Morgan Stanley

INVESTMENT MANAGEMENT

Connecting the Dots

India's Generational Shift in Consumption and Debt

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

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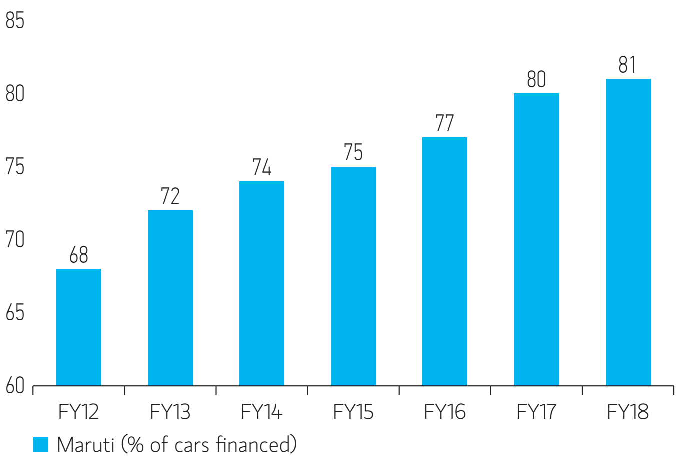
Recently, on my commute home, I saw two adjacent shops with large banners outside them. One said 'Phone on loan' and the one next to it said 'Loan on phone.' The former was obviously selling mobile phones and was offering attractive loan options to make that purchase, while the latter was a Direct Sales 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.

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 levels[1] 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

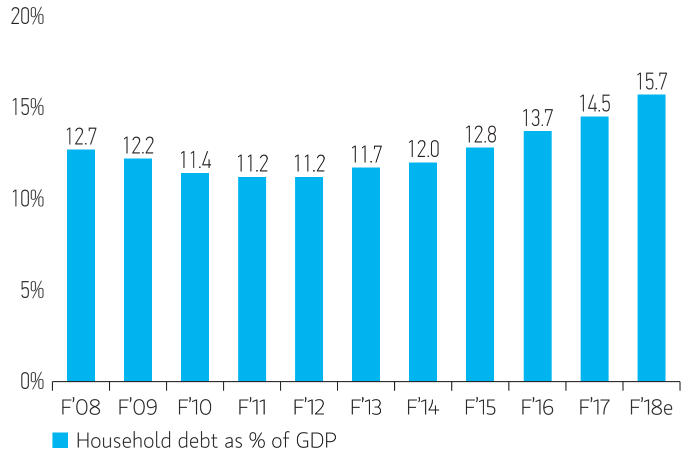
Increasing finance penetration of Maruti cars



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

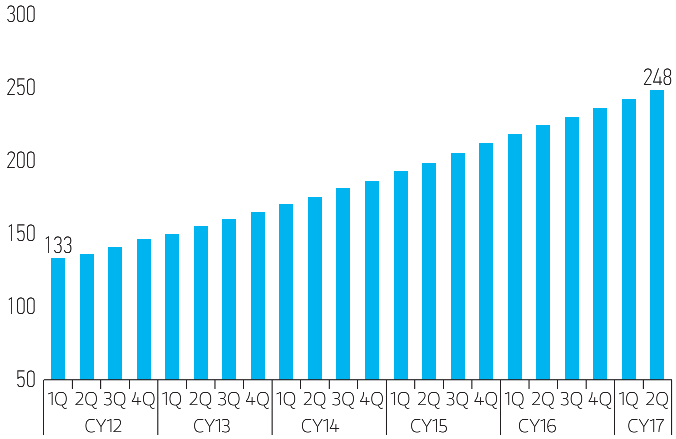
[3] Source: CEIC, BIS, Macquarie Macro Strategy. Data as of July 2018

[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

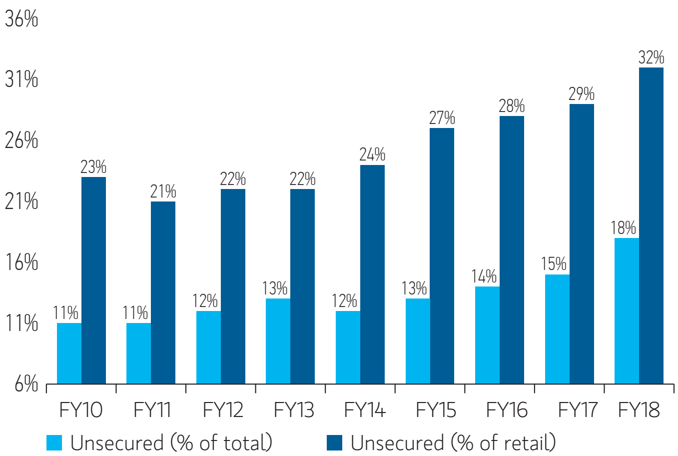
CIBIL's unique client database almost doubled in five years (in MM)



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

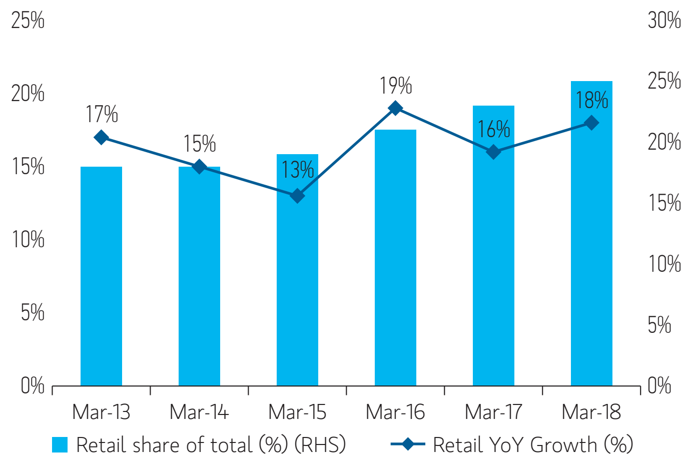
While changing attitudes, low penetration, availability and mining of data are immediate tailwinds, better asset ownership records could be a meaningful medium-term driver. Digitisation of land records is an important step in this direction, where a clear land title becomes actionable collateral for 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 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.

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

DISPLAY 5

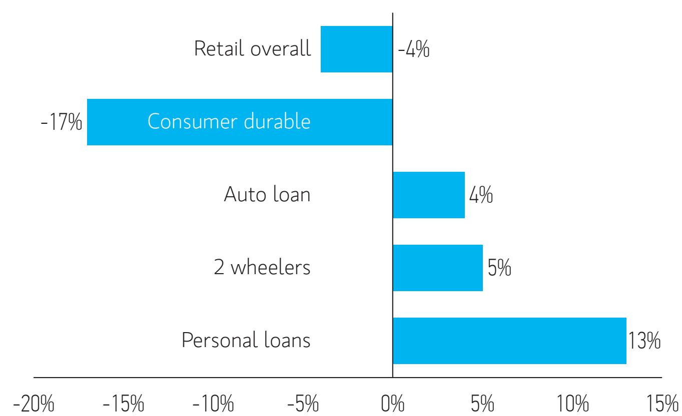
Retail credit growth



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

DISPLAY 6

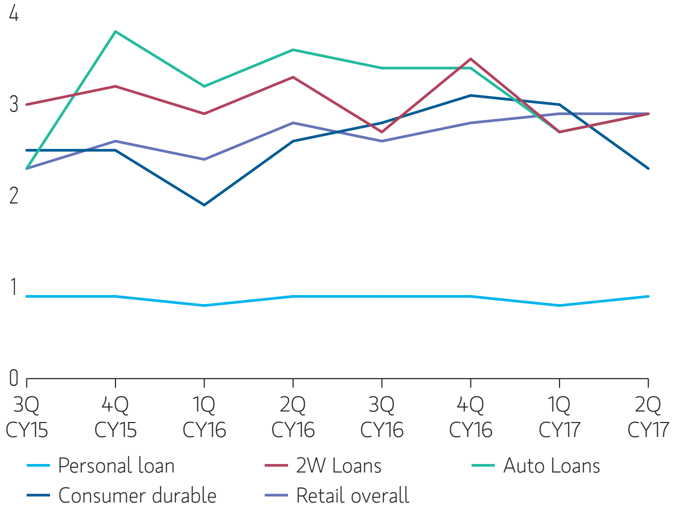
Ticket size growth of key retail products (CY13-17E CAGR)



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

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.

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.

(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.

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