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GROWTH OF RETAIL CREDIT AND ITS COMPOSITION IN INDIAN BANKING: A MACRO EVALUATION

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Abstract

An ever growing middle class population and rising income levels, combined with the demographic change of smaller household sizes has boosted demand for retail credit. There may exist meaningful inter-linkages among economic indicators and personal finance growth such that the variation in the retail credit at the macro level can be explained. Banks credit policies and credit processes are prepared with the broad risk management objective and the oversight of the credit policy remains with the senior management. However, increasing population, increase in the number of households, per capital income, number of employed people and also per capita household income, etc provide the need for fulfilling the gap between the existing level of debt and income. The purpose of this study is to provide meaningful analysis of inter-linkages among economic and financial variables such that the growth in retail credit at the macro level is explained. We conclude that with or without financial inclusion, a large section of the population or households have remained unserved with retail credit products and the gap between income to debt at retail level is increasing.

Key Words: Personal Loan, Housing Sector, Per Capita Loan

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Introduction

An ever growing middle class population and rising income levels, combined with the demographic change of smaller household sizes has boosted demand for retail credit. Meanwhile, increasing consumer spending power has also encouraged growth in consumption goods contributing to the spread of 'mall culture' and the popularity of luxury goods leading to spurge in personal finances. Strong growth in the services sector — particularly in the IT and ITES and hospitality sectors and the corporates' growing scale of operations have led to greater employment in the organized sector. Reserve Bank of India (RBI) has increased risk weights for lending banks' real estate exposure, which has served to curtail direct lending to retail sector. The purpose of this study is to provide meaningful analysis of inter-linkages among economic and financial variables such that the growth in retail credit at the macro level is explained. During the last decade, the credit scenario in India has undergone significant changes, due to reform of financial sector and also the regulatory changes both in the domestic and international sector. It is in this context that this study has considered it imperative to undertake an analysis for evaluating the retail credit loans. It is true that credit management varies across products and may include factors such as the borrower's income, the loan to-value ratio, demographic parameters and certain stability factors. Further, management of retail credit risk is governed by a Bank Board approved credit policy. These credit policies and credit processes of the Banks are prepared with the broad risk management objective. The oversight of the credit policy

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remains with the senior management. Banks generate plethora of information on the cause of riskiness, the severity and the risk mitigation actions, both as an internal management requirement and also a regulatory requirement. The credit limits for individual borrowers are subjectively determined in case of retail exposures. Recent attempts in the forms of no frill accounts or a general policy towards financial inclusion are beginnings yet to be visible in credit consumption. However, increasing population, increase in the number of households, per capital income, number of employed people and also per capita household income, etc provide the need for fulfilling the gap between the existing level of debt and income. The next section examines the growth of personal loans in India.

Personal Loans in India

We summarise the information provided by the RBI's statistical tables to understand the picture of personal finance in India. Table 1 provides the descriptive statistics of the personal loans and retail credit profile of India during the period 1996-2008. Subsequently Chart 1, Chart 2 and Chart 3 here provide the trend of retail credit consumption in India. During the observation period, the mean personal loan is Rs.12,463,240 Lakhs against a total bank credit of Rs. 66,899,292 Crores. This average personal loan amount is against a population of 1054 million with population on live employed register in the oprganised sector of only 41 millions. Within the group of personal loans, which is smaller than the Other Retail loans of Rs. 6867205 Lakhs,

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which is smaller than the largest housing loans Rs. 70,22,354 Lakhs. It may be mentioned that recently RBI had recently revised the risk weights applicable to the real estate exposure of banks which is not reflected here.

Table 1: Personal Loans and Employed Population in India (1996-2008)

Descriptive Statistics (Lakhs)

	Mean	Std. Deviation
Personal Loans	12,463,240	12,839,125
Consumer Durable Loans	2,086,070	5,069,145
Loans for Housing	7,022,354	8,214,339
Other Retail Loans	6,867,205	6,016,666
Total Credit	66,899,292	51,533,355
Population (Millions)	1054	69
Public Sector (Millions)	19	1
Private Sector (Millions)	9	1
Live Register Employed (Millions)	41	1

Source: Statistical Tables relating to banks in India (Reserve Bank of India)

Chart1: Personal Loan Composite Trend in India (1996-2008)

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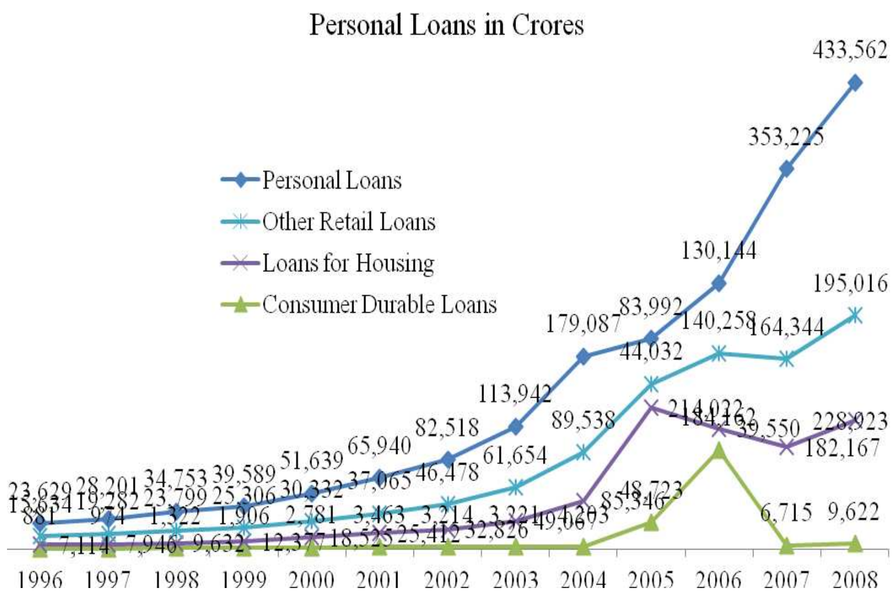

Chart 2: Shares in personal Loan Composition in India (1996-2008)

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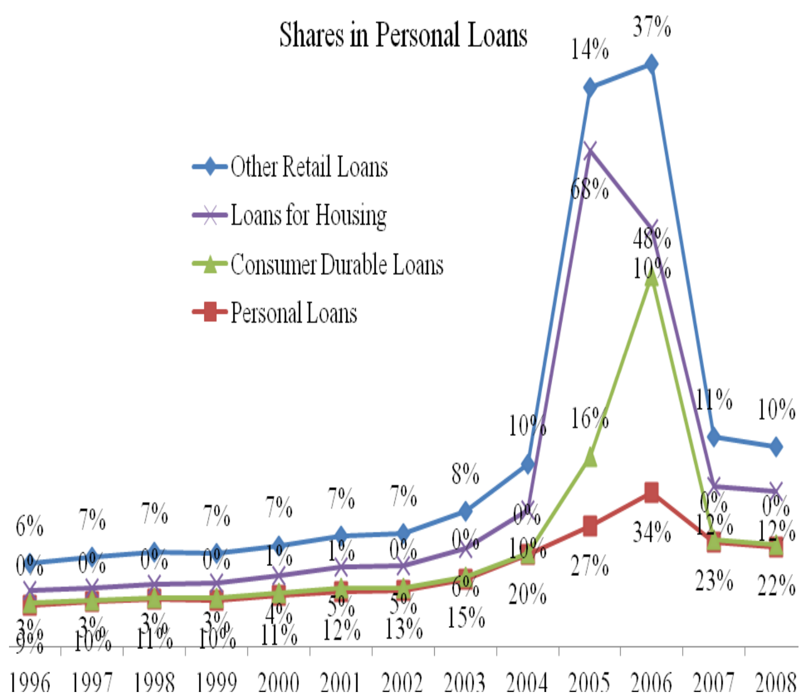

Chart1 provides the growth of personal loans and its components over the 12 year period. Retail credit has improved over a period of 12 years period which is evident from the upward trend here. Personal loans comprising the total of consumer durables, other retail loans and housing loans have consistently increased over the period with a significant jump post 2006, due to increase in home loans. However, consumer durable loans have seen fall in off take post 2005, which could be due to substitution with cash loans. Chart 2 provides the trends in the above

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personal loan categories by comparing their shares with respect to Total Bank credit. This provides the insight on the fact that post 2005, banks in general have shown their caution and conservatism towards personal finance and hence their shares have fallen. It can be seen that the housing loans had reached a peak share of 68% in 2005 and hence personal loans had reached a peak share of 35% in 2005. The fall could be due to revision in banks' credit policies.

Chart 3: Per Capita Income & Debt Trends in India (1996-2008)

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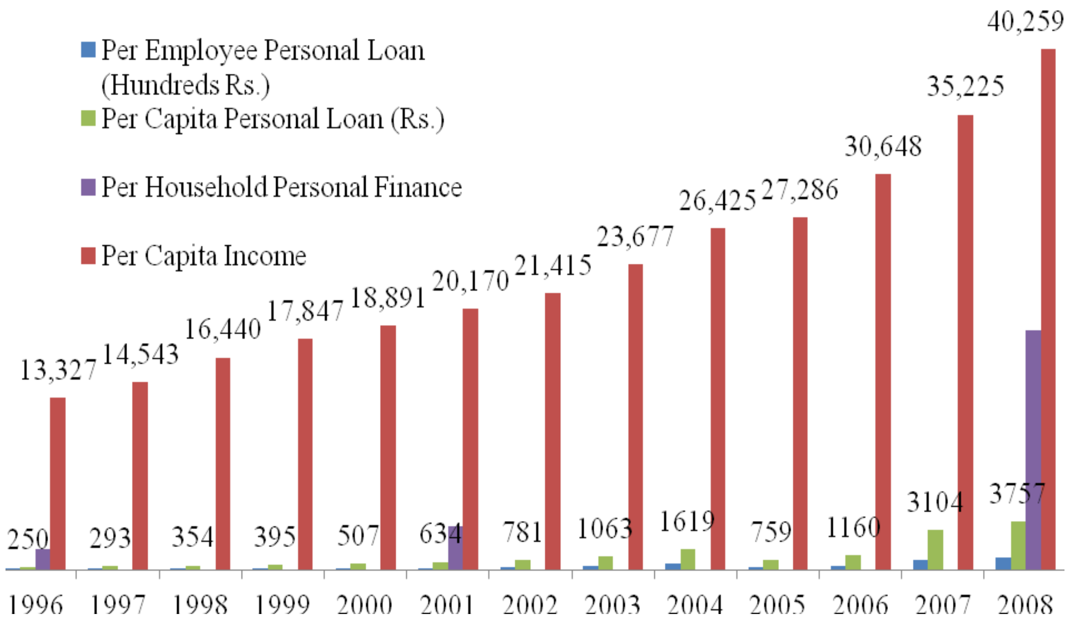

Similarly other retail categories have also seen a decline post 2005 due to policy level impact Chart 3 compares the per capita income versus per capita credit and also per employee personal loans. It also provides the trend in live register employed in oprganised sector along with the number of households. It is seen that per employee personal loans have gone up from a level of just Rs. 6037 in 1996 to Rs. 98500 in 2008, corresponding to the per capita personal loan of Rs. 250 in 1996 to over 25 times the per capita loan in 2008. No of households have also increased during this period. The number of households in 1996 was over 150,165,097 which increased to over 193,579,954 in 2001 and subsequently 233,579,954 in 2008. The

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growth in per capita personal finance has not out grown that of the per capita income. Similar is the case with respect to the households when the per capita income per households is more than that the per capital personal finance. The per household personal finance has risen from a level of Rs. 1,574 to Rs. 3,406 to Rs. 18,562, which is neglible compared to the increase in per capita income over the period. The real per capita income has risen from Rs.13,327 in 1996 to Rs. 40,259 in 2008. One possible method to reach the personal finance needs of the households is by using a combinations of tools such as the personal credit score of CIBIL or a credit foot print which may include the presence of an endowment (self owned property of house) or the status of a beneficiary (credit co-operative member, MNREGS or state govt. schemes beneficiary, etc). This provides the fact that the banking sector has a major role to play to supply credit to households for their consumption needs and the overall economic well being.

Conclusions and Policy Implications

This study attempted to examine macro trends in personal finance in India and to understand their implications for the policy makers in emerging markets such as India. It is true that historically personal finance has grown manifold since 1996. However their growth has not been significant looking at the levels of per capita income and also per capita house hold incomes in India. Increase in employment in the organized sector has definitely boosted the demand for retail credit. The gap between the income and debt levels is increasing which means banks

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have to revisit their credit policy to fulfill the needs. Credit information could come to the rescue of Banks. However, in the absence of credit information, banks could use other credit foot prints such as the presence of a family endowment (house or property) or the status of a central or state scheme beneficiary. We conclude that with or without financial inclusion, a large section of the population or households have remained unserved with retail credit products and the gap between incomes to debt at retail level is increasing. An existing level of riskiness in few risk segments may deter the banks towards a policy of open credit culture. Banks need to have a lending mindset by having better credit management tools instead of shying away from new sanctions. This can actually improve the credit eligibility and also build a culture of credit. Persistent emphasis on economic growth by the policy makers will help sustain the credit quality in the economy and improve economic well being.

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