

Why hasn't the wealth effect kicked in yet in India?

Consumption and savings growth slower, amid faster growth in non-mortgage debt

- The [RBI](#) recently published its inaugural quarterly estimates of household (HH) financial balance sheet, covering the 1QFY12- 4QFY23 period. We [replicated](#) their methodology and achieved 96-97% accuracy in our results. We, consequently, extended these estimates to 1QFY25 with some assumptions. One of the key conclusions from such analysis is that HH financial net worth (HHFNW) has improved remarkably in the post-pandemic period in India (*Exhibit 1*). Further, such improvement in India is considerably greater than that observed in other economies (*Exhibit 2*).
- Economic literature links improvements in financial balance sheets to economic growth through the wealth effect. An increase in the value of one's assets or wealth instills confidence in the owner, encouraging greater spending and, consequently, stimulating GDP growth. This phenomenon, however, has not yet materialized in India, despite the equity boom persisting for over three years. Let us examine some facts.
- *First*, it is important to note that the substantial improvement in India's HHFNW is because of the [equity & investment funds \(E&IFs\)](#), which are more volatile than other asset classes. Excluding E&IFs, HHFNW accounted for 72% of GDP in 1QFY25, compared to its peak of 82% in 4QFY21 and was only slightly higher than 67-68% in the pre-pandemic quarters (*Exhibit 3*). Notably, this ratio was higher in pre-FY12 years. Further, a comparison of HHFNW, excluding E&IFs in major economies, confirms that it has actually declined in the post-pandemic period in all other economies covered in our study (Australia (AU), Canada (CA), Japan (JP), Germany (DE), France (FR), UK, and the US), except India (*Exhibit 4*).
- *Second*, the wealth effect implies that a strong financial balance sheet should ideally lead to either a surge in HH consumption or savings. However, it is important to note that none of this is borne out by data for the Indian economy. India's HH nominal consumption posted a 9.8% CAGR in the post-pandemic period (FY20-FY24), while it reported a CAGR of 10.8% in the pre-pandemic period (FY16-FY20). Simultaneously, HH savings – using official data from FY12 to FY23 and our estimates for FY24 – also grew slowly in the post-pandemic period vis-à-vis the pre-pandemic period (at 10.3% vs. 11.6%). Notably, this is unique to India, as consumption has increased at a faster rate in all other economies during the post-pandemic period, with higher savings reported in all except AU and the US (*Exhibit 5*).
- *Third*, non-mortgage HH debt, which includes all consumption-based and unsecured loans, has also increased at a faster pace in India during the post-pandemic period. Non-mortgage HH debt has registered a 15.1% CAGR between CY20 and CY23 compared to 12.8% CAGR in the pre-pandemic period (*Exhibit 6*). Again, it has grown at a slower pace in all other economies covered in our study, barring Japan (*Exhibit 7*).
- Overall, this combination of slower growth in consumption and savings, coupled with higher growth in non-mortgage HH debt, does not inspire confidence that the increase in HHFNW reflects a strong financial position of the HH sector. In other words, the wealth effect has not materialized. Could it occur in the near future? Perhaps, but the improvement in HHFNW has already been sustained for nearly three years. How significant could the lag be?
- It is also widely known that capital market ownership is highly concentrated among the richest consumer segment. Based on the distributional financial accounts of the US, the richest 20% of the HH hold ~87% of all corporate equities and mutual funds (*Exhibit 8*). Their share has actually increased gradually from ~80% at the turn of the century. Although we don't have such data for India's economy, it is worth noting that almost 95% of all taxpayers in India didn't show any capital gains income in FY23 (short-term and long-term) and 85% of all capital gains income accrued to taxpayers who earned more than INR 10m (*Exhibit 9*). Is it then possible that the immense surge in HHFNW is also a reflection of the rising income inequality in India? If it has not been able to create any spill-over effects so far on aggregate HH income and/or consumption growth, what assurances are there to hold on to this possibility in the near future?
- Lastly, it is important to remember that the net worth of the US HHs reached record highs in 2006 and 2007, just before the world economy was struck by the worst economic crisis since the Great Depression (*Exhibit 10*). This indicates that a surge in HHFNW may not necessarily result in higher spending/savings growth and it may dissipate rapidly, especially when driven by the equity market.

Exhibit 1: India's HHFNW estimated at a new peak of 116% of GDP in 1QFY25...

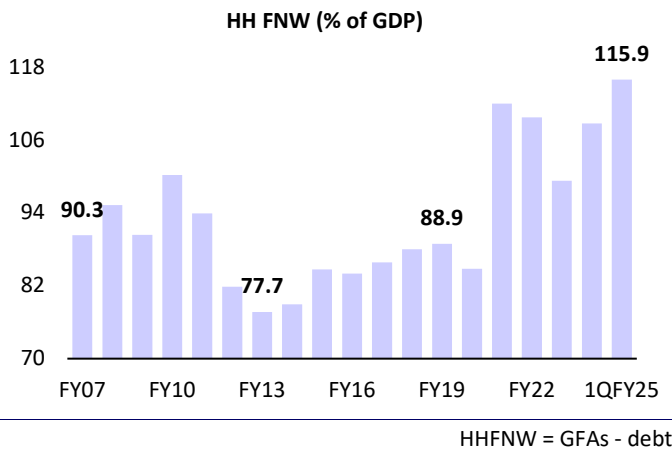


Exhibit 2: ...and the improvement in the post-pandemic period is much higher than in other economies

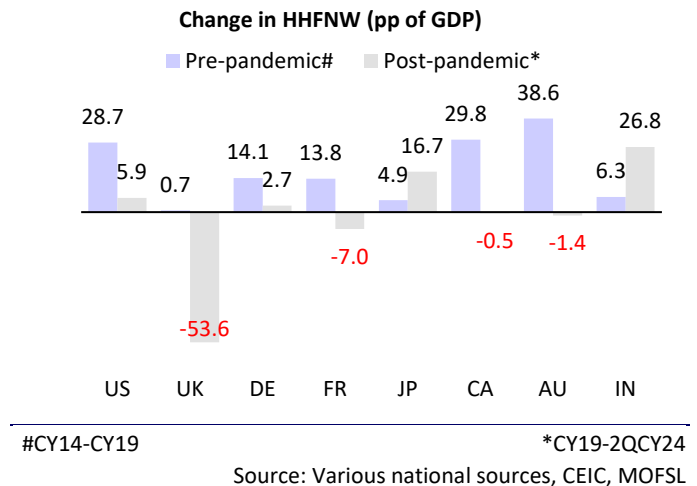


Exhibit 3: Capital markets have played a substantial role in pushing HHFNW higher in recent quarters

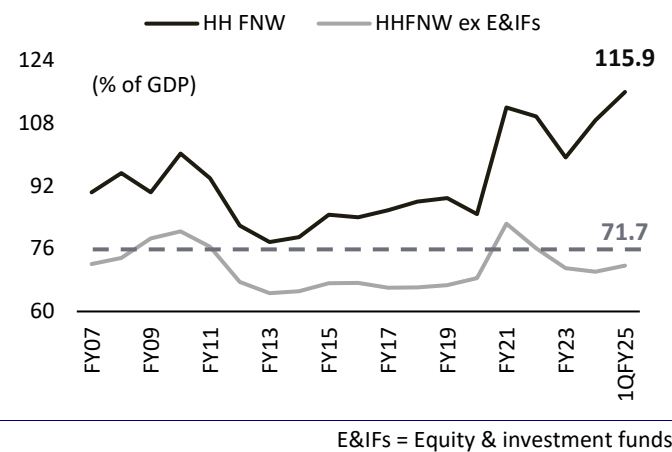


Exhibit 4: A comparison of the share of HH sector in listed equity markets in a few major economies

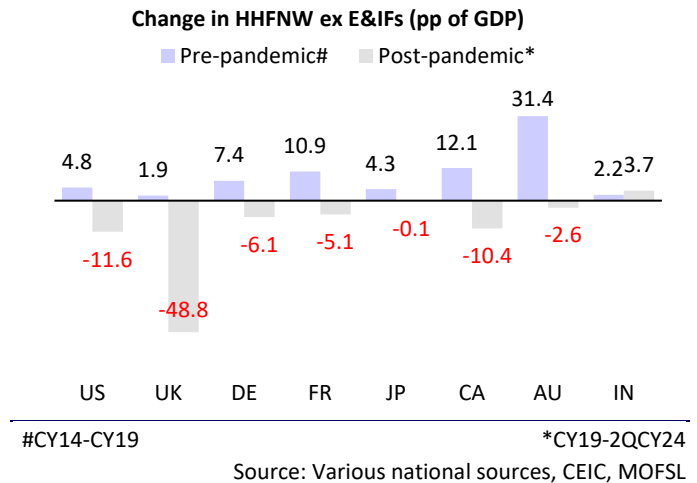
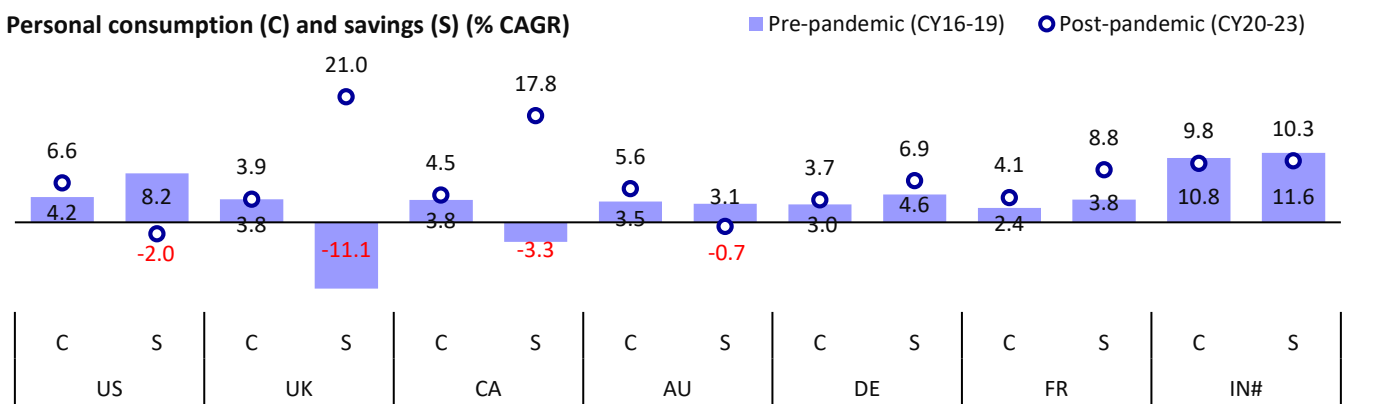
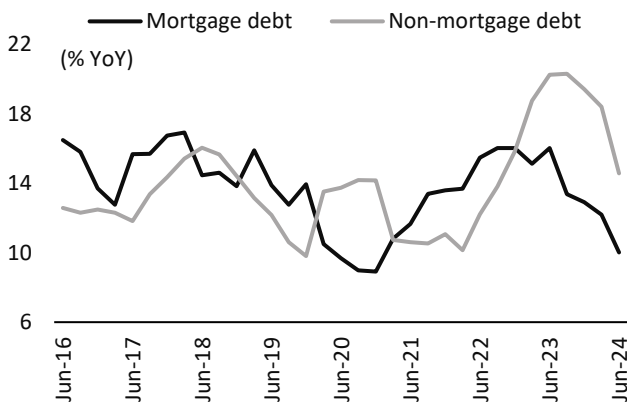


Exhibit 5: India is the only economy where both personal consumption and HH savings increased at a slower pace in the post-pandemic period



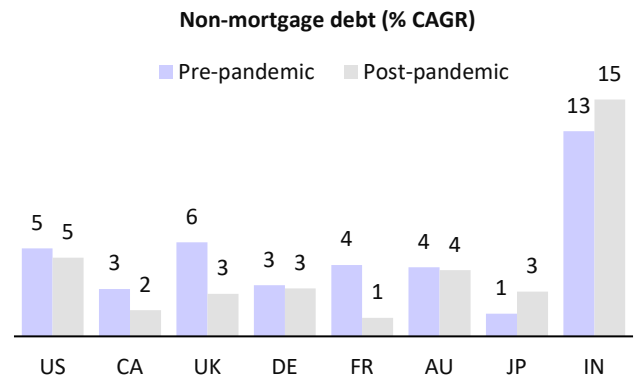
C = personal final consumption expenditure (PFCE) and S = HH total savings
Source: Various national sources, CEIC, MOFSL

Exhibit 6: Non-mortgage HH debt grew faster in the post-pandemic period...



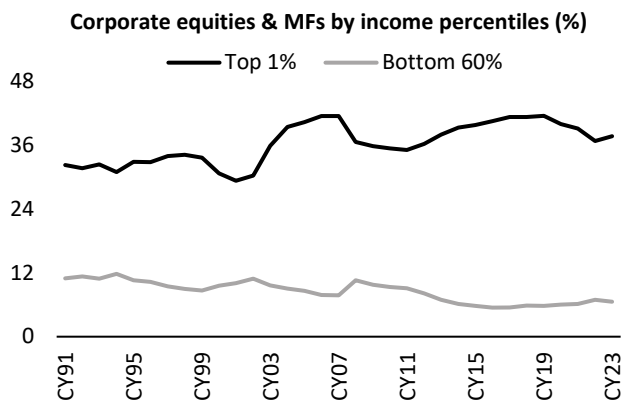
Non-mortgage HH debt includes agriculture loans, business loans and all consumption-loans, including unsecured loans

Exhibit 7: ...which is in stark contrast to slower growth in other major economies



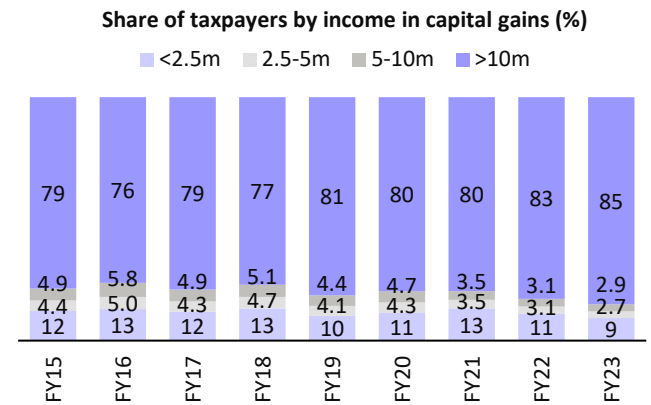
Pre-pandemic = CY15-CY19, and Post-pandemic = CY19-2QCY24
Source: Various national sources, CEIC, MOFSL

Exhibit 8: Top 1% richest consumers hold ~38% of all corporate equities and mutual funds in the US



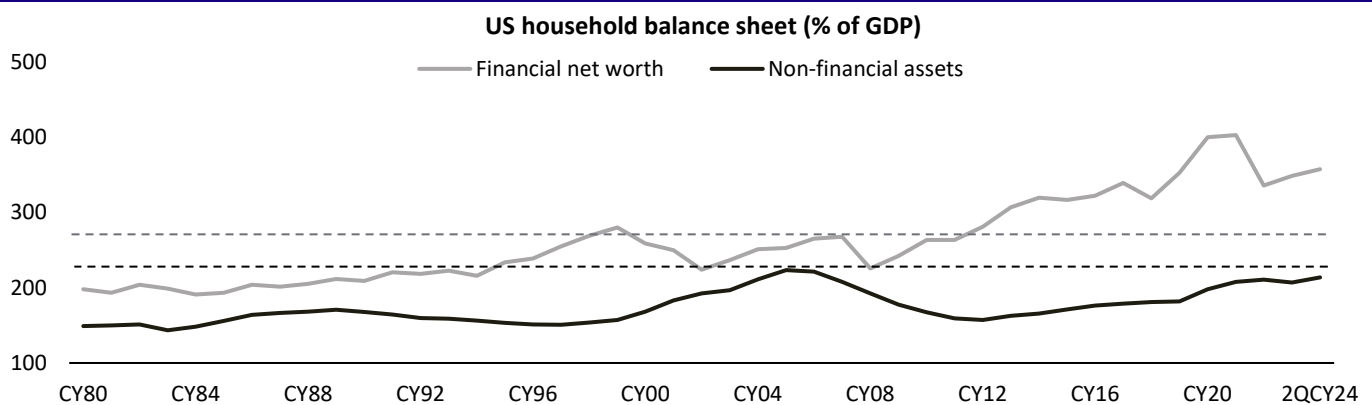
By income percentile Source: US Federal Reserve, MOFSL

Exhibit 9: 85% of all capital gains income in India accrued to taxpayers who earn more than INR10m



Source: India income tax department, MOFSL

Exhibit 10: Long-term trends in the US HH financial and non-financial net worth



US HH total net worth (financial and non-financial) rose sharply between 2003 and 2007 and was at all-time high in 2006
Source: US Federal Reserve, CEIC, MOFSL

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