Business Standard

# India's consumption acceleration

**To benefit from the spending boom, we need guideposts to understand which goods will see a surge in demand and when**

**Akash Prakash April 23, 2019** Last Updated at 00:13 IST

Now that the Chinese economy has started to slow structurally, many investors are looking for the next driver of global consumption. In multiple products, be it smartphones or cars, Chinese demand has seemingly plateaued. Given that China was till recently driving global demand across products, the need for a new global consumption engine is obvious.

For most, India is the next frontier: A population of 1.3 billion people, median age below 30 and the world's fastest growing major economy. I have seen multiple reports recently from both financial analysts and consultants highlighting the India consumption potential. They all make use of a consumption acceleration framework loved by the consultant community, and used successfully to track and project consumption trajectories of multiple emerging economies at various stages of economic development.

The basic framework lays out the concept that demand, for certain goods and services, will grow disproportionately as incomes rise and the structure of demand shifts. Household spending on certain goods and services does not grow smoothly, despite steady income growth. Spending seems to accelerate on different products as we cross different income thresholds.

Here is an example taken from a recent Gavekal report: If an economy has a bell shaped income distribution curve and the average income of the economy were to grow by 25 per cent from \$10,000 to \$12,500, then the percentage of population earning more than \$15,000 would not increase by just 25 per cent. It would rise seven-fold from 2.3 per cent to 15.9 per cent. This is the acceleration dynamic at work. Obviously, demand for products consumed by this cohort would accelerate dramatically, much more than the 25 per cent headline growth in average incomes.

All the reports I have seen have tried to model this consumption acceleration phenomenon for India. To do so, one has to make certain modelling assumptions. First of all, one has to understand the income distribution curve of the country. While India does not have the bell shaped curve beloved of textbooks, there is limited data on the actual distribution. While we had a GDP per capita of \$2,000 in 2018, more than two-thirds of the population earned less than half of that. Therefore, income distribution in India has a very long tail. Most analysts look at proxies like the consumption data from sample surveys and build out a distribution curve.

Then you have to project income growth for the economy. Will we continue growing for another decade at greater than 7 per cent? The growth assumed makes a big difference. Most of the reports have India growing at between 7.5 per cent and 8 per cent for the next five years and then gradually tapering to 7 per cent thereafter.

One has to also model urbanisation, as urban incomes are much higher than rural incomes. Faster urbanisation will lead to greater consumption. In order to understand the impact on demand for specific goods and services, we need to establish certain income thresholds, at which consumption tips and starts to grow rapidly. Once you have established the income thresholds, you can model how many new households are entering each income cohort over the coming decade and its likely impact on consumption.

The cleanest categorisation I have seen is in the Gavekal report. They have three buckets, the first, called the emerging consumer, has an income level between Rs 2 lakh and Rs 5 lakh based on 2016 prices. This category tends to buy entry level smartphones and two-wheelers. The second category is the aspiring consumer, with an income between Rs 5 lakh and Rs 12 lakh. They can buy an entry-level car and start vacationing overseas. The final category is the affluent consumer with an income over Rs 12 lakh. They buy designer brands and prioritise experiences.

Looking through the various reports, their modelled income distribution and economic growth rates, with the above categorisation, certain conclusions are clear. Firstly, less than half of India's households are currently involved in the modern consumption economy. As per the Gavekal categorisation, today we have 71 million households in the emerging consumer bucket, 33 million as aspiring consumers and only 18 million in the affluent consumer bucket. That is only 120 million households, less than half the total economically engaged.

Using a scenario of nearly 8 per cent GDP growth till 2025, tapering to 7 per cent by 2030, combined with a continuation of current urbanisation trends, these number change drastically. Over the coming decade, we will see the number of households in the emerging consumer bucket double to 140 million, the aspiring consumers triple to over 100 million and affluent consumers quadruple to 72 million. The number of households involved in the modern consumer economy will move from 120 million to over 310 million.

To get a sense of how important economic growth is to this equation, consider this: A difference of two percentage points in GDP growth over a decade (difference between a high growth and low growth scenario) will change the number of households in the upper two consumption buckets from 193 million to 136 million. That is almost 60 million fewer households uplifted because of slower growth for just a 10-year period.

To understand the real impact of accelerating consumption for certain goods and services, we need to see not just the net numbers being added to each of the above three categories (as some households enter and others leave) but the gross additions to each category from the cohort below. Looking at it from this perspective, the last decade was clearly the era of the emerging consumer cohort. In 2009, about 2.5 million new households entered the emerging consumer bucket per annum, this has continuously grown and in 2019 about 12 million new households will enter this bucket ( data from Gavekal). This number will continue to grow, peaking at about 15 million by 2025. Thereafter, as India grows wealthier, the affluent consumer bucket will take leadership and start adding the most new households. From 4 million new consumers added in 2019, we will see almost 10 million new households being added annually to the affluent consumer grouping by 2025, and then 13 million by 2030. It will cross the emerging consumer grouping in new additions.

This switch from the emerging consumer grouping to the affluent consumer group in the coming decade as the biggest recipient of new consuming households will have some interesting implications.

Over the last decade, we saw a surge in consumption for those categories favoured by the emerging consumer grouping. Two-wheelers, for example, tripled in sales from seven million to over 21 million. Basic consumer goods also had strong growth as penetration rates improved across all categories.

Over the coming decade, as the aspiring consumer grouping gains more prominence, different categories should benefit — car sales, for one. Over the last decade, we have seen passenger vehicle sales grow from 1.2 million to 2.2 million, and the sales trajectory should accelerate in the coming decade, as by 2025, 10 million new consumers will enter the potential car purchasing income bucket per annum. Branded clothing and foreign travel are other categories poised to explode for exactly the same reasons.

India will grow through its own consumption acceleration dynamic just like we have seen in China and other emerging markets. It is critical to understand, however, what this acceleration will look like and which goods and services will be impacted in what time frame. An analysis like the one done by Gavekal and others are helpful guideposts in understanding this upcoming growth acceleration and how to position for it.

---

*The writer is with Amansa Capital*