The Return to Retail Lending*

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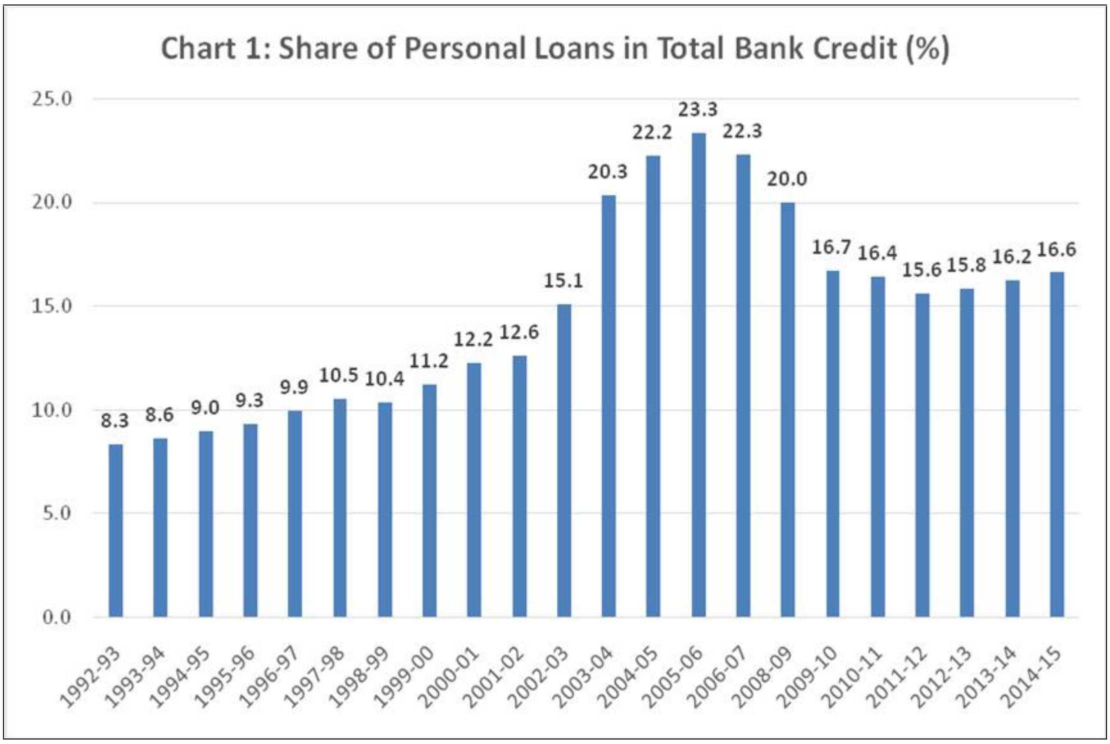
With an increase in the bad loans burdening the books of the banking sector, commercial banks once again seem to be focusing on the retail lending business. While broadly defined as lending to individuals, retail lending covers a host of loans: those meant for investment in housing, those for purchases of consumer durables and automobiles and those for education, deferred payments on credit card expenditures or unspecified purposes.

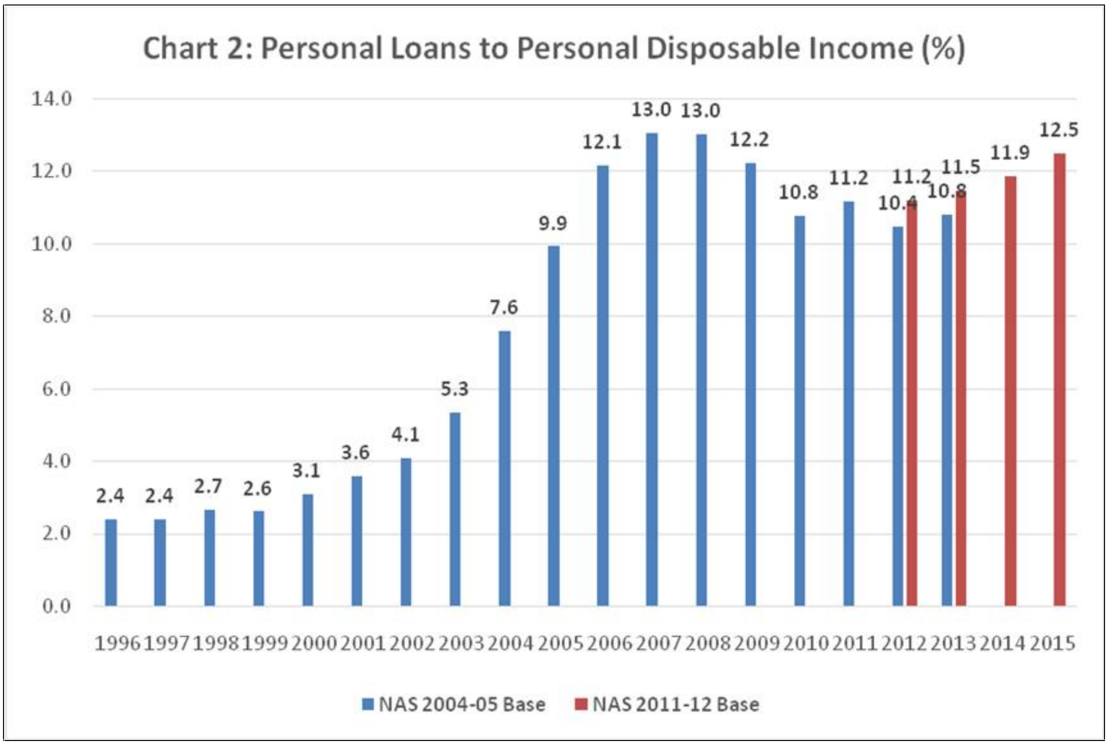
The post-liberalization changes in banking practices included an increased emphasis on retail lending, which transited from being a risky and cumbersome business to one considered easy to implement, profitable and relatively safe. In some instances, such as housing, the income earned (rent received) or expenditure saved (stoppage of rent payment) from the investment is seen as providing a part of the wherewithal needed to service the loan. In other areas, confidence that future incomes to be earned by the borrower would be adequate to meet interest and amortization payments provides the basis for enhanced retail lending.



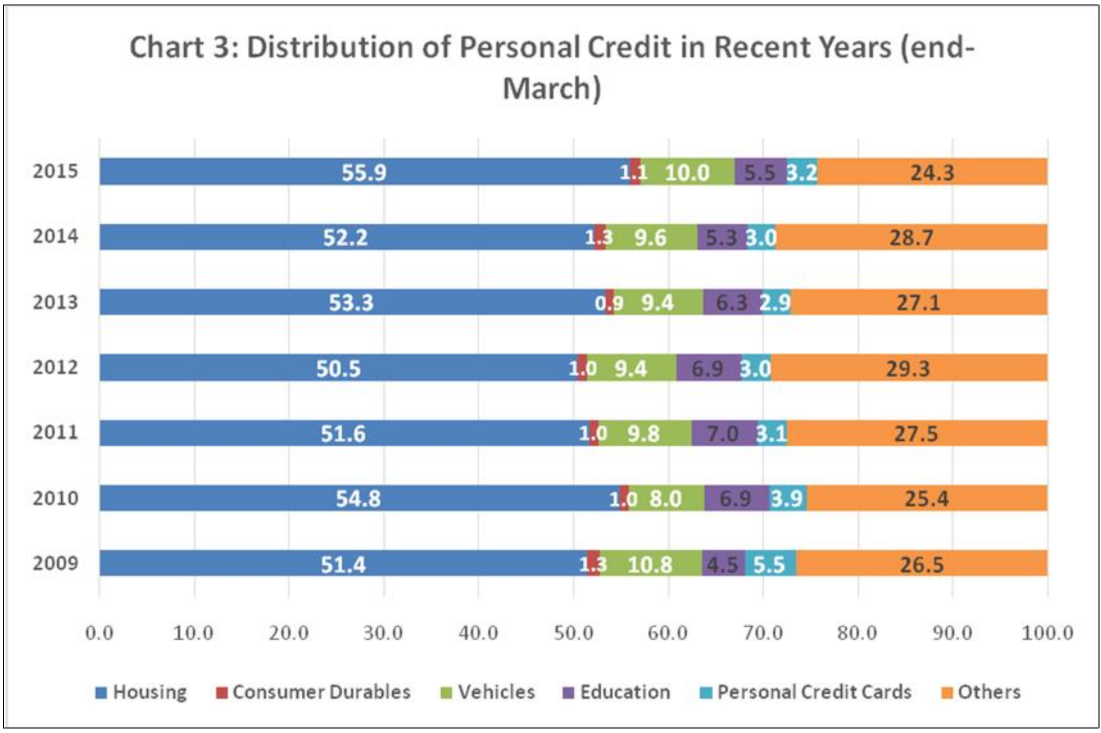
The result of the transition in perception has been a sharp increase in the share of retail lending in total advances since the early 1990s. After having risen gradually from 8.3 per cent of total outstanding bank credit at the end of 1992-93 to 12.6 per cent in 2001-02, the share of personal loans rose sharply to touch 23.3 per cent at the end of 2005-06 (Chart 1). This was a time when total bank credit too was booming. It is to be expected when there is a sharp increase in lending to a few sector of this kind, those who would have earlier been considered risky or not creditworthy could enter the universe of borrowers.

Not surprisingly, by this time the fear that overexposure could result in an increase in defaults had begun to be expressed. Addressing a seminar on risk management in October 2007, when the subprime crisis had just about unfolded in the US, veteran central banker and former chair of two committees on capital account convertibility, S.S. Tarapore, warned that India may be heading towards its own home-grown sub-prime crisis (Refer "Sub-prime crisis brewing here, warns Tarapore" Business Line, Wednesday, Oct 17, 2007). Banks too began to hold back as reflected in a gradual decline in the ratio of personal loans to gross bank credit from 23.3 per cent to 15.6 per cent in 2011-12. While this was still above the level at the beginning of the previous boom, the decline in share did suggest that the retail lending splurge had moderated.

However, more recently, this decline in the share of retail lending has reversed, rising from 15.6 per cent in 2011-12 to 16.6 per cent in 2014-15. Figures on rates of growth tell a clearer story. According to Care Ratings, over the financial years ending March 2015 and March 2016, while overall non-food credit grew at 8.6 and 9.1 per cent respectively, personal loan growth rates were 15.5 and 19.4 per cent respectively. Over the financial year ended March 2016, the home loan segment grew by 19.4 per cent, vehicle loans by 22 per cent, and credit card outstanding by 23.7 per cent.



The reason for this turn are not difficult to find. First, the other major area of growth in bank lending has been infrastructure, which today accounts for a large proportion of the non-performing assets on the books of the bigger banks. So banks have been seeking out new avenues of lending. With industry not performing too well and agriculture languishing, retail lending emerges as the preferred choice. Second, since retail lending was discouraged in the period prior to financial liberalization, the exposure of the retail sector to debt is still quite low. The ratio of personal loans to personal disposable income has indeed increased in India, from 2.4 per cent at the end of 1995-1996 to 13 per cent in 2007-08, and it still is at a historically high level of around 12.5 per cent (Chart 2). However, this is extremely low when compared with, say, South Korea, where in 2013, when it faced a housing loan crisis, the ratio of household debt to household disposable income was around 150 per cent. While that may be far too high a figure for a country like India with a much lower per capita income to approach, it has considerable headspace in this area. Finally, default rates on retail lending, even if increasing, are still quite low. In the case of the State Bank of India for example, NPAs in its retail loan portfolio are placed at a little above 1 per cent, whereas the aggregate NPA ratio is above 6 per cent according to recent estimates. So shifting to retail lending seems a sound idea.



That of course depends on the degree to which increasing exposure in the retail market requires diversifying the retail portfolio of banks. As of now, housing loans overwhelmingly dominate that portfolio, accounting for well above 50 per cent of the total (Chart 3). With loan-to-value ratios in housing still low in many cases, and housing serving as good collateral, NPAs in this segment are among the lowest. There are three other areas that account for a reasonable share of personal loans outstanding: automobiles, education and credit card outstanding.

Of these, while the automobile loan segment is not a high default area, education is definitely proving to be so. Government policy mandates provision of education loans of up to Rs. 4.5 lakh without collateral. So recovery too is difficult. Yet the inability to find jobs after financing education with loans is resulting in rising defaults, which, according to reports, average 8 per cent of such loans.

Moreover, well over a quarter of retail lending is in the “others” category, and possibly against shares, etc. by banks trying to build their retail portfolio. Here too, rising default is a probability as aggregate lending increases and recovery difficult.

That prospect notwithstanding, it is more than likely that India would witness another retail lending boom, led by banks trying to maximize their presence in this ostensibly underexploited area. That may well result in exposure of a kind that warrants the fears expressed earlier by the late S. S. Tarapore.

* **This article was originally published in the Business Line on August 1, 2016.**