India’s Consumption Puzzle: Wage Growth Problem Explained

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Wage Growth Problem Latest News

- With the Union Budget 2026–27 approaching, attention is shifting from consumer-focused measures to other growth drivers.
- This makes it timely to assess whether household consumption—after tax and GST support—has truly strengthened.

Policy Push to Support Consumption

- In 2025–26, the government took multiple steps to boost household consumption.
- Income tax rates under the new regime were cut, followed by long-awaited GST rate rationalisation in September, aimed at lowering prices and stimulating demand.
- Following GST cuts, demand for consumer durables rose, especially vehicle sales.
    - Data from TransUnion CIBIL showed consumer durable loan demand during the Dussehra–Diwali period rose about 1.5 times year-on-year, suggesting renewed consumer confidence.

- Lower taxes contributed to a sharp fall in headline retail inflation to a record 0.25% in October. However, the full benefit of tax cuts may not have been passed on to consumers.
- Some of the rise in demand may only be temporary, as many households postponed their purchases earlier and then bought everything at once after-tax cuts reduced prices.

Consumer Confidence Tells a Mixed Story

- The RBI's Consumer Confidence Survey (November 1–10) showed improvement in overall sentiment for both rural and urban households.
- Yet, a closer look reveals stress:
    - Rural households reported worsening perceptions of current income and spending.
    - Urban households saw a slight improvement in income perceptions but reported weaker current spending.

The Underlying Concern

- Despite supportive policy measures and headline indicators, income and spending perceptions remain fragile, particularly in rural areas.
- This suggests that India's consumption recovery may be uneven and vulnerable, with wage and income growth emerging as key constraints.

Inflation-Led Wage Gains Mask Underlying Weakness

- While rural demand is widely seen as improving, recent data show that the rebound in real rural wage growth has been driven mainly by **falling inflation** rather than strong income gains.
- Real rural wages rose to 4.1% in the first quarter of 2025–26 after stagnating for three years, largely because rural CPI inflation dropped sharply to 2.4%.
- Nominal rural wage growth stood at 6.5%, the highest since mid-2023, highlighting that sustaining consumption will depend on **continued wage growth**, not just low inflation.

India's Wage Growth: Inflation Is Doing the Heavy Lifting

- According to experts, nominal wages must keep pace with inflation, which bottomed out in late 2025 and is now expected to rise.
- If wages do not increase—especially relative to core inflation—any prolonged fall in food prices could hurt rural incomes and weaken future demand.

Urban Wages: Growth Limited by Flat Pay Increases

- Urban wage trends are often gauged through staff costs of listed companies.
- RBI data on over 3,000 non-financial firms shows real urban wage growth rose to 5.7% in July–September 2025, the highest in more than two years.
- However, this improvement was mainly due to low inflation of 2.1%.

- In nominal terms, urban wage growth stood at 7.8%, a level that has largely remained unchanged since mid-2023.

The Core Issue

- In both rural and urban areas, recent gains in real wages are driven more by low inflation than strong pay hikes.
- To sustain consumption as inflation rises, nominal wages will need to increase, not just rely on price softness.

Borrow to Spend: Rising Household Debt Clouds Demand Outlook

- While personal loan growth has picked up, it follows the RBI’s November 2023 move to rein in retail lending, especially unsecured loans.
- This highlights concerns over the sustainability of credit-led consumption.

Household Balance Sheets Under Stress

- Indian households’ financial health weakened after the pandemic as savings were used to cope with income shocks.
- As a result, household borrowing rose sharply:
    - Financial liabilities **increased** from 3.9% of GDP in 2019–20 to 6.2% in 2023–24, before easing to 4.7% in 2024–25.
    - Net financial assets **fell** to a multi-decade low of 4.9% of GDP in 2022–23, recovering only modestly to 6% in 2024–25.

Debt Rising Faster Than Income

- According to economists, between FY09 and FY23, **industrial wages** grew 1.9 times, while **real personal bank debt** rose 2.9 times, reaching 3.6 times by FY25.
- This points to a rising household debt burden relative to income.
- With households increasingly borrowing to sustain spending and future demand looking uncertain, **private investment remains subdued**.
- Businesses are hesitant to expand capacity when the strength of long-term consumption growth is unclear.

Limited Budget Room to Boost Consumption

- Economists believe the Union Budget offers little fiscal space for direct measures to drive consumption.
- According to them, existing support will continue as the RBI’s **125 basis points of rate cuts** in 2025 are still working through the economy.
- With inflation expected to remain benign, the Budget is likely to stay focused on capital expenditure and supporting labour-intensive export sectors affected by US tariffs, while maintaining fiscal discipline to preserve buffers for any future need to stimulate consumption.

Source: IE