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# Credit and Economic growth: India story

*Global economies have been tackling the challenges of uneven growth, divergence in global central bank actions, risk of looming war and escalating geo-political tensions. India on the other hand is one of the fastest growing emerging economies. It has the potential to achieve a robust growth of 8% surpassing its peers by harnessing the demographic dividend to its full potential supported by strong investment opportunities and sound macroeconomic fundamentals. Technological advancement and green energy will play a pivotal role. Higher economic activities will generate credit opportunities in the country. The study aims to analyze this relationship in the last few years across sectors.*

India's economy has been growing at a steady pace compared to its global counterparts. In more than a decade (last 12-years), the economy has registered a strong and steady growth of 5.9% even as it witnessed global health emergency such as Covid-19 pandemic. If this period is excluded, growth scales up further to 6.6% driven by structural reform measures, prudent fiscal management coupled with political stability. Notably in the last 12-years, the average nominal GDP growth stands at 11.1% and the SCB's credit growth at 11.7%. Notably, there is strong relationship between the credit growth and GDP growth. To understand this better further, the study attempts to analyze the impact of any change in credit growth to a change in GDP growth and this is denoted with a multiple factor or elasticity between these two variables. The analysis has been done for the period between FY12 and FY24 across different variables and this has been divided in to 2-phases of 5/6 years each.

The caveats to the study includes the following:

- The Covid-19 period (FY21 and FY22) has been excluded for some variables in phase-2 while calculating elasticity multiple as it doesn't provide an accurate picture.
- In order to avoid further distortion, any extreme values or outliers have also been excluded from the estimation.

**Table 1: Elasticity across economic sectors over two phases**

| Indicators | Phase-1 | Phase-2 |
|---|---|---|
| Agriculture Credit/Real Agri GVA | 2.4 | 2.8 |
| Industry Credit/IIP | 1.6 | 0.9 |
| Industry Credit/Industry GVA | 2.5 | 1.2 |
| Industry credit/Manufacturing GVA | 2.6 | 0.7 |
| Industry credit: Construction/Construction GVA | 2.9 | 2.4 |
| Service credit: Tourism, Hotels/Services GVA: Hotels & Restaurant | 1.4 | 2.0 |
| Services credit: Professional Services/Financial services GVA | 2.4 | 3.4 |
| Services credit: Comm Real Estate/Real estate GVA | 1.3 | 1.3 |
| Services credit/services GVA | 1.6 | 2.1 |
| Personal Loan (excl housing)/PFCE, current price | 1.1 | 1.9 |
| Housing Credit/Nominal GDP | 1.3 | 1.9 |
| Credit/Nominal GDP | 1.0 | 1.1 |

Source: CEIC, Bank of Baroda Research

The change in credit growth to change in Nominal GDP growth has remained steady in the last 12 years, with the average multiple for both phase-1 and phase-2 standing at 1.0 and 1.1 respectively. This simply implies if the nominal GDP of the country in FY25 is expected to grow by 10.5% as per the Budget. The credit growth therefore for the same period is likely to expand by at least 1.1*10.5%. The credit disbursals across sectors in the span of last 12-year has remain resilient. This can be understood better through sectoral analysis:

- *Credit to agriculture sector* has grown at a robust pace, with long run average growth of 11.7% from FY12 to FY14. Notably, growth in agriculture credit continued to remain buoyant even as other sectors were marred during the pandemic period. The steady growth in agriculture credit was attributed to ease of credit as a major percentage of these demands were fulfilled though institutional credit. Additionally timely initiatives such as moratorium facility, interest subvention by RBI and government also helped in curtailing losses. Notably, the elasticity of agriculture credit growth to Real agriculture GVA growth has noticed an improvement in Phase 2 at 2.8 level from 2.4 in the phase-1.

- The long run average growth to *industry credit* has remained stable at 6.7% in the last 12-years. Banks have been cautious in terms of lending, especially before the pandemic as the banking sector was facing a crisis due to rapidly increasing NPA. To counter the same, higher prudential measures were introduced by banks which has created healthy balance sheet and stronger credit system. Furthermore, to facilitate the credit to the industrial sector, special measures were introduced during the pandemic period such as ECLGS along with collateral free loans to cater to the MSMEs. Such schemes helped in improving the credit growth especially in the last 2-years.

- The elasticity of industrial credit to real industrial GVA has decelerated in phase 2 to 1.2 from 2.5 in Phase-1. Interestingly, the elasticity of industry credit to manufacturing GVA has also been lower in phase-2 at 0.7 (2.6 in phase-1). Some of the reasons attributed for this moderation include the following, there is access and easier availability of alternate sources of credit such as NBFCs route, borrowing from bond market and ECBs. There is also AIF (alternative investment fund) which provides access to private credit specially catering to those who are unable to avail credit form either bond market or banks. However, it is still at a developmental stage and needs monitoring at regulatory level.

- Credit disbursal to *services sector* has registered an average long term growth of 13.5% for the period ranging between FY12 and FY14. The sector recorded highest growth in FY24 at 23.5% and has been expanding at a steady pace over the years. The elasticity between services credit to services GVA has improved further in phase-2 to 2.1 from 1.6 in phase-1. Notably for the real estate sector, the elasticity for commercial real estate to real estate GVA has remained stable under both the phases. The elasticity multiple for credit to hotels and tourism to real GVA for hotels and restaurant has rather improved in phase 2 at 2 from 1.4 in phase-1, signifying growing credit demand from this sector.

- Banks have been focusing on expanding its retail loan book and that has resulted in higher credit disbursement across categories including personal loans, credit card outstanding and housing loans. The share of consumer credit to total credit has also been growing steadily and this includes both secured and unsecured lending. This has been further supported by higher elasticity in phase-2 (1.9 from 1.3 in phase-1) for the variables personal loan (excl housing) to nominal PFCE. The long run average growth for the last 12-years for Nominal PFCE has registered double digit growth of 11.9%.

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