India’s credit-fuelled consumption boom

India’s consumption growth has experienced nothing short of an explosion over the last five decades. The steady rise in India’s national income over FY06-12 at a nominal compound annual growth rate (CAGR)of 13% clearly had a primary role to play in driving the 12.1% per annum growth in private final consumption expenditure that India experienced over this period. The rise of “networks” was the second factor which is likely to have driven steady consumption growth as India experienced an unprecedented rise in telecom, financial and road networks over FY06-12. Robert Gordon in his book *The Rise And Fall Of American Growth* (2016) has shown the critical role played by “networks” in driving consumption growth in any economy. The relentless rise of these networks in India drove a rise in awareness as well as demand for a host of consumer goods, including mobile phones, cars, two-wheelers and houses.

Even as the rise of consumption in India until FY12 can be explained by the rise in incomes and “networks” or enablers of consumption, growth in both these variables plateaued after FY12. India’s national income growth for instance slowed to 12.4% over FY12-17 and yet consumption growth was recorded at an average of 13.6% over this period. Despite the evident slowdown in income growth, employment growth as well as networks’ growth, consumption growth remained strong in India with the share of consumption in gross domestic product (GDP) rising from 56% in FY12 to 59% in FY17.

Furthermore, employment growth slowed meaningfully over FY12-17. Even as there is no pan-India data available from a government source on the state of employment in India after FY12, the collapse in the industrial sector growth proves that the country’s mass low-skill labour employment engine had come to a juddering halt. Another sector that creates jobs for low-skilled labour, namely construction, saw its growth rate plummet.

So what was responsible for driving private consumption growth over FY12-17? Our analysis suggests that the rising penetration and use of retail credit over this period is likely to have played a key role in sustaining consumption growth over FY12-17 and this is the main reason why consumption growth did not stall despite slowing national income growth. Even as India’s total bank credit to GDP ratio declined by about 100 basis points (bps)over FY12-17, the “retail credit” to “private consumption” ratio rose by about 150 bps over the period. This is mainly because, in the absence of corporate credit demand, both banks and non-banking financial companies (NBFCs) have aggressively pushed retail credit growth.

So the big question that needs to be answered at this stage is: Is India’s retail credit-fuelled consumption growth sustainable? If income growth, employment growth as well as networks growth remain compromised over the next few years, then can consumption growth remain unaffected?

We believe that a hard stop to India’s consumption binge is likely sooner rather than later for four sets of reasons: (1) the current bout of consumption growth in India has not been supported by investment growth, (2) consumer confidence in India has dipped to a four-year low; (3) Indian households’ savings ratio stands at an 18-year low of 19% of GDP, and (4) retail non-performing asset (NPA) problems have started to raise their head and are likely to worsen.

India’s consumption boom has not been supported by investments

Cross-country evidence suggests that only consumption booms that are accompanied by an increase in investments tend to be sustainable as more investments result in higher job creation, which in turn help fuel consumption growth even when penetration levels may be peaking. India’s

ongoing consumption boom is an aberration as contrary to cross-country experience, its ongoing consumption growth has been accompanied by a drastic fall in the investment to GDP ratio.

Consumer confidence in India has dipped meaningfully in 1QFY18

Besides the absence of strong fundamental underpinnings to India's consumption growth, it is worth noting that consumer confidence in India dipped quite comprehensively in 1QFY18 as per the Reserve Bank of India's consumer confidence survey. It has been recorded at an 11-quarter low in 1QFY18 with consumer perception regarding employment potential going forward being at an 15-quarter low.

Households' savings ratio stands at an 18-year low

Even as a once-in-a-generation transition away from physical to financial savings is currently underway, it is worth noting that Indian households' overall savings ratio ebbed to an 18-year low in FY16 and India's consumption-to-GDP ratio has consequently edged up.

Retail NPA problems have started to raise their head

Retail NPAs have already started showing signs of concern. In this part, we describe early warning signs from: (1) micro-finance institutions, and (2) housing finance companies. Several micro-finance institutions (MFIs) are struggling for collections, which might hit their earnings. This is because of demonetization coupled with widespread rural distress. Furthermore, after stable and pristine asset quality over FY09-16, housing finance companies are showing early signs of stress where gross NPAs and credit costs have surged for many housing finance companies in the recent quarters.

This rise of consumption growth appears to be the result of the rise of retail credit. As corporate credit demand waned, banks and NBFCs aggressively pushed retail credit, resulting in India's retail credit-to-GDP ratio rising from 13% in FY12 to 16% in FY17. Given that we expect employment growth to remain weak and given that cross-country evidence suggests that only consumption booms that are accompanied by an increase in investments tend to be sustainable, we highlight the high risk of a hard stop to India's consumption boom materializing sooner than later.

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