DEBT SERVICE RATIO

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In our previous lessons we have studied the concepts of "liquidity" and "savings" ratio.

We now will discuss the concept of "Debt Service" ratio.

So what is “Debt Service” ratio?

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Debt Service ratio stands for the percentage of your income that goes towards the payment of debt. It shows how far you are from a debt trap

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Let's say your house EMI is Rs 20000, your car EMI is Rs 7000, your personal loan EMI is Rs 4000 and your credit card bill is Rs 2000. Thus the aggregated value of your total EMI per month is Rs 33,000.

Let's say your salary is Rs 100,000 per month. In this example your debt service ratio = Total EMI/Monthly Salary= (33000/100000)% = 33%

So how much should the debt service ratio be?

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1. A 30% to 35%debt service ratio is considered alright.
2. In case the income of an individual is high this ratio may go up to 40% to 45%
3. Anything above 45% is not advisable as that can bring you to the edge of a debt trap
4. Only if one earns an exceptionally high income, the debt service ratio can go beyond 45%

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Hope this lesson has succeeded in clarifying the significance of “debt service” ratio

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