (India fiscal deficit: India's FY23 fiscal deficit narrows to 6.4%, meets budgeted target - The Economic Times (indiatimes.com)).

However, to achieve this goal there are a lot of conditions that must be met based on the SFB equation, which is derived from an accounting identity. To ensure a lower fiscal deficit and to achieve their set target, the finance ministry will have to ensure that the domestic private sector is willing and able to leverage or at least lower their desire for net financial asset accumulation from the present levels. In other words, the domestic private sector will have to increase investments (I) and/or reduce savings (S). Additionally, to support the government reduce the fiscal deficit, a reduction in the current account deficit may also be required. This will have to through an increase in exports rather than a reduction in imports – the latter may instead witness an increase if savings were to fall (consumption rise).

Although private sector savings rate has seen a sharp decline since the end of the pandemic, many experts are assuming that there is not going to be any major deviation from the longer-term trend, remaining about 7% of GDP in FY 2022 (RBI: Post-pandemic spends dragged household savings in FY23, rate climbing up now: RBI - The Economic Times (indiatimes.com)).

Table 2: Household savings rate (% of GDP)

Year	HH Savings Rate
2012-13	7.4
2013-14	7.4
2014-15	7.1
2015-16	8.1
2016-17	7.4
2017-18	7.6
2018-19	7.9
2019-20	7.7
2020-21	11.5
2021-22	7.6

Source: Reserve Bank of India - RBI Bulletin

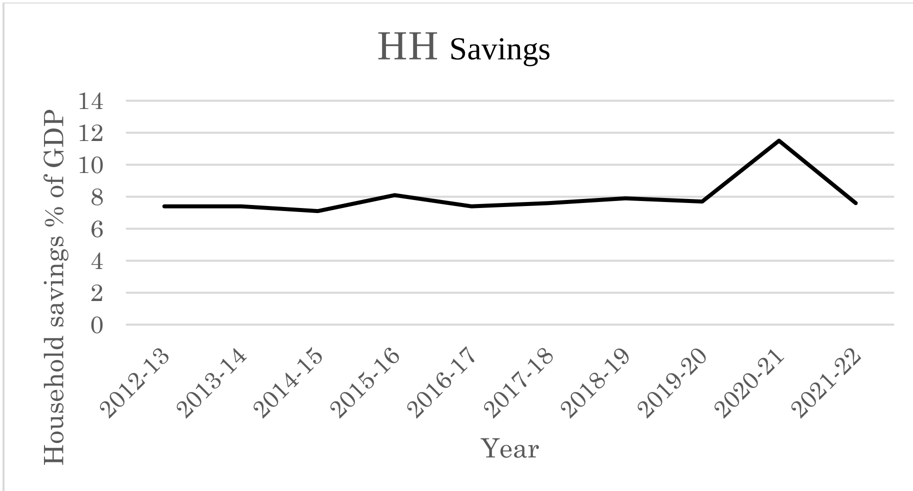

Figure 3: Household savings % of GDP source: the flow of funds 2021-22
Source: [Reserve Bank of India - RBI Bulletin]

However, the situation in FY 2023 has bucked the trend and is reported at a five-decade low of 5.1% of GDP ([RBI Data Household Savings Drop To Record Five Decade Low In 2022-23 Assets Liabilities (abplive.com)]). The fall in savings rate by the household sector is also reflected in increased spending on consumption goods. This can be seen with the rising debt levels of households in the economy especially in the post-pandemic induced consumption boom.

Figures 4, 5 and 6 below, all extracted from the RBI's FoF report, show households as one of the one of the largest borrowers, holding a significant amount of debt. The RBI has sounded alarm bells on the consumption spree of the households.

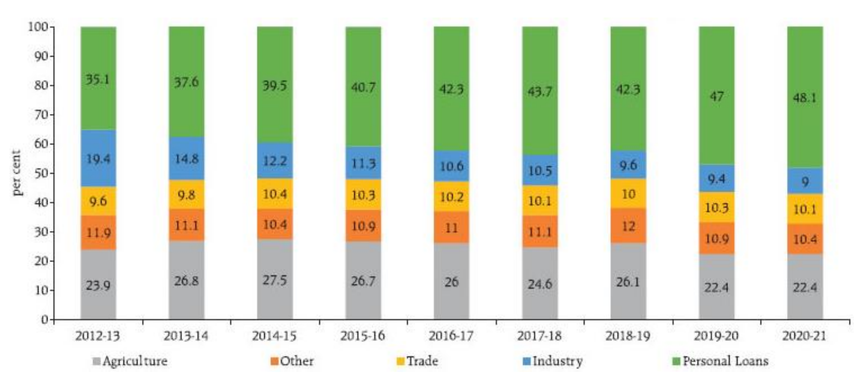

Figure 4: Outstanding credit extended by scheduled commercial banks (SCBs) to households
Source: [Reserve Bank of India - RBI Bulletin]

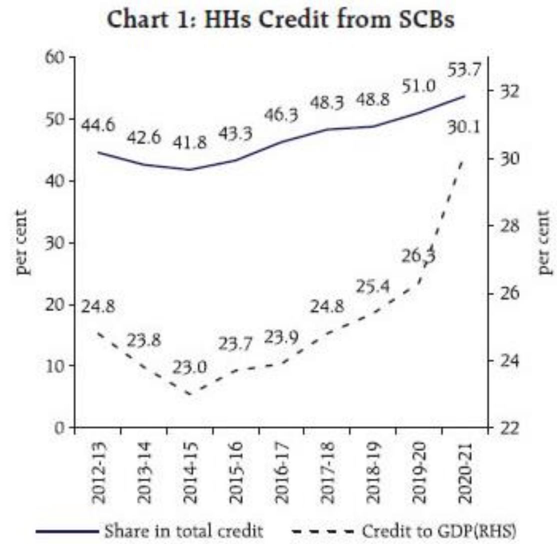

Figure 5: Household credit from scheduled commercial banks (SCBs)
Source: [Reserve Bank of India - RBI Bulletin]

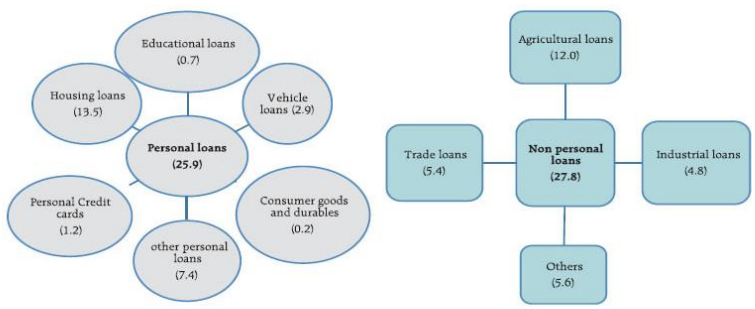

Figure 6: Bank credit to households: personal and non-personal loans
Source: [Reserve Bank of India - RBI Bulletin]

This debt bubble creates a perilous situation; if the household sector were to reverse its present desire to spend and instead increase its savings appetite, there could be economic crisis unless accommodated by higher fiscal deficits. In other words, this sudden deleveraging spiral would raise the deficit to counterattack the low expectations of the domestic private sector. This may also mean a current account surplus; however, not one where exports are rising and India's competitiveness is improving. Rather, it would be falling imports due to a growing amount of savings by the domestic private sector and reduced spending on imported goods and machinery.

Conclusion

While the present rise in consumption spending is inducing private sector investment demand, a household deleveraging cycle could also mean a dampening of private sector planned investment and consequently, the need for a more accommodative fiscal policy.