

Connecting the Dots

India's Generational Shift in Consumption and Debt

ACTIVE FUNDAMENTAL EQUITY | GLOBAL EMERGING MARKETS EQUITY TEAM | MACRO INSIGHT | JULY 2018

Recently, on my commute home, I saw two adjacent shops with large banners outside them. One said 'Phone on loan' and the one next to it said 'Loan on phone.' The former was obviously selling mobile phones and was offering attractive loan options to make that purchase, while the latter was a Direct Sales Agent of a financing company offering personal loans wherein it required just one phone call to get the loan preapproved. These two shops seemed quite symbolic of what is happening to consumption and household debt in India.

The other incident that took me further on this chain of thought happened at a family gathering. We were gathered to celebrate the birthday of a Generation Z niece and I asked her what gift she wanted. I was surprised by her response when she said "I want an add-on credit card"—she was turning sixteen. While I was surprised, the septuagenarians in the family, for whom loan was another four-lettered word, were totally aghast. I think I was witnessing a diametrical attitudinal shift towards leverage that had happened over three generations in India and that is a trend which I think is here to stay: the trend that the Indian household, over the next few years, will increasingly lever itself up and spend on consumption.

AUTHOR



SWANAND KELKAR

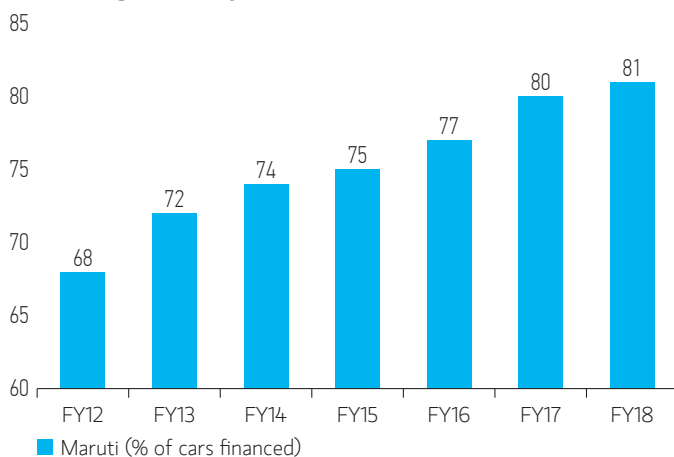
*Managing Director
Morgan Stanley
Investment Management*



This is not a trend which is starting out now and one can find evidence for this in various data. Take for instance, the finance penetration of Maruti cars, i.e. the percentage of cars sold on which the buyer has taken a loan. That percentage has steadily increased from 68% in F12 to 81% in F18 (*Display 1*). At a broader level, household debt to GDP has inched up from 11.2% in F12 to 15.7% in F18 (*Display 2*). This trend has legs to run and will be aided by a confluence of several factors apart from the attitudinal shift. For starters, 15.7% household debt to GDP is fairly low by Emerging Market standards which has an average of 39%.¹ While it is tempting to think that this would be tightly correlated with per capita GDP, there are idiosyncratic differences between countries. South Africa, with per capita GDP of about USD 6,000, has about 44% household debt while Thailand, with a similar per capita income, has almost 78% debt.¹ Indonesia, with twice the per capita GDP of India, has similar household debt levels¹ but in an individual product like two-wheelers, finance penetration is in excess of 70%² while that number is 35% in India.³

DISPLAY 1

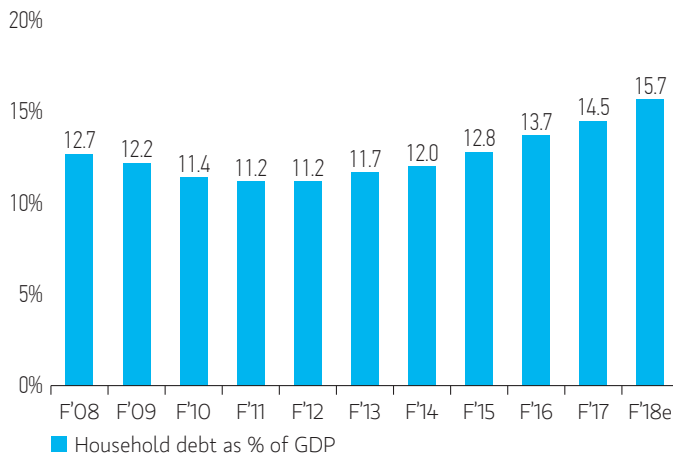
Increasing finance penetration of Maruti cars



Source: RBI, Macquarie Macro Strategy. Data as of July 2018.

DISPLAY 2

Increasing household debt as a percentage of GDP



Source: RBI, Macquarie Macro Strategy. Data as of July 2018.

e- Estimated

An important enabler for this trend in India could have been the formation of credit information bureaus such as CIBIL (Credit Information Bureau (India) Limited), that lenders can access to check the credit history of their prospective borrowers. About a decade ago, in the absence of income documents, lenders relied on surrogate verification while assessing creditworthiness. In an extreme case, if you stepped out of the airport and had an economy class boarding pass you were preapproved for a silver credit card while if you had a business class boarding pass you got a gold card. Things are more sophisticated now where CIBIL itself has a database of 248 million unique borrowers which has almost doubled in over five years (*Display 3*). Put differently, lenders are able to verify CIBIL records of over 80% of individual borrowers today versus only 60% five years ago.⁴ While information on credit history has been one of the enablers, data-savvy lenders, especially banks, are using their own customers' banking data to extend targeted loans. India's largest private sector bank, for instance, has disclosed that 50% of their incremental personal loans and 70% of incremental credit card loans are extended to customers who have an existing relationship with the bank.⁵ Aided by such data analytics, the bank has been able to grow its share of unsecured loan book from 22% of retail loans in F12 to 32% in F18 (*Display 4*) and this share gain has happened within a retail loan book that itself has grown at 22% CAGR.

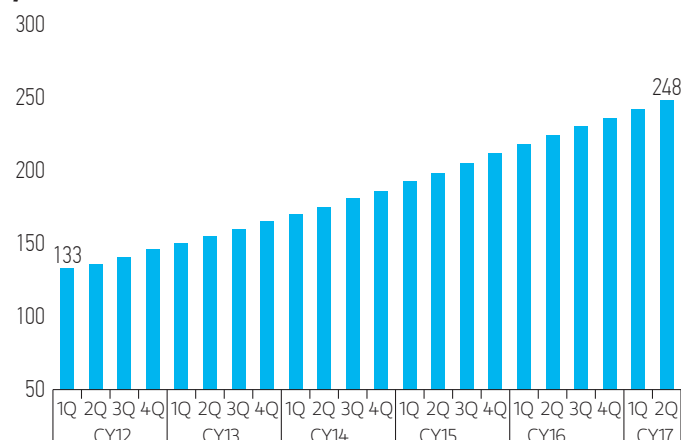
¹ Source: IMF, RBI, CEIC, BIS, Macquarie Macro Strategy. Data as of December 2017

² Source: CLSA, Morgan Stanley Investment Management Research. Data as of May 2018

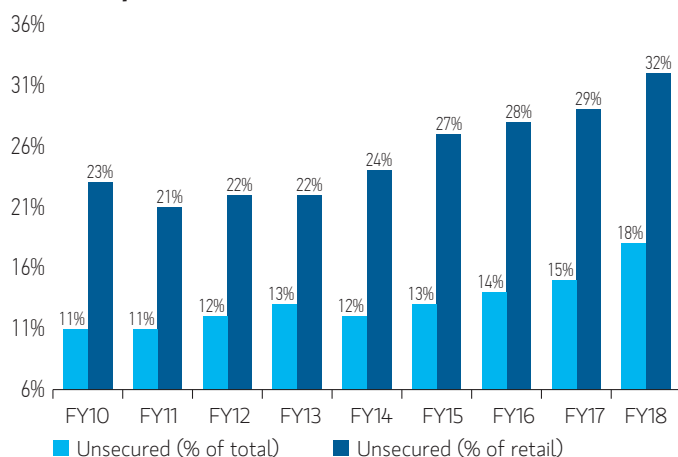
³ Source: CEIC, BIS, Macquarie Macro Strategy. Data as of July 2018

⁴ Source: CIBIL, Macquarie Macro Strategy. Data as of December 2017

⁵ Source: Company data, Macquarie Macro Strategy. Data as of January 2018

DISPLAY 3**CIBIL's unique client database almost doubled in five years (in MM)**

Source: CIBIL, Macquarie Macro Strategy. Data as of December 2017

DISPLAY 4**India's largest private sector bank's unsecured lending in retail space**

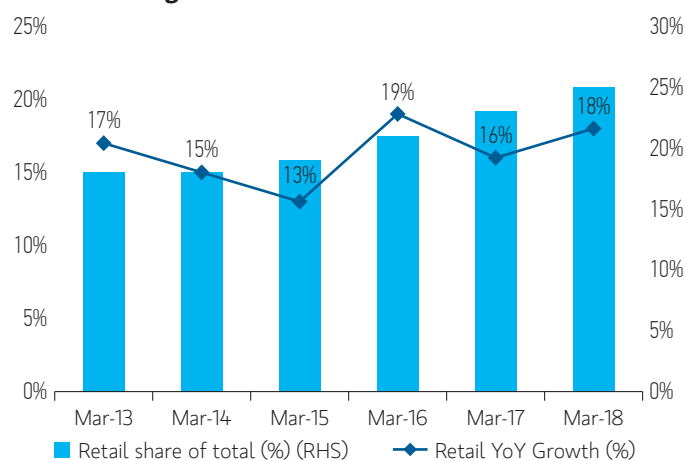
Source: Company Data, Macquarie Macro Strategy. Data as of March 2018

While changing attitudes, low penetration, availability and mining of data are immediate tailwinds, better asset ownership records could be a meaningful medium-term driver. Digitisation of land records is an important step in this direction, where a clear land title becomes actionable collateral for lending, especially in rural areas. Digitisation of land records has continued apace in India with 86% of land records digitised as of date and about 48% where even the asset transfers are digitally recorded.⁶

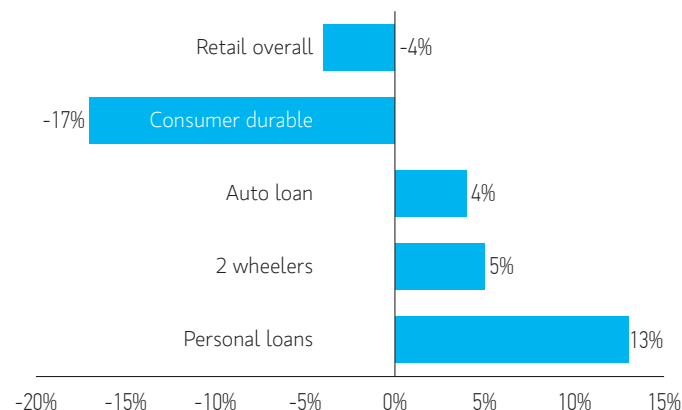
I can already imagine the (septuagenarian) naysayers objecting that this is a bad precedent and will eventually end in tears of crisis. The distinction here is that overuse of leverage is bad and it might

⁶ Source: Department of Land Resources, Ministry of Rural Development. Data as of July 2018

be worthwhile to see if there are signs of overheating. Exhibit A of naysayers is that almost all incremental credit growth, of late, has been retail-led and that is a sign of overheating. While that may be true, retail credit by itself (and this includes secured mortgages) has grown at an average of about 18% over the past three years and it is abysmally low growth in other parts of the economy that has made retail's contribution look outsized (*Display 5*). Another possible sign of overheating is increase in individual ticket sizes, i.e. growth is not driven by more borrowers but by giving more credit to the same borrowers. Here again we do not see anything out of the ordinary (*Display 6*) and the final test of the pudding is in the bad loan numbers (*Display 7*). Again, there is nothing to report, with the NPA (Nonperforming Assets) numbers actually improving in some categories.

DISPLAY 5**Retail credit growth**

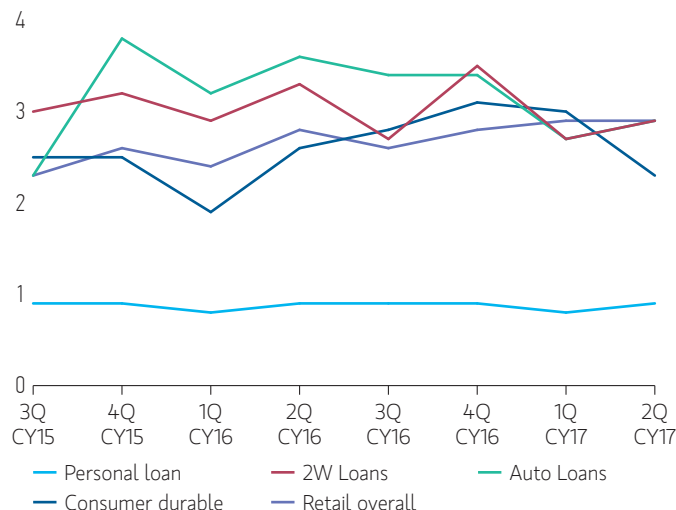
Source: RBI, Macquarie Macro Strategy. Data as of March 2018

DISPLAY 6**Ticket size growth of key retail products (CY13-17E CAGR)**

Source: TransUnion CIBIL data, Study by FICCI-BCG. Data as of November 2017. E-Estimated

DISPLAY 7

Delinquency rates by select retail products (%)



Source: TransUnion CIBIL data, Study by FICCI-BCG. Data as of November 2017

DEFINITIONS

Price-Earnings (P/E) is the price of a stock divided by its earnings per share for the past 12 months. Sometimes called the multiple, P/E gives investors an idea of how much they are paying for a company's earning power. The higher the P/E, the more investors are paying, and therefore the more earnings growth they are expecting. **Gross Domestic Product (GDP)** is the monetary value of all the finished goods and services produced within a country's borders in a specific time period. It includes all private and public consumption, government outlays, investments and net exports. **Compound Annual Growth Rate (CAGR)** is the year-over-year growth rate of an investment over a specified period.

DISTRIBUTION

This communication is only intended for and will be only distributed to persons resident in jurisdictions where such distribution or availability would not be contrary to local laws or regulations.

United Kingdom: Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA. **Dubai:** Morgan Stanley Investment Management Limited (Representative Office, Unit Precinct 3-7th Floor-Unit 701 and 702, Level 7, Gate Precinct Building 3, Dubai International Financial Centre, Dubai, 506501, United Arab Emirates. Telephone: +97 (0)14 709 7158). **Germany:** Morgan Stanley Investment Management Limited Niederlassung Deutschland Junghofstrasse 13-15 60311 Frankfurt Deutschland (Gattung: Zweigniederlassung (FDI) gem. § 53b KWG). **Italy:** Morgan Stanley Investment Management Limited, Milan Branch (Sede Secondaria di Milano) is a branch of Morgan Stanley Investment Management Limited, a company registered in the U.K., authorised and regulated by the Financial Conduct Authority (FCA), and whose registered office is at 25 Cabot Square, Canary Wharf, London, E14 4QA. Morgan Stanley Investment Management Limited Milan Branch (Sede Secondaria di Milano) with seat in Palazzo Serbelloni Corso Venezia, 16 20121 Milano, Italy, is registered in Italy with company number and VAT number 08829360968. **The Netherlands:** Morgan Stanley Investment Management, Rembrandt Tower, 11th Floor Amstelplein 11096HA, Netherlands. Telephone: 31 2-0462-1300. Morgan Stanley Investment Management is a branch office of Morgan Stanley Investment Management Limited. Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom. **Switzerland:** Morgan Stanley & Co. International plc, London, Zurich Branch/ Authorised and regulated by the Eidgenössische Finanzmarktaufsicht (FINMA). Registered with the Register of Commerce Zurich CHE-115.415.770. Registered Office: Beethovenstrasse 33, 8002 Zurich, Switzerland, Telephone +41 (0) 44 588 1000. Facsimile Fax: +41 (0) 44 588 1074.

So what could you do as an investor? Two things, in my opinion: look for financiers who are sensibly extending such loans to retail borrowers, relying on data and technology to make better credit decisions and lower costs; also look for categories of products that the consumers are buying with this credit. These could start with shoes (yes, we did see an easy monthly instalment option for a pair of shoes) and can go right up to a home. Like all powerful trends this trend could be prone to getting overextended in due course of time but based on currently available data, it might be early to worry about that just yet.

And no, the niece did not get the credit card.

U.S.: A separately managed account may not be suitable for all investors. Separate accounts managed according to the Strategy include a number of securities and will not necessarily track the performance of any index. Please consider the investment objectives, risks and fees of the Strategy carefully before investing. A minimum asset level is required. For important information about the investment manager, please refer to Form ADV Part 2.

Please consider the investment objective, risks, charges and expenses of the fund carefully before investing. The prospectus contains this and other information about the fund. To obtain a prospectus, download one at morganstanley.com/im or call 1-800-548-7786. Please read the prospectus carefully before investing.

Morgan Stanley Distribution, Inc. serves as the distributor for Morgan Stanley funds.

NOT FDIC INSURED | OFFER NO BANK GUARANTEE | MAY LOSE VALUE | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY | NOT A DEPOSIT

Australia: This publication is disseminated in Australia by Morgan Stanley Investment Management (Australia) Pty Limited ACN: 122040037, AFSL No. 314182, which accept responsibility for its contents. This publication, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act. **Hong Kong:** This document has been issued by Morgan Stanley Asia Limited for use in Hong Kong and shall only be made available to "professional investors" as defined under the Securities and Futures Ordinance of Hong Kong (Cap 571). The contents of this document have not been reviewed nor approved by any regulatory authority including the Securities and Futures Commission in Hong Kong. Accordingly, save where an exemption is available under the relevant law, this document shall not be issued, circulated, distributed, directed at, or made available to, the public in Hong Kong. **Singapore:** This document should not be considered to be the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor under section 304 of the Securities and Futures Act, Chapter 289 of Singapore ("SFA"), (ii) to a "relevant person" (which includes an accredited investor) pursuant to section 305 of the SFA, and such distribution is in accordance with the conditions specified in section 305 of the SFA; or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. **Taiwan:** This material is provided for information purposes only and does not constitute a solicitation where such a solicitation is unlawful. The products mentioned herein this material may or may not have been registered with the Securities and Futures Bureau of the Financial Supervisory Commission in Taiwan, Republic of China ("ROC") pursuant to relevant securities laws and regulations. Such products may only be made available in the ROC if they are (a) registered for public sale in the ROC or

(b) availed on a private placement basis to specified financial institutions and other entities and individuals meeting specific criteria pursuant to the private placement provisions of the ROC Rules Governing Offshore Funds.

IMPORTANT INFORMATION

The views and opinions are those of the author as of the date of publication and are subject to change at any time due to market or economic conditions and may not necessarily come to pass. Furthermore, the views will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date of publication. The views expressed do not reflect the opinions of all portfolio managers at Morgan Stanley Investment Management (MSIM) or the views of the firm as a whole, and may not be reflected in all the strategies and products that the Firm offers.

Forecasts and/or estimates provided herein are subject to change and may not actually come to pass. Information regarding expected market returns and market outlooks is based on the research, analysis and opinions of the authors. These conclusions are speculative in nature, may not come to pass and are not intended to predict the future performance of any specific Morgan Stanley Investment Management product.

Certain information herein is based on data obtained from third party sources believed to be reliable. However, we have not verified this information, and we make no representations whatsoever as to its accuracy or completeness.

All information provided has been prepared solely for information purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The

information herein has not been based on a consideration of any individual investor circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

Past performance is no guarantee of future results.

This communication is not a product of Morgan Stanley's Research Department and should not be regarded as a research recommendation. The information contained herein has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research.

This document may be translated into other languages. Where such a translation is made this English version remains definitive. If there are any discrepancies between the English version and any version of this document in another language, the English version shall prevail.

Morgan Stanley Investment Management is the asset management division of Morgan Stanley.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without MSIM's express written consent.

All information contained herein is proprietary and is protected under copyright law.

Explore our site at www.morganstanley.com/im