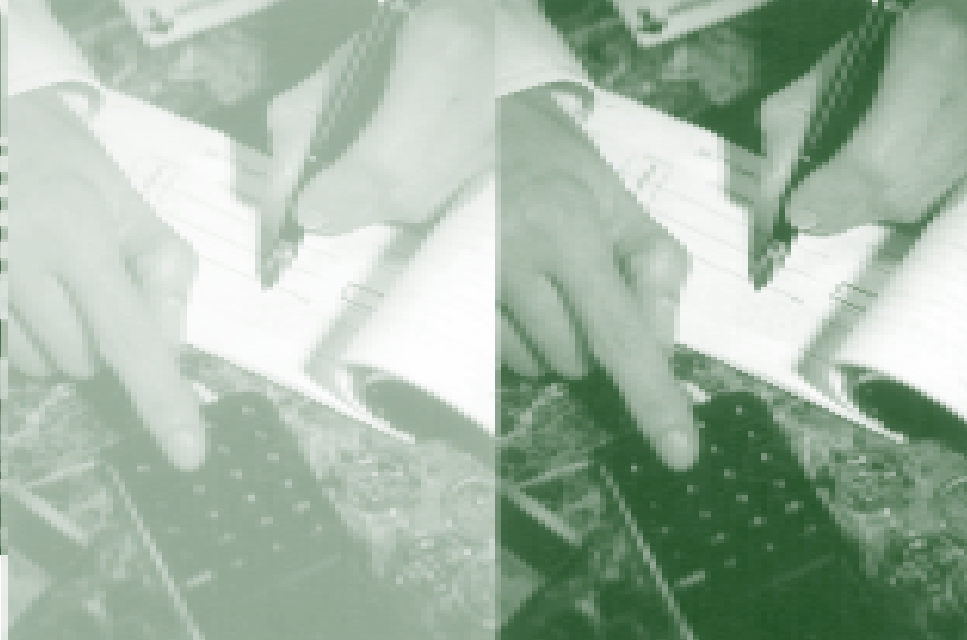




**BSE**  
The Stock Exchange of India

Annual Capital  
Market Review '03



SECTION 3 : MARKET TRENDS

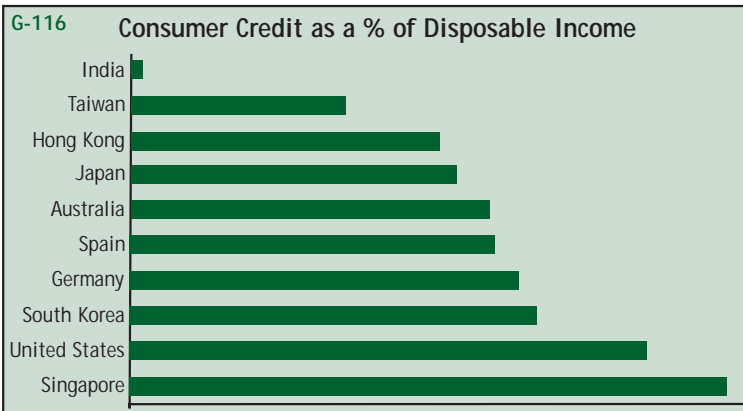
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# Consumer Credit

There is no gainsaying the fact that the resilience of the global economy to the recent downturn could be essentially credited to consumer spending. As unemployment rates spiked up and industrial activity subsided, the consumer dug deeper into the wallet to keep the engine moving. And moved it did. That being said, the shades of regurgitation were evident as delinquencies went up globally while in the US where mortgage refinancing counterbalanced the southward pressure on household assets, foreclosures were at a record high. The highly leveraged global consumer has shown symptoms of “throwing up” in certain economies such as Korea, where consumer spending has been strong enough to prompt increased weighting of that economy in key emerging market benchmark indices. However, potentially disastrous it might seem, strong credit culture still hasn’t penetrated as much as in United States in most of the developed world, leave alone emerging markets (see Chart ‘Consumer Credit as a % of disposable income’). For the same reason, most global consumers do not have to “pay-back” their splashing woes. If anything consumer credit is gathering strength globally, outside United States. In United States where consumers still spend in excess of that economy’s GDP, growth in revolving credit has slowed (see Chart ‘Consumer Revolving Credit – United States’) and banks and credit companies are looking elsewhere to sustain growth in receivables.



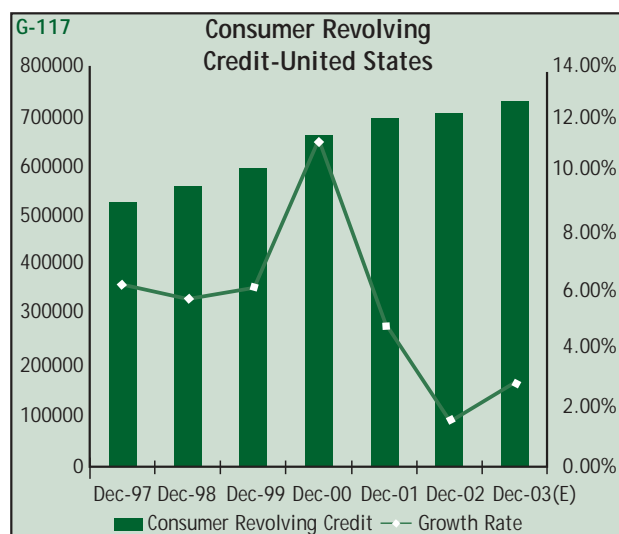
**Fast-forward to history** – Availability of credit history underpins a strong and vibrant consumer credit system in an economy. However a young credit system doesn’t preclude strong credit growth as we have seen in developed economies such as Spain and emerging countries such as South Africa and

Korea. Relative youth of centralized credit bureaus in these economies hasn't discouraged global players to venture into these markets in order to have a pre-emptive edge. Whichever way you look at it, is there much of a case in demanding credit history in economies that haven't had a strong credit system to begin with. It boils down to a question of scale. With consumer credit still at low levels of GDP, there hasn't been too much of volumes in these markets to justify having a centralized credit bureau. However as receivables growth continues, one might expect wider efforts on the part of policyholders to weed out inefficiencies in the system by having a strong system in place.

There is a strong case for having a centralized credit system. That said, it definitely isn't a be-all, end-all in itself. Take a look at the sub-prime market in United States. It was arguably the strongest component of the credit spectrum over the past 6 years as credit monolines tapped this credit hungry segment with intelligent risk based pricing to swell their risk adjusted margins. Credit checks on this segment historically kept the big banks away from this end of the spectrum – a segment that proved to be extremely profitable for those who knew how to manage it. Recent problems however busted this segment as unemployment rose with big names such as *NextCard* blowing up and other such as *Providian*, *Metris* and *Capital One* facing strong regulatory pressure. The problem was that unlike prime and super-prime consumers, consumers at the lower end of the credit spectrum didn't participate in the refinancing boom and were therefore unable to churn out equity from the mortgages. That doesn't however defeat the very argument that credit should be given where its due. Though delinquencies in the sub-prime segment reached historical peaks, smart lenders such as Capital One and the credit card giant MBNA continue to be able to cap delinquencies and manage their risk-adjusted margins. Managing credit through risk based pricing involves sophisticated proprietary risk models that do not stop at centralized risk information; rather they build upon it to channelize account acquisition activity. As more of these firms venture into emerging markets and other markets outside United States, it would provide a fillip to consumer credit and would force banks to re-evaluate their underwriting systems. This bodes well for the economy as a whole as the credit culture gets created in new economies.

**Another brick in the wall** – With more players converging and employment outlook improving, consumer credit is set to widen its roots in emerging economies. Lack of credit information, relaxed underwriting systems and a payment infrastructure that lacks penetration are just a few issues that need to be dealt with. That said, there remains a strong case for building presence in these markets as acquisition costs remain low and an adequate risk framework make these markets investible enough. Each potential obstacle could in effect be another brick in the wall towards developing a vibrant economy that can sustain strong growth in consumer spending through policy tools.

**Divergence in Performance: Lessons well learnt** – Consumer Credit growth and subsequent performance in markets have shown varying trends with careless origination activity in markets such as Korea leading to rising loss rates while subdued credit in markets such as Spain and South Africa delivering steady growth. While Spain arguably has one of the best infrastructures



Source: Federal Reserve

in Europe with ATM penetration higher than elsewhere in EU, South Africa, Mexico and few other emerging markets are creating a quality credit infrastructure of their own, which allows sophisticated data mining and risk management, allowing more and more players to give a serious look at these markets.

**The Indian household credit is still far from maturing with high interest rates and lack of bankruptcy and credit infrastructure precluding wide penetration. However receivables growth looks impressive albeit on a relatively lower base. As risk management infrastructure builds up, banks and monolines would press ahead into the country, giving a boost to household spending in an economy where services continue to show growth. As the dust settles globally on the consumer, there will be fewer players left, each ready to take a shot at the resurgent profligate.**

Korea was a case of extreme negligence with most Chaebol backed credit cards 'jumping the gun'. It was a case that defied the traditional oriental averseness to credit. While only 16% of personal consumption was transacted on credit cards as early as 1999, that number shot past 50% last year as household credit rose to close to 70% of GDP. The phenomena that was widely eulogized across the board turned out to be based on lackluster market and credit assessment and non-risk-based pricing – it was nothing but a push for policy loans. Delinquencies spiked up this year to over 12% on credit cards. However the huge spreads that issuers enjoyed kept the cushion intact. Nonetheless, the Korean credit explosion was stunning and others could take a lesson out of it in that volumes when combined with sound risk underwriting will keep the boat intact.

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