India's Household Debt Crisis

> **Mains GS III** - *Indian Economy and issues relating to planning, mobilization, of resources.*

Why in News?

Household debt has surged dramatically in the years after the pandemic.

What is the status of house hold debt in India?

- **Household debt** – It refers to the total amount of debt owed by households to various financial institutions.
- It is measured as a percentage of GDP (Gross Domestic Product), representing the total borrowings of households relative to the size of the economy.
- **Components of household debt**
    - **Unsecured loans** - Personal loans, credit cards, consumer durables
    - **Secured loans** – Housing, Gold and vehicle loans
    - Retail credit from NBFCs (Non-Banking Finance Companies) and HFCs (Housing Finance Companies)
    - Loans from microfinance institutions
- **Household debt in India** – It has experienced a dramatic surge in the post-pandemic period
    - 2021 - 36.6% of GDP
    - 2023 - 40.2% of GDP
    - 2024 - 42.9% of GDP

> *Household debt averaged around 33% of GDP between 2015-2019, indicating a significant increase in recent years.*

- **Credit growth –** Between March 2021 and March 2024
    - Retail credit from NBFCs and housing finance companies grew by 70%
    - Loans from microfinance institutions rose by 67%
- **Shift in borrowing patterns** - There has been a noticeable shift towards unsecured loans for consumption rather than asset creation, particularly among lower-income groups.
- **High share of personal loans** - As of January 25, 2025, the personal loan book of banks was roughly a third of all credit extended.
- It is greater than loans to the services sector, industry and agriculture individually.

What factors contributed to rise in house hold debt?

- **Structural issues in economy** – The surge in household debt is a consequence of structural issues such as,
    - Inadequate job creation
    - Subdued income growth
- **Low income growth** – Household incomes have not grown at a pace to sustain consumption and savings.
    - Household disposable income growth - 43%
    - Bank personal loans growth - 75%.
    - Consumption growth- 49%

To slow down the credit growth and control household debt, RBI has increased risk weights on consumer credit for some segments in November 2023.

- **Aggressive lending practices** - Financial institutions, including banks and non-banking financial companies (NBFCs), aggressively expanded unsecured personal loans.
- Between March 26, 2021 and March 22, 2024, personal loans by the banking sector grew by 75 per cent.
- NBFCs' unsecured loan portfolios grew by approximately 130% during this period.

What are the challenges of high household debt burden?

- **Financial stress on households -** Greater indebtedness means a larger portion of disposable income goes toward loan repayment.
- **Low private consumption** – Higher debt servicing ratio leads to lower household disposable income.
- **More unsecured loans** – The unsecured personal loan book of banks rose by 82%, and NBFCs grew by 130%.
- Such loans were mostly availed by low-middle income class people
- This indicates that, post the pandemic, the less well-off went on a credit binge to support their consumption.

Credit binge refers to a period of excessive borrowing and spending, often characterized by a surge in credit card usage and debt accumulation.

- **Multiple loan burden** – Nearly 60% of personal loan customers had more than three active loans.
- In microfinance, almost 6% of borrowers had loans from four or more lenders.
- **Consumption based credit** - It is a matter of concern when more and more loans are taken for consumption purposes, and not for investment.
- **Expanding income inequality –** The debt burden appears to affect different income groups differently.
- Lower-income households (earning less than Rs.5 lakh annually) are taking *unsecured*

loans primarily for consumption needs which may widen existing socioeconomic divides.

- **Long-term financial security –** The shift toward consumption loans rather than investment loans may impact households' long-term financial security.
- **Economic burden on economy – T**he banks have been writing off unsecured retail loans, due to increase in NPA in retail loans.
- **Delinquency of loans -** India's microfinance sector faces rising delinquencies due to household over-indebtedness, with 27% of borrowers taking new loans to repay old ones.
- **Risk of debt trap** - When debt reaches unsustainable levels, households may face sudden *drops in living standards*.
- **Other concerns** - Reduced ability to invest in education, healthcare, and other areas that affect social mobility.
- Increased financial *anxiety and stress-related health issues.*
- Greater dependence on credit for basic needs.

What lies ahead?

- A possible solution to deal with could lie in the Indian Bankruptcy Code.
- Government could implement stronger regulations on multiple lending to the same borrower.
- Expanding financial literacy programs to improve household debt management.
- Boosting labour-intensive manufacturing through targeted industry incentives.

Reference

The Indian Express| India's Household Debt Crisis

Quick facts
Twin Balance Sheet Problem • The twin-balance sheet problem refers to deterioration in financial health of banks and corporates at the same time. • Twin balance sheet problem was the primary concern in the previous decade (before the pandemic). • **Over-leveraged corporate sector –** Companies took excessive debt. • **Banking system plagued by bad loans** – Financial institutions faced significant non-performing assets as overleveraged corporate sector cannot pay back loans. • **Economic impact** – This combination held back private investment in the economy • Post covid the Indian economy has moved away from the twin-balance sheet problem of banks and corporates to twin-balance sheet advantage. To know more about this, click here