RBI HIGHLIGHTS RISING HOUSEHOLD DEBT: ECONOMY

NEWS: Is rising consumer credit cause for concern?

WHAT'S IN THE NEWS?

Rising household debt in India, driven by increasing consumer loans and consumption borrowing, poses risks to economic stability, especially for lower-income groups. Regulatory measures have slowed credit growth, but rising defaults among vulnerable borrowers highlight the need for careful monitoring.

Rising Household Debt in India

1. **Financial Stability Report (FSR) 2024**
    - The **Financial Stability Report (FSR) 2024** published by the Reserve Bank of India (RBI) highlights the significant concern over the rising household debt in India. The report outlines the increasing stock of household debt in the country and how it may pose potential economic risks.
    - **Increase in Household Debt**: Household debt in India has grown steadily from **36.6% of GDP in June 2021** to **41% in March 2024**, and it is expected to reach **42.9% in June 2024**. This consistent rise is a cause for concern, even though India's household debt remains lower than that in many other emerging economies.
    - **Concern for Lower-Income Borrowers**: The primary concern is that lower-income borrowers, who are most vulnerable, may struggle with higher debt levels. This can increase the risk of defaults and lead to broader economic instability.

Shifting Use of Borrowed Money
2. **Asset Creation vs Consumption**

- **Declining Household Asset Holdings**: There has been a decline in household asset holdings from **110.4% of GDP in June 2021** to **108.3% in March 2024**, indicating a shift in how borrowed money is being used.
- **More Loans for Consumption**: Traditionally, debt is used to acquire assets (such as homes, vehicles, or investments), but the increase in borrowing has primarily been for consumption purposes rather than for asset creation. This trend suggests that households may be taking on debt to meet immediate needs or lifestyle requirements, which can be an indicator of economic vulnerability.
- **Impact on Economic Growth**: When loans are used for consumption rather than asset creation, it reduces the potential for long-term wealth accumulation and can

slow economic growth. This shift is particularly concerning as it may indicate underlying weaknesses in the economy, especially among lower-income households.

Health of Borrowing and Borrowers

3. **Borrowing Structure and Credit Quality**

- **Healthy Borrowing Structure**: Despite the rise in overall household debt, several factors indicate that the structure of borrowing remains relatively healthy.
- **Increase in Borrowers, Not Debt per Borrower**: The rise in household debt is primarily driven by an increase in the number of borrowers rather than an increase in debt per borrower. This suggests that while more people are borrowing, the individual debt burden is not growing significantly.
- **Improved Credit Quality**: The proportion of sub-prime borrowers (those with lower credit ratings) has decreased, while the share of prime and super-prime borrowers now holds nearly **two-thirds of total household debt**. This shift indicates that the overall credit quality of borrowers is improving, as higher-rated borrowers tend to borrow more responsibly.
- **Asset Creation by Super-Prime Borrowers**: Super-prime borrowers, who have the highest credit ratings, have been borrowing more, but the majority of their loans are being used for asset creation (e.g., buying property, investing) rather than consumption. This is a healthier borrowing pattern because it adds to wealth creation rather than increasing the financial burden for non-asset-related consumption.

Impact of Consumer Borrowing on Credit Growth

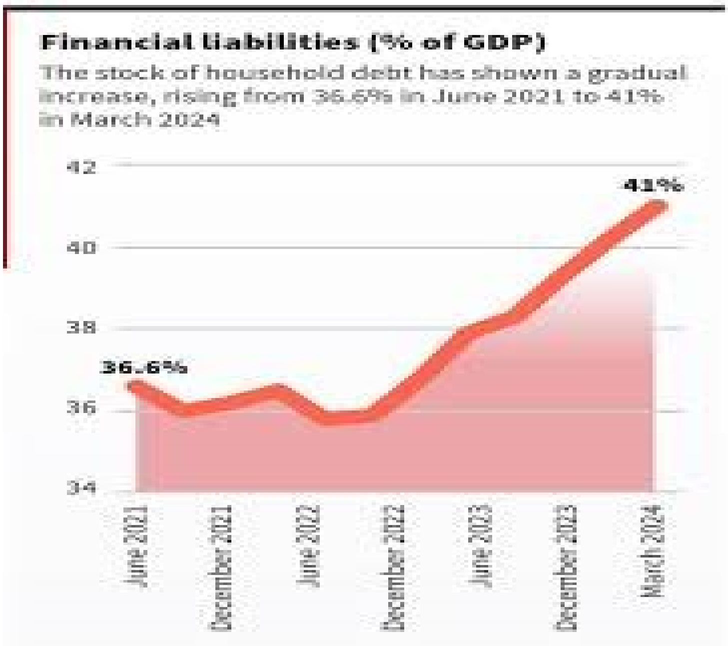
4. **Credit Growth Driven by Consumer Borrowing**

- **Pandemic-Induced Surge in Borrowing**: Since the COVID-19 pandemic, consumer borrowing has been a key driver of credit growth in India. Individuals increasingly turned to loans for personal consumption, such as home loans, vehicle loans, and personal loans, to make ends meet or to fund lifestyle needs.
- **Regulatory Measures to Slow Credit Growth**: In response to the rapid rise in borrowing, the RBI introduced regulatory measures in **September 2023**. These measures aimed to slow down the pace of credit growth by tightening lending standards and ensuring that loans are given to financially sound borrowers.
- **Shift Toward Healthier Borrowers**: As a result of the regulatory measures, there has been a shift toward lending to healthier borrowers, which means that the overall quality of the loan portfolio has improved. This shift has helped reduce risky lending practices and minimize the potential for widespread defaults.

Rising Consumption Loans and Income Inequality

5. **Shift Towards Consumption Loans**

- **Increasing Share of Consumption Loans**: The share of loans taken for consumption purposes has been steadily rising. These loans include personal loans, credit card debt, and loans for daily expenses.
- **Lower-Income Households Borrowing for Consumption**: Households earning less than **₹5 lakh per year** are primarily borrowing for consumption, with many relying on **unsecured loans** like credit card debt to cover daily expenses. These loans do not require collateral and tend to have higher interest rates, placing a greater burden on the borrower.
- **Wealthier Households and Asset-Based Loans**: In contrast, wealthier households tend to borrow for purchasing homes or other long-term investments (e.g., business expansion). This borrowing for asset creation is generally more sustainable than borrowing for consumption.
- **Disparity in Borrowing**: Among **sub-prime borrowers**, around **50%** of loans are taken for consumption, while among **super-prime borrowers**, about **64%** of loans are for asset creation. This demonstrates a stark contrast in borrowing patterns based on income levels, with lower-income households more likely to incur debt for short-term consumption rather than long-term asset building.



Rising Debt Stress for Lower-Income Groups

6. **Defaults and Financial Stress**

- **Increase in Defaults**: There has been a noticeable rise in **personal and credit card loan defaults** in September 2024 compared to the previous year. This signals growing financial stress among lower-income borrowers who are struggling to meet their repayment obligations.
- **Multiple Loan Defaults**: Many lower-income borrowers who have credit card or personal loan debt also carry housing or vehicle loans. If they default on one loan, all other loans can be classified as **non-performing loans (NPLs)**. This situation escalates financial risks as multiple loans become problematic for the borrower, amplifying the risk of default for banks and financial institutions.
- **Broader Economic Weaknesses**: If defaults on unsecured loans continue to rise, particularly among lower-income groups, it could create broader economic vulnerabilities. This could lead to tighter credit conditions, reduced consumer spending, and lower economic growth overall.

Concerns About Household Debt and Economic Growth
7. **Income Insecurity and Financial Innovations**

- **Unsecured Loans and Income Insecurity**: The rise in unsecured consumer loans is seen as an indicator of growing **income insecurity** among households, particularly in the aftermath of the pandemic. These loans, often used for consumption, suggest that many households are struggling to meet daily needs and have turned to borrowing to fill the gap.
- **Encouraging Borrowing Through Financial Innovations**: Financial innovations like **credit cards** have encouraged more borrowing, particularly among lower-income households. While these financial products can offer convenience, they may also promote unsustainable debt levels, especially when used for consumption.
- **Fewer Assets Created**: The increase in consumption loans means that fewer assets are being accumulated by households. When borrowing is focused on immediate needs rather than long-term investments (like housing or education), it limits opportunities for wealth creation and can lead to long-term financial instability.

Effects on Economic Growth and Multiplier Effect
8. **Impact of Debt on Economic Growth**

- **Contribution of Lower-Income Households**: Lower-income households tend to contribute more to economic growth because they spend a larger proportion of their income. Their spending on goods and services generates demand, which fuels economic activity and promotes growth.
- **Debt Repayments and Reduced Consumption**: However, when lower-income households become burdened with debt, a larger share of their income goes toward

loan repayments rather than consumption. This reduces their ability to spend on goods and services, which in turn slows down economic growth.

- **Impact on the Income Multiplier**: The income multiplier, which refers to the amount of economic activity generated from a unit of investment, is reduced when households are burdened with debt. This is because less disposable income is available for consumption, thereby reducing the overall economic impact of investment.
- **Policy Implications**: Policies like **income tax cuts** or other forms of stimulus may not have the desired effect on economic growth if poorer households are already overwhelmed by debt. In such cases, debt repayment takes precedence over increased consumption, which diminishes the potential for such policies to boost economic activity.

Conclusion

9. **Policymaker's Role in Monitoring Debt Trends**

- **Concerns Over Rising Consumer Debt**: While the rise in borrowing by prime borrowers (those with better credit ratings) suggests a healthier overall loan portfolio, the increasing levels of **consumer debt**, especially **unsecured loans**, remain a significant concern.
- **Need for Monitoring**: Policymakers must closely monitor the rise in unsecured loans and consumption debt to avoid potential future economic instability. If left unchecked, rising household debt, particularly among lower-income groups, could lead to financial stress and broader economic weaknesses, affecting the stability of the financial system and overall economic growth.

Source: https://www.thehindu.com/business/Economy/is-rising-consumer-credit-cause-for-concern/article69317390.ece