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CC Dynamics-Consumption and Credit picture

An analysis of consumption demand and bank credit offtake has shown that:

- *The consumption picture is puzzling. But the funding side of demand has evolved strongly.*
- *Consumption demand by type of goods such as durables and semi-durables have shown that in FY23 demand elasticities of retail credit has picked up considerably and the same momentum is likely to continue in future.*
- *Strong housing demand coupled with the push for affordable housing has also resulted in improved elasticity of housing loans as well.*
- *Overall, formal source of finance is playing a crucial part in driving India's consumption demand. However, for certain segments the focus should be on quality lending and cautious monitoring of the same to prevent overheating.*

Background:

The consumption story of Indian economy is still fuzzy. In fact, for private final consumption expenditure (PFCE), the growth rate as per second advance estimates has been projected to be lower at 3% in FY24 (in real terms) compared to first advance estimates estimate of 4.4%. As per recent report of Retailers Association of India, retail sales growth showed an asymmetric picture with FMCG goods gaining momentum and consumer durables and electronics lagging. The guidance of major consumer goods related companies in its recent quarterly results on the other hand spoke of the concentration of demand towards the high-end segment with non-discretionary spending taking a back seat. High frequency indicators of consumption demand also painted a mixed picture. Vehicle sales (Two, three and PV sales), albeit with a high base, has posted a double-digit growth in both Jan'24 and Feb'24. Domestic air passenger traffic has shown some moderation, so has GST and Eway bills. So, it's very difficult to interpret the demand side dynamics.

However, when we look at the funding side of consumption demand, the picture is entirely different. Of late, retail credit offtake has undergone a decisive shift. The 5-Year CAGR ending FY23 for retail credit (personal loans excluding housing and education) has been at 19.4% and the run rate in FYTD24 (till Jan'24) is at 16.5%. There also have been regulatory checks in place as there was much debate surrounding the sudden spur in uncollateralized loan demand to finance consumption. From FY19 onwards (barring FY21 & FY22), growth in retail credit has exceeded 20%; and FY23 growth rate has been more than a decadal high. Much of this may be attributed to the pent-up demand phenomenon and resumption of economic activity post the Covid induced slowdown as during the same time, rebound was also visible in the PFCE component of GDP.

We have tried to juxtapose the PFCE component of GDP with the funding side of it, especially retail credit offtake of banks and tried to map the two.

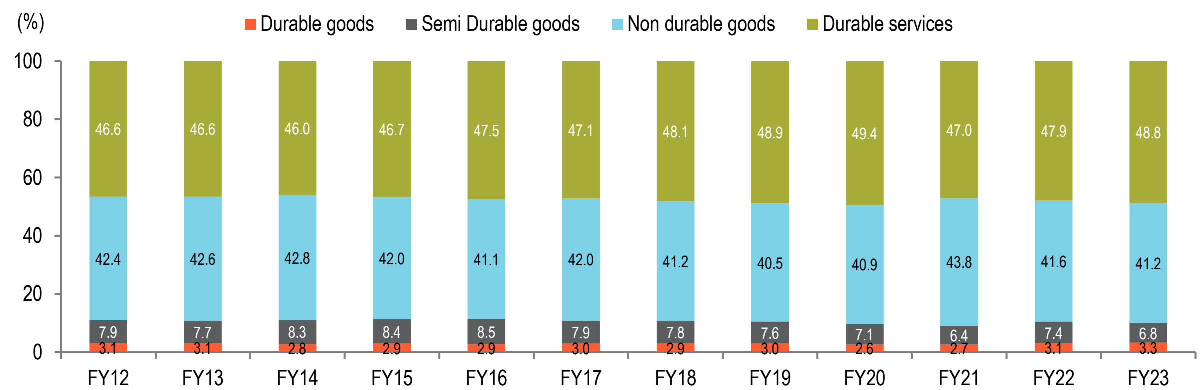
To get a clearer picture the mapping is done w.r.t type of consumer goods, for example, durable goods are mapped with retail credit and for housing and education, separately bank credit offtake to these two sectors have been used. Next, we have used the concept of elasticity to see how the bank's role in propelling private consumption demand has fared over the years.

How has Consumption demand moved?

We all know overall PFCE growth has shown some trailing in recent past. However, for a better understanding we have looked at two quinquennium's, 1) Ranging from FY12-17 and 2) Ranging from FY18-23. For Period 1. Overall PFCE grew by 10.9% with a solid double-digit growth visible in both durable and non-durable part of consumption demand. To elaborate **durable consumption goods** as per National Accounts Statistics definition, include furniture, fixtures, carpets, heating and cooking appliances, refrigerator and air conditioners, personal transport equipment, radio, TV, Jewellery ornaments, etc. to name a few. **Semi-Durable consumption goods** include clothing and footwear, Glassware, tableware, household utensils, miscellaneous personal goods etc. to name a few. **Non-durable consumption goods** include food, beverages and tobacco, fuel and power, newspaper, books, and magazines etc. to name a few.

Fig. 1 shows that over the years, shares of durable goods have picked up in overall PFCE. A lot of it has occurred post Covid where a lot of correction came into play, and it continued in FY23 as well. On the other hand, a downward correction happened in the shares of non-durable goods. Even shares of durable services which include Rent and water charges, domestic and laundry services, medical services, educational charges, hotels, and restaurants, etc. to name a few, rose to their highest in the current series. The shift is structural, or a one-off event post the pandemic, would only be clear in the coming years. But some transformation is visible in the consumption pattern of the economy.

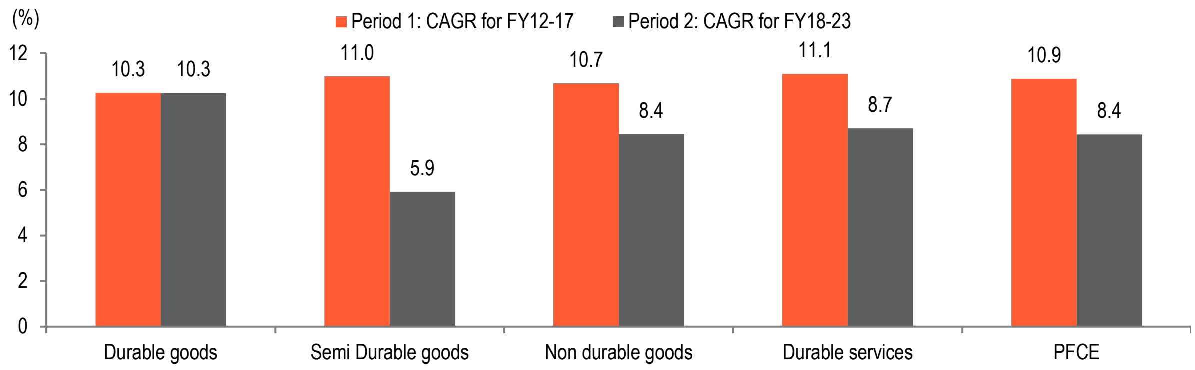
<u>Fig 1: How shares of different components of PFCE have evolved.</u>



Source: CEIC, Bank of Baroda Research, Note: All variables are at current prices

Fig 2. shows how the CAGR of two quinquennium have advanced**.** Notably**,** what stands out in the graph is that for durable goods, demand has been stable in both the periods. In fact, when the CAGR of overall PFCE went down to 8.4% in Period 2 from 10.9% in Period 1, for durable goods it remained stable at 10.3% outpacing all other subcomponents of PFCE. However, for semi-durables and non-durables, shares have moderated considerably, partly impacted by higher inflationary pressure.

Fig 2: Growth in Durable goods segment holding strong.



Source: CEIC, Bank of Baroda Research, Note: All variables are at current prices

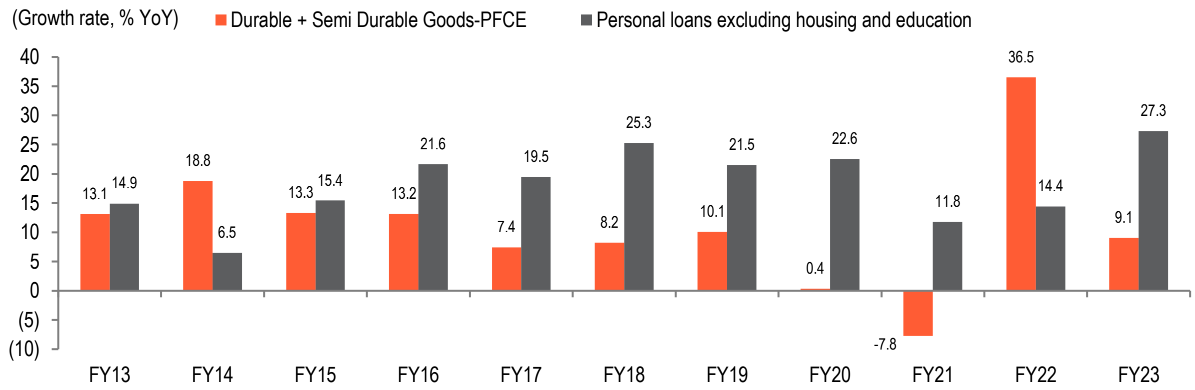
Juxtaposing the credit data with consumption:

In this section, we analyze whether the funding side of consumption also buttresses the same story as seen on the demand side. Here we have aggregated durable and semi durable goods and tried to look at the trajectory of the same with the trajectory of retail credit. One thing needs to be clarified first before bringing credit and consumption demand into the picture. PFCE is a flow concept. A flow is a quantity measured per unit of time. On the other hand, bank credit is a stock concept. A stock is a quantity measured at a given point in time. So, a better way to look at is using the incremental credit during the year and then comparing it with the PFCE for the year.

Durables and semi durables

Fig 3. shows that for FY16, FY17 and FY18, a credit offtake in the retail sector has translated into a similar pickup in demand for durable and semi durable goods. Also for FY23, a similar trend is observed. However, a vanilla YoY picture doesn't translate to any conclusive picture. Thus, we have used the ratio of incremental retail credit to durables and semi-durables demand.

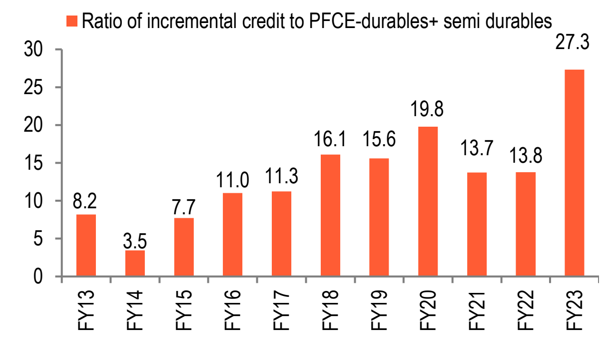
Fig 3: Growth in Durable goods segment holding strong.



Source: CEIC, Bank of Baroda Research, Note: All variables are at current prices

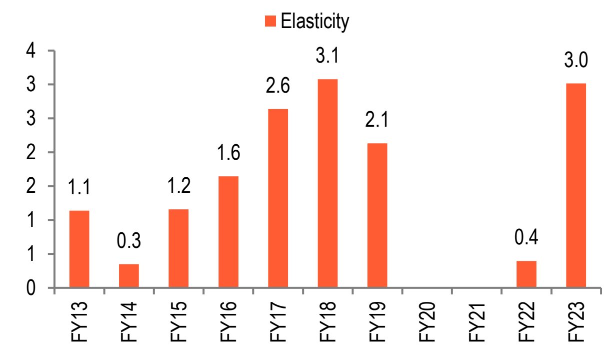
Fig. 4 shows how the role of formal financing is increasing over the years in financing consumption demand. The incremental retail credit to finance durables and semi-durables picked up significantly in FY23 and it is the highest in more than a decade. All of this is a lagged impact of monetary stimulus offered during the Covid period. **Fig 5.** Shows how elasticity has moved over the years. Thus a 1% increase in PFCE of durable and semi durable segment is leading to a faster pace of increase in retail credit. The elasticity touched 3, last noticed in FY18, when credit growth and economic activity were robust.

Figure 4: Incremental credit demand of durables and semi durables have picked up significantly in FY23



Source: CMIE, Bank of Baroda Research, Note: Credit means Personal loan excluding housing and education, All variables are at current prices

Figure 5: Elasticity has shown improvement as well

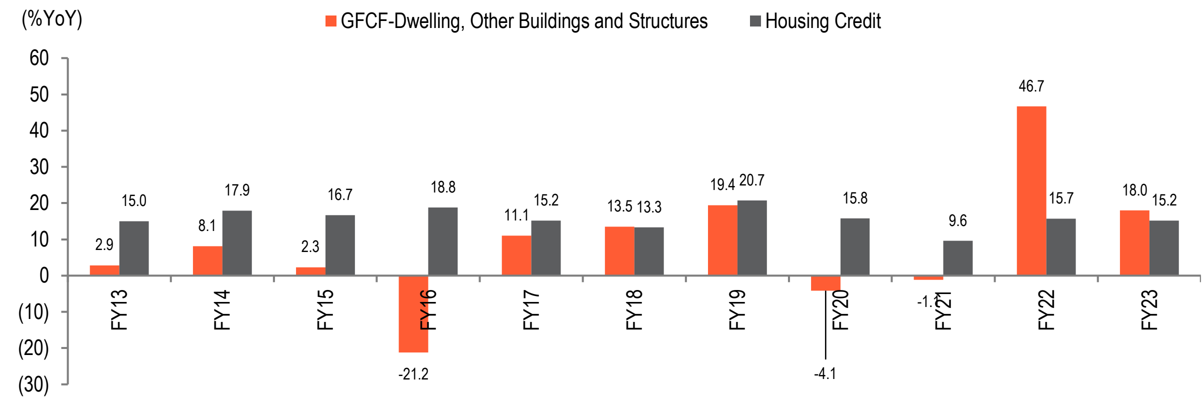


Source: CMIE, Bank of Baroda Research, Note: elasticity measures the effect on Personal loans excluding housing and education due to 1% increase in consumption demand of durables and semi-durables, Blank spaces are the distorted values due to Covid-19

Housing demand and housing credit

Fig 6. shows the movement of housing construction and credit offtake to housing sector. For housing construction can be a proxy for housing demand, we have taken the households dwelling, building and other structures of Gross Fixed Capital Formation of GDP. We have seen that for years such as FY14, FY15, FY19, FY22 and FY23, an increase in housing demand has led to an increase in housing credit offtake. However, for a better picture we have looked at the elasticity data.

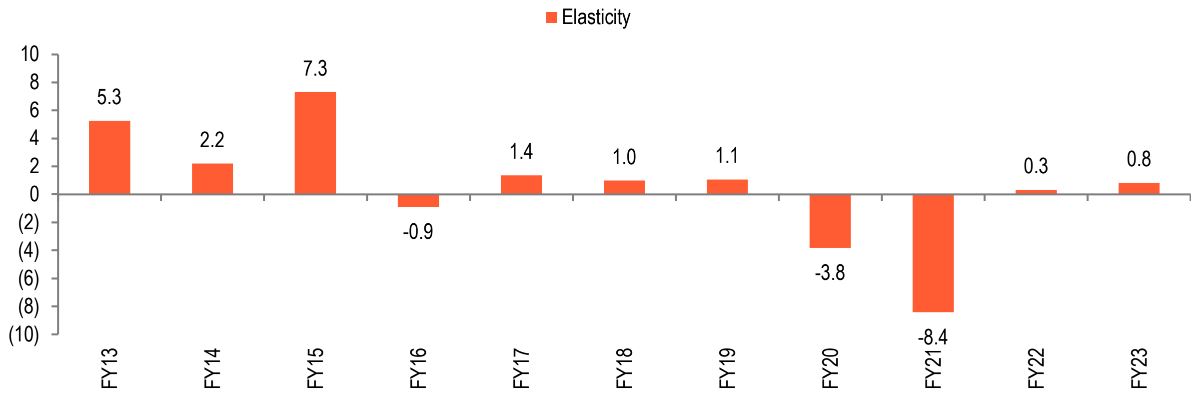
Fig 6: Growth in GFCF-dwellings and housing credit



Source: CEIC, Bank of Baroda Research, Note: All variables are at current prices

Fig 7. shows the elasticity picture. Elasticity of housing loans has improved in FY23 and recovered from the lows seen during pandemic but still lower than the pre-pandemic numbers. It was a period where construction activity was at a standstill due to lockdown restrictions. However, elasticity is expected to undergo further upward correction as seen in years between FY17-19, where there has been considerable pickup in housing demand.

Fig 7: Demand elasticity of housing loan has recovered from lows.

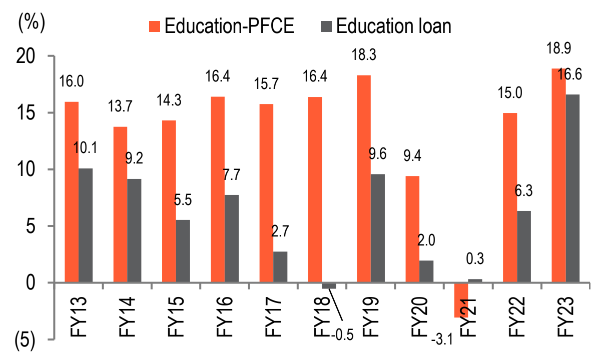


Source: CEIC, Bank of Baroda Research, Note: elasticity measures the effect on housing loans due to 1% increase in housing construction. For housing: households dwelling, building and other structures of Gross Fixed Capital Formation of GDP have been used.

Education and Education loans

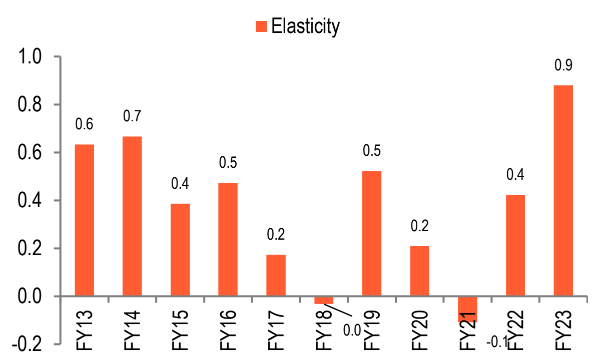
Fig 8. shows that in most of the years except FY15 and Covid period, there has been a fair degree of relation between education component in PFCE and education loan. Demand elasticity of education loan has reached its highest since FY12 as seen in **Fig. 9**. This is attributable to a favourable demographic dividend in favour of India and aspiration for higher studies among the young population.

Figure 8: Growth in education loan and education component of PFCE



Source: CMIE, Bank of Baroda Research, Note: Credit means Personal loan excluding housing and education, All variables are at current prices

Figure 9: Elasticity has improved



Source: CMIE, Bank of Baroda Research, Note: elasticity measures the effect on education loans due to 1% increase in education in PFCE

Concluding remarks

The analysis done shows that there is a growing relationship between household consumption, housing and education and demand for credit. The elasticity rates were volatile during covid but have recovered since. An elasticity of around 1 has been seen for housing and education loans. In case of retail loans (excluding home and education loans), the growth in durable and semi-durable goods has a stronger relation. These would be the focus points going ahead.

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