Households and India's Stock Markets*

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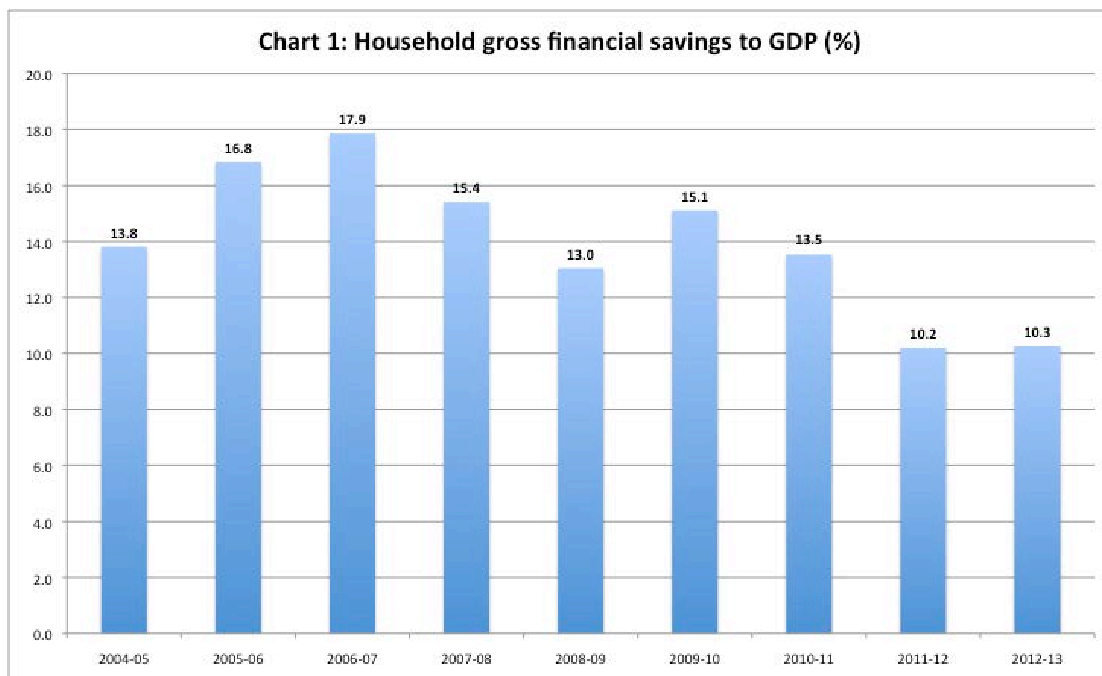
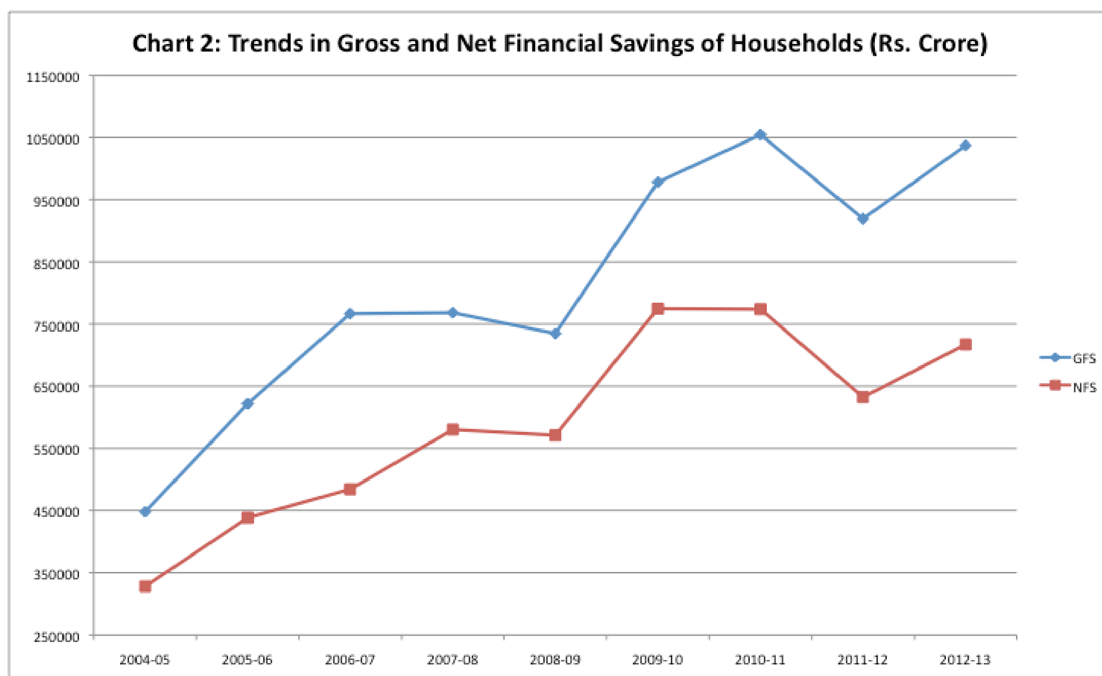
Over the last three years the Indian stock market has seen a near persistent bull run. Between 23 November 2011 and 28 November 2014, the closing value of the Sensex rose by 280 per cent, or an average of more than 90 per cent a year. That signals the kind of yield that the market would have generated even for those who had a portfolio that replicated trends in the 30-stock Sensex. Interestingly, this was a time when households were cutting back on their financial savings with the ratio of gross financial savings of households to GDP falling from 15.1 per cent in 2009-10 to 10.3 per cent in 2012-13. That retreat has affected household exposure to stock markets as well, one consequence of which is the extremely poor performance of the primary market and the virtual absence of IPOs from all but the largest of firms.



Households in India (as elsewhere) are major contributors to the nation's savings. Based on the National Accounts series with 2004-05 as base, the share of household savings in gross financial savings of the nation as a whole fell from 72.7 per cent in 2004-05 to 60.9 per cent in 2007-08, then rose to 74.7 per cent in 2009-10 and stood in 2012-13 at 72.7 per cent (the same level recorded in 2004-05). Thus, though volatile, the share of household savings in aggregate savings has mostly remained in the 70 to 75 per cent range.

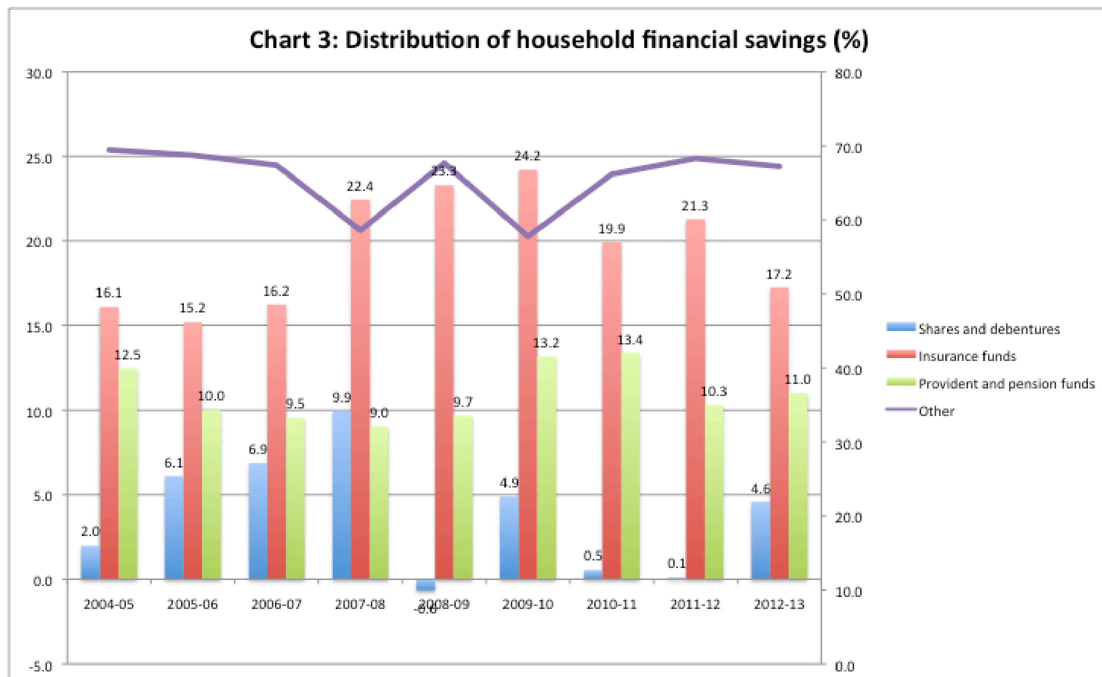
The national accounts statistics compute households' savings as the sum total of household financial savings and the savings of households in physical assets. As direct capital formation estimates from the household sector are not available, the value of household savings in physical assets is computed as a residual, by deducting independently estimated figures of capital formation in the public and private corporate sectors from an estimate of capital formation for the economy as a whole generated through a commodity flow approach.

This has two implications. The estimates of household savings in physical assets are less robust than desirable. And, those estimates include ‘physical savings’ by unincorporated enterprises, besides households per se. Partly as a consequence of these features, the relative share of financial and physical savings in the total savings of households fluctuate over a very broad range. Thus, over the period 2004-05 to 2012-13 the share of household physical savings in total household savings fluctuated between 48.1 per cent and 69.2 per cent, with no clear trend. Further, in the year 2008-09, when the global financial crisis is reported to have adversely affected economic activity in India, physical savings by households is reported to have risen by more than 40 per cent in nominal terms from Rs.5,38,137 crore to Rs.7,59,846 crore.



Such problems do not afflict the estimate of the financial savings component of household savings, which is calculated from holdings of different kinds of financial instruments and their distribution across sectors. It is widely accepted that the period since 2004-05 has been characterised both by a high degree of financial development in the Indian economy and by a credit boom in which household debt has increased considerably. While the former tendency is expected to encourage a shift to the safer, more transparent and higher yielding instruments that financial development is expected to generate, the latter by increasing household liabilities or debt would tend to reduce net financial savings. It would, therefore, be useful to see how financial development led by financial liberalisation has affected household savings behaviour.

Chart 2 presents the trends in the nominal value of gross and net household financial savings. There are two features of these trends that are noteworthy. First, as is to be expected, while financial savings by households have risen in nominal terms over the period at a compound annual rate of 9.4 per cent per annum, there is a clear dip in 2008-09 when the global financial crisis affected India. Second, the gap between gross and net financial savings has increased over the years, corroborating the expectation that household debt has been increasing during these years. However, the overall trend is for a rise in net household financial savings.



The question that remains is the degree to which households have chosen to park their financial savings in instruments directly or indirectly linked to the stock market. As Chart 3 shows, other than for two years, throughout the period 2004-05 to 2012-13, around 70 per cent of household savings in financial assets was in the category "Other", consisting of currency, bank and non-bank deposits or claims on government. So the first conclusion is that instruments through which households can be exposed directly or indirectly to the equity market (Shares and debentures, Insurance funds and Provident and pension funds) have on average accounted for between 30 and 33 per cent of household financial savings during this period. It is only in 2007-08 and 2009-10 that this figure moved up to around 42 per cent. Moreover, of those two years it was only in 2007-08 that the category Shares and debentures, which reflect direct stock market exposure, was the beneficiary, accounting to close to 10 per cent of household financial savings. Overall, it was only in the three years 2005-06 to 2007-08 that the share of Shares and debentures in total household financial savings was above 5 per cent.

Returns from stock markets seemed to have influenced the trend in household financial savings behaviour. Between 31 March 2005 and 31 March 2008, the Sensex rose from 6493 to 15644 or by 140 per cent, implying an average return of 47 per cent a year. But those who stayed in the market subsequently would have registered substantial losses as the Sensex was close to 8450 by end-November 2008 and did not cross the 10000 mark till April 2009. Depending on when an investor entered and exited the market, the yields could vary hugely. The resulting experience possibly influenced the decision of many investors to stay out of the market when the next boom occurred, resulting in a collapse and subsequent marginal recovery of the share of household financial savings that reflected direct exposure to the markets. (In fact Reserve Bank of India figures, which vary slightly from those reported by the CSO, show that the share of Shares and debentures in financial savings fell from 4.2 per cent in 2012-13 to 2.3 per cent in 2013-14.)

There is a view which holds that "in the long run", perhaps of well above 10 years, returns from the stock market are better than those from deposits. Even if true, this is

unlikely to be a determining influence on household financial behaviour. Households do not seem to operate with such long time horizons, being influenced more by returns registered in much shorter periods. And here the stock market seems to be an extremely uncertain source of returns, sometimes delivering large gains in the short run only to be followed by large losses. This dissuades investors from enlarging their overall exposure to the market in India, and to the extent they do, encourages them to invest only through intermediaries like mutual funds, insurance companies or pension fund managers.

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