June 2023

India Strategy

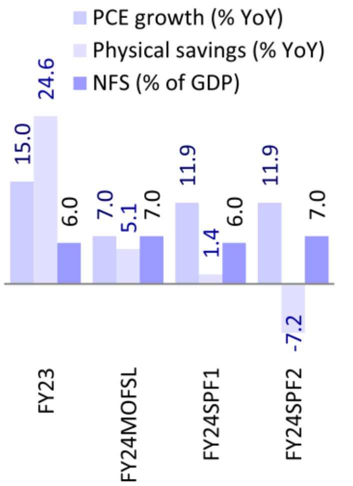
BSE Sensex: 63,915 **Nifty-50: 18,972**

Expect slowdown in consumption and/or real estate in FY24

It could disrupt the retail lending boom

- Private consumption accounts for about 60% of India's GDP. After falling to an all-time low of 56.2% of GDP in FY12, the share of private consumption increased to 59% of GDP in the pre-Covid period (FY16-FY19) and further to 61.3% of GDP in FY21, before easing to 60.6% of GDP in FY23, primarily due to very slow growth in 2HFY23. Although consumption is the primary economic activity for households, they also invest in residential properties (also called physical savings) and save in financial assets. Investments by households **account** for 35-40% of total investments in the country, totaling 11-12% of GDP.
- In the past couple of years, notwithstanding higher inflation, the consumption and real estate sectors have performed very well at the expense of financial savings. Our calculations suggest that net financial savings (NFS) dropped to a three-decade low of 6% of GDP in FY23, while physical savings increased to a decade-high of ~13% of GDP. However, in 2HFY23, the growth in private consumption and residential investments weakened substantially, boosting financial savings.
- Based on these estimates, we believe that NFS could have bottomed out and may rise in the near future. Thus, we expect household spending trends in FY24 to match more with 2HFY23, rather than 1HFY23. In that case, due to weak income growth this year, growth will subside significantly in either private consumption or real estate investments or both.
- According to the recent RBI survey of professional forecasters, although consumption growth is expected to weaken in FY24, its share in GDP is projected to rise, implying a further fall in household savings. It means the consensus is more inclined toward a sharp deterioration in the real estate sector, which could surprise investors. This could be a trigger to disrupt the mortgage lending growth within the retail lending boom seen during the past 9-10 quarters.
- Alternately, we expect the slowdown in private consumption to be more severe than the consensus projections, implying that the deterioration in real estate could be less intense. However, since non-mortgage personal loans are the fastest-growing category within household debt, this scenario could also be equally forceful in disrupting the retail lending boom. Overall, an expected slowdown in consumption and/or residential real estate in FY24 could unsettle credit growth in the country.
- Lastly, in stark contrast to our base case, FY24 could be a repeat of FY23 (or 1HFY23), wherein financial savings fall further, supporting private consumption and real estate. If so, it will certainly make FY24 more tolerable, pushing the above-mentioned concerns into FY25.

In contrast to our forecasts, the consensus sees a sharper deterioration in real estate sector in FY24



SPF1 assumes unchanged NFS, SPF2 assumes NFS at 7% of GDP
FY23 are MOFSL estimates
Source: RBI, CEIC, MOFSL

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Household financial position in FY23: Tale of two halves

- Private consumption expenditure (PCE) accounts for about 60% of India's GDP. This, we believe, is a more optimal ratio, compared to less than 50% share in China and South Korea, and about 70% share in the US and many European nations. After falling to an all-time low of 56.2% of GDP in FY12, the share of private consumption in India increased to 59% of GDP in the pre-Covid period (FY16-FY19) and further to 61.3% of GDP in FY21, before easing to 60.6% of GDP in FY23 *(Exhibit 1)*.
- Although consumption is the primary economic activity for the household sector in an economy, they also invest in residential property (= physical savings) and save in financial assets. As discussed in our **recently published note**, households accounted for as much as 43% of total investments in FY23, the highest share in 18 years.
- In other words, our estimates suggest that consumption spending accounted for 76.2% of personal disposable income (PDI) in FY23, the highest in 25 years (and same as in FY00 and FY17). Within the remaining 24% of PDI, the share of financial savings was just 7.4%, the lowest in more than three decades, while the share of physical savings was at a decade-high last year *(Exhibit 2)*.

Our estimates suggest that consumption spending accounted for 76.2% of personal disposable income (PDI) in FY23, the highest in 25 years (and same as in FY00 and FY17)

Exhibit 1: Real personal consumption growth has been very strong during the past two years…

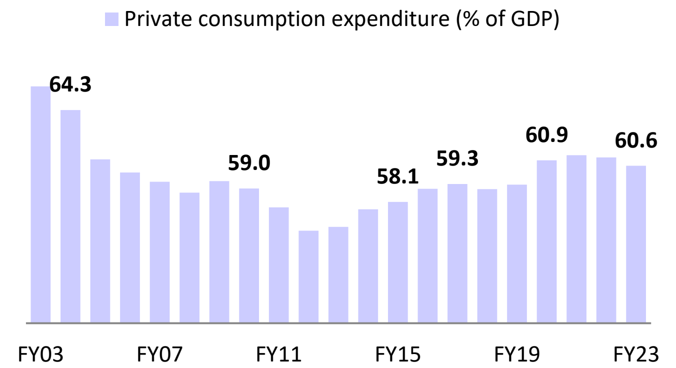
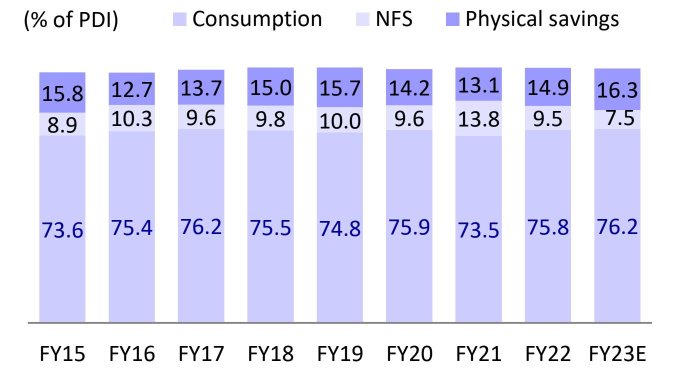


Exhibit 2: …and residential real estate sector has also increased tremendously



FY23 are MOFSL estimates FY22 PDI is also our estimates

Source: Central Statistics Office (CSO), CEIC, MOFSL

In 1HFY23, consumption growth was very strong, physical savings also grew sharply, but financial savings collapsed. It was a mirror image in 2HFY23.

- Importantly, the story of FY23 was of two halves. In 1HFY23, consumption growth was very strong, physical savings also grew sharply, but financial savings collapsed. It was a mirror image in 2HFY23, as financial savings recovered, while growth in consumption and physical savings moderated *(Exhibit 3-4)*. Please note all estimates regarding financial and physical savings in FY23 are our estimates, as the official data has not been updated since FY22.
- According to official estimates, nominal/real consumption growth subsided to just 7.6%/2.5% in 2HFY23, from 24.2%/13.6% in 1HFY23 and an average growth of 16.5%/9.4% in the previous two years (including 1HFY23). Our estimates suggest that growth in physical savings also moderated to 10.7% YoY in 2HFY23, compared to 37% YoY in 1HFY23. At the same time, NFS increased 23.1% YoY in 2HFY23, growing for the first time in the past four half-year period.

Exhibit 3: Growth in private consumption moderated substantially in 2HFY23

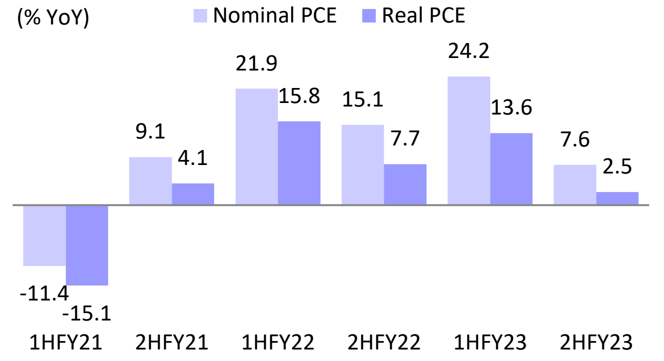
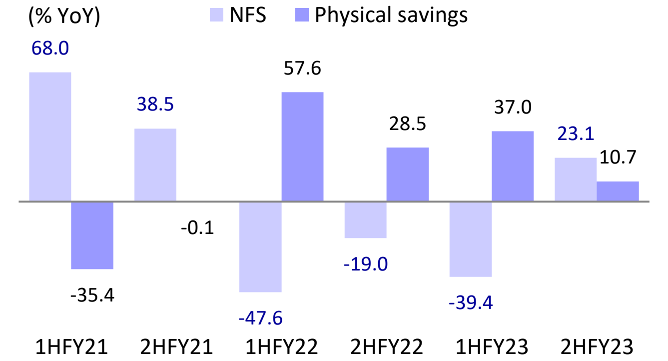


Exhibit 4: Growth in physical savings also moderated, as (net) financial savings recovered



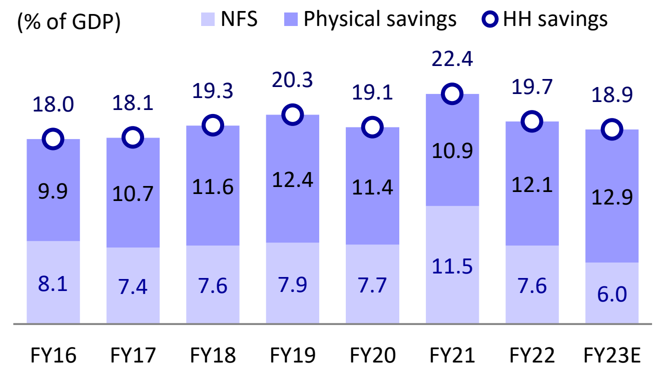
FY23 NFS and quarterly physical savings are MOFSL estimates
Source: CSO, RBI, CEIC, MOFSL

Our calculations suggest that NFS dropped to a three-decade low of 6% of GDP in FY23, while physical savings increased to a decade-high of ~13% of GDP.

Expect slowdown in consumption and/or real estate in FY24

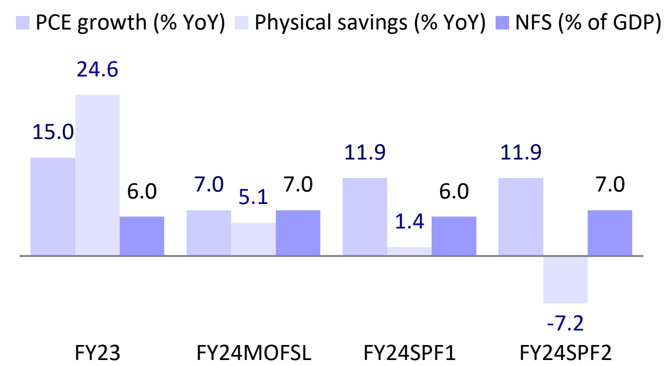
- Notwithstanding higher inflation during the past couple of years, the consumption and real estate sectors have performed very well at the cost of financial savings. Our calculations suggest that NFS dropped to a three-decade low of 6% of GDP in FY23, while physical savings increased to a decade-high of ~13% of GDP. However, in 2HFY23, consumption growth weakened substantially and the growth in physical savings moderated, boosting financial savings *(Exhibit 5)*.
- Based on our analysis and estimates, we believe NFS could have bottomed out and may rise in the near future. In short, our base case projection is that, in terms of household spending, FY24 will match 2HFY23, instead of 1HFY23. If so, with weaker income growth in FY24 (as is unanimously believed), growth is expected to subside significantly in either consumption and/or real estate investments this year. The former implies a broad-based slowdown (since consumption is a pervasive activity), while the latter signifies a reversal of upper hand in the K-shaped recovery (since property is by far the biggest ticket item purchased by a consumer in their lifetime).

Exhibit 5: Household NFS stood at three-decade low, though physical savings were at a decade-high in FY23



FY22 and FY23 are MOFSL estimates

Exhibit 6: In contrast to our forecasts, the consensus sees a sharper deterioration in real estate sector in FY24



SPF1 assumes unchanged NFS, SPF2 assumes NFS at 7% of GDP
FY23 are MOFSL estimates
Source: RBI, CEIC, MOFSL

The consensus seems more inclined toward a sharp deterioration in the real estate sector, which could catch investors by surprise.

- According to the recent RBI survey of professional forecasters (82nd round, the responses for which were received during 13th May to 2nd June, 2023), although consumption growth is expected to weaken in FY24, its share in GDP is projected to rise. As against an expected nominal GDP growth of 10% (assuming GDP deflator of ~4% with 6% real GDP growth), the consensus projects nominal PCE to grow 11.9% YoY in FY24. If achieved, this would mean a surge in the share of private consumption to 61.6% of GDP in FY24, higher than in FY21. It would also mean that household savings would fall further this year. If so, then the consensus seems more inclined toward a sharp deterioration in the real estate sector, which could catch investors by surprise. Assuming 11.9% growth in nominal PCE and ~10% growth in PDI (same as GDP), if NFS remain unchanged at 6% of GDP, growth in physical savings would be just 1.4% YoY in FY24, compared to ~25% YoY in FY23E (shown as scenario-SPF1 in *Exhibit 6* above). In contrast, an improvement in NFS to 7% of GDP would mean a contraction of 7.2% YoY in physical savings, worse than in FY20 and FY21 (scenario SPF2 above).

We believe that the slowdown in private consumption could be more severe than the consensus projection.

- Alternately, we believe that the slowdown in private consumption could be more severe than the consensus projection, leading to a further fall in the PCE-to-GDP ratio. Our forecasts suggest that nominal/real PCE growth could be only about 7%/4% YoY, implying the PCE-to-GDP ratio of 60% this year. Accordingly, the moderation in growth of residential real estate would be more gradual (at 5% YoY) than the consensus forecasts, and financial savings are likely to pick up toward 7% of GDP in FY24 *(Exhibit 6)*.
- Lastly, in stark contrast to the consensus and our base case, FY24 could be a repeat of 1HFY23, wherein financial savings fall further, supporting private consumption and real estate. For instance, assuming 10% nominal GDP/PDI growth and 11.9% growth in PCE, if physical savings also grow 10%, it would imply a fall in NFS to less than 5% of GDP this year, which is totally unsustainable. If so, this will certainly make FY24 more tolerable, pushing the above-mentioned concerns into FY25.

Slowdown could disrupt the retail lending boom

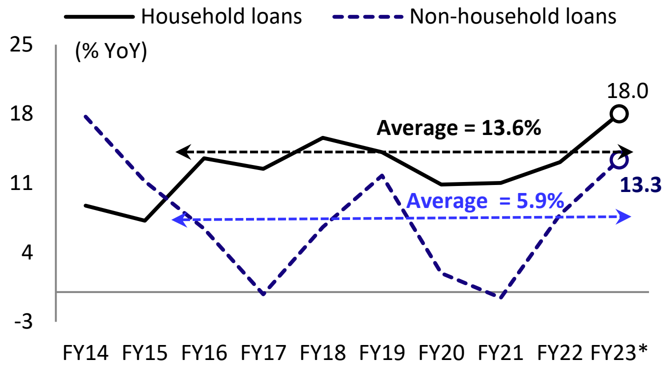
- Overall, we argue that there is a high probability of a significant slowdown in private consumption and/or residential real estate in FY24. This is because we do not believe (or hope) that financial savings could fall further from the three-decade lowest level in FY23. Since the household sector has been the key driver of bank credit growth in the past few years, such a slowdown could be a trigger to disrupt the retail lending boom.

The household sector now accounts for as much as 56% of the SCBs' loan book, up from 51% in FY20 and just 42% in FY15.

- It is well known that corporate lending has failed to pick up in the past many years. Household loan book (including agriculture, retail/personal and businesses/MSMEs) has grown at more than double the pace of growth in the non-household loan book of scheduled commercial banks (SCBs) during the past eight years (FY16-FY23). As against an average growth of 13.6% in household loans, the non-household loan book has posted an average growth of just 5.9% during the corresponding period *(Exhibit 7)*. Accordingly, the household sector now accounts for as much as 56% of the SCBs' loan book, up from 51% in FY20 and just 42% in FY15.

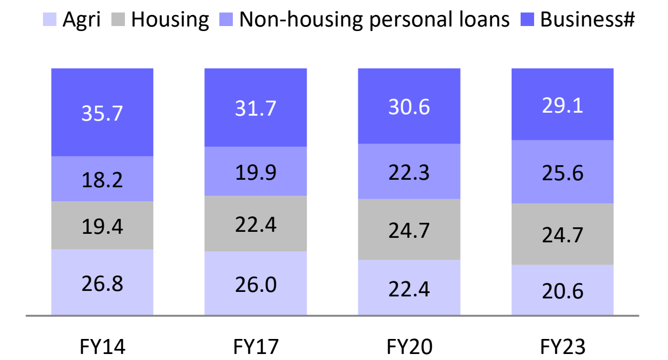
- Since banks account for about four-fifths of total household debt in the country, an analysis of their break-up suggests that non-housing personal loans have increased at a disproportionate pace during the past few years. Within SCBs' household loan book, the share of non-housing personal loans jumped to 25.6% in FY23, from just 18% a decade ago. The share of housing loans has also increased, while the share of agricultural and business loans has fallen *(Exhibit 8)*.

Exhibit 7: SCBs household loans have grown at more than double the pace in non-household loan book…



* FY23 data based on quarterly basic statistical return (BSR-1)

Exhibit 8: …and non-mortgage personal loans have grown at the fastest pace



Business is residual; Including industrial, services and other loans

Source: RBI, CEIC, MOFSL

- Therefore, a slowdown in private consumption is very likely to hurt growth in non-housing personal loans. If so, it is very likely that bank credit growth could weaken more than the current market expectations.
- Further, since physical savings are also expected to grow at a slower rate (assuming financial savings recover this year), mortgage loan growth (and thus, housing finance companies, along with SCBs) could also witness a deceleration in FY24.

An expected slowdown in household spending, driven by a recovery in financial savings in FY24, could restrict credit growth in the country.

- Overall, be it the market consensus or our base case, an expected slowdown in household spending, driven by a recovery in financial savings in FY24, could restrict credit growth in the country.

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UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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