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2019-20: An Enigma or an Anomaly***

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Slowdown of the Indian Economy during 2019-20: An Enigma or an Anomaly¹

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Abstract

In this paper, we analyze the deep and anomalous economic slowdown in 2019-20, when the Indian economy grew at a rate of 4 per cent, the lowest in a decade. We argue that the slowdown was largely confined to one year, 2019-20. The growth rate in the prior years averaged at 7 percent a year, and in none of the other years was it significantly below this average rate of growth. In contrast to some of the prevailing narratives, the slowdown did not permeate widely across sectors and activities. It was concentrated primarily in the manufacturing sector. The agriculture sector grew faster than before, and the services sector experienced only a mild deceleration, that too in the last two quarters of the year. On the demand side, the slowdown was primarily reflected in a sharp contraction in exports. In comparison, consumption decelerated by a milder amount, investment growth was broadly flat, and government expenditure grew at a faster pace than in the previous decade. The slowdown can be accounted for by the following three factors. First, about a 50 basis points worth of the slowdown was due to the COVID-induced lockdown in the last week of March 2020. Second, more than 100 basis points worth of the slowdown was due to the collapse in exports, attributed both to a large global slowdown in trade, and to the fact that India lost ground to other countries in maintaining its market share in a slowing market. Finally, the credit collapse from banks, Non-Banking Financial Companies (NBFCs), and Housing Finance Companies (HFCs) mattered, which likely made the lack of credit an impediment to production, investment, export, and consumption decisions.

¹ Comments are welcome at pgupta@nacer.org.

I. Introduction

Multiple diverse narratives prevail on the Indian economy. One of them suggests that it has been one of the fastest growing economies in the world, on the verge of catapulting into a growth trajectory of 8-10 per cent. Another one asserts that India's economy was experiencing a deep slowdown even prior to the advent of COVID and is unlikely to recover from it soon. These conflicting narratives are being rehashed as the economy recovers from the ravages of the COVID pandemic and prepares to settle into a new equilibrium growth trajectory. But what would the post-COVID growth trajectory look like?

The projection of future growth rates is harder due to the fact that breaking a continuous streak of a nearly 7 percent growth rate during the previous years, growth slowed down ominously to barely 4 percent at the onset of Covid.² Deceleration of growth to 4 per cent seems to be an aberration, given that the estimates of structural growth are much higher for the Indian economy, and there were no apparent shocks that impacted the economy during 2019-20 that justify a slowdown of this extent.³ Most of the large economic or policy shocks occurred in the years prior to 2019-20, e.g., demonetization in 2016-17, implementation of GST in 2017-18, and a capital flow reversal episode in 2018-19. Yet, the economy registered healthy growth rates of 8.3, 6.8, and 6.5 percent, respectively, during these years, an average of 7.3 percent which was highest in the world (Panagariya, 2022).

A number of growth-supportive reforms were announced in 2019-20. The major ones included reduction in corporate tax rates, a consistently accommodating monetary policy, and reforms aimed at improving the business environment, including a relaxation in FDI limits in specific sectors. Besides, the GST tax design and tax revenues had started to stabilize, and macroeconomic stability was maintained throughout the year.⁴

The answer to the question as to where post-COVID growth rates will settle, hinges on the factors to which the slowdown in 2019-20 can be attributed. Was there indeed a structural breakdown of the growth process in the Indian economy that would be hard to mend? What could be the scope for policies to influence the specific drivers of growth?

In order to better understand what ailed the economy during 2019-20, we conduct a detailed accounting exercise as a starting point, in which we decompose and attribute the deceleration in the Gross Domestic Product (GDP) to different economic activities. We establish that the slowdown can be primarily accounted for by the manufacturing sector, which contracted by 2.4 percent during the year, as compared to an annual average growth rate of 7.4 percent in the previous years. Agriculture, on the other hand, grew at 4.3 percent, higher than the average of the previous years; and the services sector experienced a relatively milder deceleration, growing by 7.2 percent, as compared to 8.2 percent in previous years. Within industry, besides manufacturing, construction activity started on a weak note at the beginning of the year and

² We are using the First Revised Estimates of the GDP released on 29 January 2021. The Second Revised Estimate for 2019-20 was released on 31 January 2022.

³ Most estimates indicate India's potential growth rate to be much higher than 4 percent. An RBI working paper, 2016, estimated India's potential growth rate to be 8 percent during 2003-08, and 7 percent during the years thereafter. IMF's Article IV report for October 2021 estimated India's potential growth in the medium- to long-term to 7.3 percent.

⁴ The years refer to fiscal years in the paper unless otherwise indicated. For example, 2019 refers to fiscal year 2018-19, which runs from 1 April 2018, until 31 March 2019. GDP refers to GDP at market price, unless otherwise indicated. We are not addressing issues related to data quality that have been raised vociferously in Subramanian and Felman (2019), and that have been equally zealously rejected by many others (Purnanandam, 2019; *Economic Survey*, 2019-20). While a full rebuttal of the former is beyond the scope of this paper, it is important to note that the national accounts data that yielded an economic contraction of 24 percent in the first quarter of 2020-21, and an annual contraction of 7.5 percent during the full year, is unlikely to have an inherent upward growth bias.

weakened further during the year. Within the services sector, the deceleration was concentrated in the last two quarters of the year.

An analysis of GDP growth from the expenditure side indicates that private consumption was steady in the first three quarters when the growth rate averaged at 7 percent, identical to the growth rate of the previous years. It was in the last quarter that consumption growth slowed down sharply to 1.9 percent. Government expenditure grew at a robust rate of 7.9 percent during the year, higher than the average of 5.8 percent achieved during the previous years. Investment growth (Gross Fixed Capital Formation) too was relatively stable at 5.4 percent, as compared to a marginally high rate of 5.9 percent recorded in previous years.⁵

It was the exports that were hit precipitously during the year. Taken together, the exports of goods and services contracted by 3.3 percent, as compared to the annual growth rate of 4.6 percent achieved in previous years. The exports of goods, accounting for 60 percent of India's exports basket, contracted by 6 percent, as compared to an annual growth rate of 3.4 percent in previous years. Although the slowdown in services exports was less steep, it was still significant, with services exports slowing down to 1 percent from a growth of 7 percent witnessed in previous years. Imports too declined during the year, contracting by 0.8 percent in contrast to a growth rate of 3.3 percent recorded in previous years.

The next obvious question to ask is: What can the slowdown in manufacturing, construction, and services as a part of the Gross Value Added (GVA), and in exports and consumption as a part of the GDP, be attributed to? We analyze three possibilities. The first is the impact of COVID. A number of high-frequency indicators show that economic activity collapsed in March 2020, just as it did subsequently in the first quarter of 2020-21. India imposed a curfew for 14 hours on 22 March 2020; followed by a full-fledged nationwide lockdown starting on March 25, which eventually lasted until 31 May 2020.⁶ While these lockdowns impacted economic activity precipitously, the economy had perhaps already started to weaken prior to the lockdowns as COVID spread in parts of China, Europe, and the US. Despite the fact that the formal lockdown in India was confined to the last week of March 2020, based on the extent of the decline in economic activity in the first quarter of 2020-21, our estimate shows that it shaved off nearly 50 basis points from the annual growth rate in that one week alone.

A second important factor was the slowdown in global trade, which impacted India too. Global trade has been slowing down for nearly a decade. After growing at about 10 percent a year during the period 2001-2012, it grew by only 1.5 percent a year between 2013 and 2018, and contracted by 1.5 percent in 2019 (as per the data provided in the World Development Indicators, WDI). The prevalence of slow economic growth globally, trade tensions, and increased economic and policy uncertainty are likely to have fueled this contraction (IMF, 2019).

Indian exports correlate strongly with the global trade volumes. Goods and services exports together contributed a negative 0.70 percentage points to growth in 2019-20, as compared to a positive contribution of 100 basis points in previous years. Thus, the decline in exports accounted for nearly 170 basis points of the growth turnaround in 2019-20. Here, it may be argued that since exports are import-intensive, we need to account for the slowdown in imports that accompanied the slowdown in exports. We assume a 33 percent import intensity of exports. Even after correcting for a commensurate decline in imports, nearly 120 basis points of the contribution in the decline in growth can be attributed to the collapse in net exports.

⁵ While fixed investment experienced steady growth, it was stocks that contracted sharply during the year. Stocks account for 2 percent of GDP, and are generally volatile.

⁶ On 19 March 2020, the Government announced a 14-hour long 'Janata Curfew' (people's curfew) to be observed on Sunday, 22 March 2020. Thereafter, on March 24, it announced a nationwide lockdown starting from 25 March 2020 for a period of 21 days, which was later extended twice until 31 May 2020.

A last factor that stands out, and which potentially contributed to the slowdown in growth, is the collapse of credit from the banks and the Non-Banking Financial Companies (NBFCs) during the year. Nominal bank credit growth grew at 6.5 percent during 2019-20, which was much slower than the rate of growth of nominal GDP, and the rate of growth credit of in the previous years, when nominal credit grew at 8.7 percent during the period 2013-14 to 2018-19; and at 23 percent in the decade of the 2000s. NBFCs picked up the slack for a few years, growing at 18 percent a year during the period 2013-14 to 2018-19, but their credit growth too slowed down to 7 percent in 2019-20. Meanwhile, credit growth by the Housing Finance Companies (HFCs) almost completely died down, and credit from the Cooperative banks too slowed down. The RBI's Report, "Trend and Progress on Banking in India", attributes the credit declines to risk aversion, impaired balance sheets (especially of the NBFCs), higher cost of funds, liquidity squeeze, and rating downgrades of the NBFCs.⁷

The growth post-COVID will be contingent upon maintaining and actively seeking greater integration with the global markets. Going forward, recovery in the global trade for goods and services, and accessing a large, diversified, and durable share of this market would be important. Not all emerging markets lost exports proportionally when global trade slowed down during the last decade. Several countries gained market shares even in a slowing market, including Bangladesh, Cambodia, Vietnam, and others.

Currently, India supplies only 1.5 percent of the global market for goods, and 3.5 percent of the global market for services. The aim could be to increase the shares of the global market for goods and services to at least 5 percent each. All the three sectors of the economy, that is, agriculture, industry, and services, can contribute more to growth if they are able to access a larger foreign market. The government as well as the private sector can play an active role in expanding the market size, through new trade agreements, as well as commercial collaborations.⁸ Examples from other countries show that it is feasible to grow exports even in a slowing market, by remaining competitive, forging new trade opportunities and securing new markets, and maintaining a relatively competitive exchange rate.

Growth will also depend on re-imagining India's financial sector space. Financial stability had emerged as a potential risk a few years ago. Due to a series of efforts, the sector is now stable. However, despite becoming stable, credit growth by the public sector banks has remained lackluster. Between 2015 and 2020, the credit growth of public sector banks was 3.2 percent a year, as compared to 18 per cent a year for private banks. This is despite an infusion of nearly 2.5 percent of GDP in recapitalization of the public sector banks, equivalent to 4 per cent of their assets, over the past 10 years. As a result, the share of public sector banks in total banking has declined, from nearly 80 per cent of the total loans outstanding in 2010 to less than 60 percent in 2020.

Despite interest rates having remained low in the past, credit growth has remained anemic.⁹ Due to the very slow pace of credit growth from public sector banks, creditors have started leveraging credit from private banks as well as the non-bank sources of credit—NBFCs, equity markets, private equity and debt, and the external commercial borrowings.

It is about time that the policy and regulatory attention is focused on holistically developing the financial sector. The time seems ripe to rethink the role and scale of the banking sector, especially that of the public sector banks, and to enhance the role of well-regulated and well-capitalized private sector banks. Public sector banks may continue to play the niche role of investing in government securities, priority sectors, and meeting the inclusion and social objectives as are deemed to be important. They will need to be right-sized to play this role. Meanwhile, the needs of the private sector may continue to be met more

⁷ These took place in the aftermath of the default by Infrastructure Leasing and Financial Services Ltd (IL&FS) on its debt payment obligations in September 2018.

⁸ See Freund and Pierola (2012), and Eichengreen and Gupta (2013) on the importance of the exchange rate for achieving success in exports.

⁹ Raghunath (2021).

effectively by more nimble and dynamic private banks, and debt and equity markets. NBFCs and HFCs play an important role in meeting the financing requirements of Micro, Small and Medium Enterprises (MSMEs) and households, and they too ought to be enabled to grow in a well-regulated environment.

The government currently holds 81 percent of the (unweighted average) equity in public sector banks. As per the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, the government must hold a 51 percent stake in public sector banks at all times. Thus, the government's stake can be brought down to about 51 percent, even before any planned outright change in ownership. Research shows that even a partial decline in State ownership results in improved performance. The proceeds from such partial privatization may be used as seed money to start new private banks or foster growth in the existing ones, with a clear pathway to redeem this stake in a few years.¹⁰

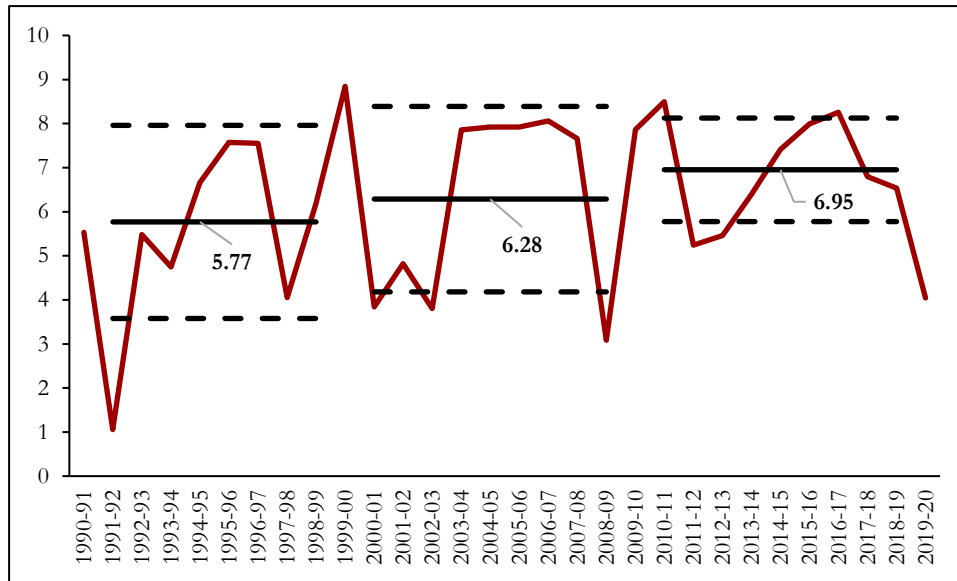
II. Was the Slowdown during 2019-20 a Multi-year Structural Slowdown?

As established in Ahmad et al. (2018), economic growth in India has steadily accelerated over the past three decades. The annual growth rate accelerated from 5.8 percent during the 1990s to 6.3 percent during the 2000s, and further to 6.9 percent during 2010-2019 (Figure 1). There have been the usual variations around these decadal averages due to the domestic business cycle, and the global trade and liquidity conditions. Even though growth accelerated temporarily to 8.3 percent, much above the decadal average, in 2016-17, it reverted to the average in the following two years. Thus, during 2017-18 and 2018-19, when growth rates equaled 6.75 percent and 6.5 percent, respectively, they did not display a structural slowdown, but remained within a one standard deviation band around the average (Table 1). On the other hand, the sharp slowdown in the growth rate to about 4 percent in 2019-20 seemed to be an anomaly rather than a routine deviation from the trend growth rate, both because it was a third year of below average growth—going by the duration of other business cycles in India, growth should have started to revert by this time—and because of the extent of the slowdown.

Thus, contrary to some other views which perceive the slowdown to be a multi-year affair, lasting from 2017-18 until 2019-20, or even worse that India has lost out a decade worth of growth, we believe that due to the reasons cited above, 2019-20 was an idiosyncratic year, necessitating a thorough understanding of the sources of the slowdown. Incidentally, since the economy was severely impacted by the COVID pandemic during the following two years, it is not possible to establish a pattern of slowdown extending further into subsequent years. Thus, 2019-20 ought to be analyzed as a standalone year.

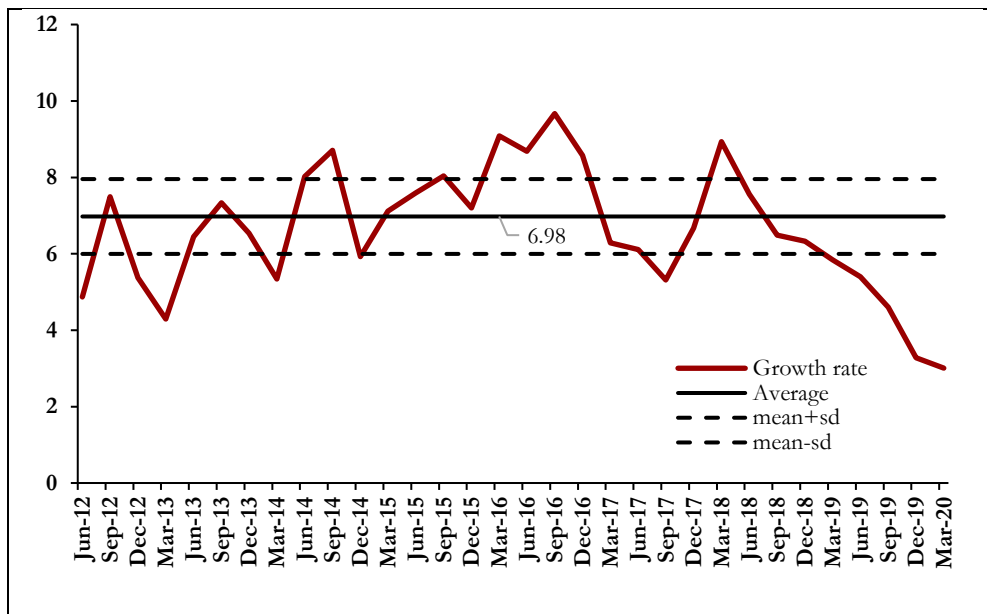
¹⁰ See, Sarkar and Sensarma (2010). A new bill was slated to be introduced in the Parliament to allow lowering of the Government's minimum shareholding to 26 percent, but has not been introduced as yet. (<https://www.cnbctv18.com/finance/centre-may-not-completely-offload-its-stake-in-two-public-sector-banks-report-11603432.htm>.)

Figure 1: Long-term Growth Trend and Aberrations Therefrom



Source: National Accounts Statistics (NAS), downloaded from the CEIC database. *Note:* ‘Year’ refers to the year in which the corresponding financial year ends. The decadal averages (in solid black lines) have been presented for the years 1991-2000, 2001-2010, 2011-2019, with one standard deviation above and below (represented by dashed black lines).

Figure 2: Quarterly Growth Rates and One Standard Deviation Band



Source: NAS, downloaded from the CEIC database. *Note:* The average (in solid black line) is the annual average from 2012-13 to 2018-19, with one standard deviation above and below (represented by dashed black lines).

*Why do we not consider 2018-19 in the analysis?*¹¹

Some observers have commented that the economic slowdown in India started in 2018-19 when growth averaged at about 6.5 percent a year. However, when compared to the average growth rate of about 6.8 percent during the rest of the decade prior to 2018-19, the growth rate of 6.5 percent is not statistically different. Besides, in our analysis of the quarterly growth rates of GDP, GVA and its components, the growth rate for 2018-19 is not statistically below the average of the previous years, Table 1. However, the growth in 2019-20 is nearly 3 percentage points below the average figure for the other years.¹²

Table 1: Annual and Quarterly Averages for GDP Growth

	(1) 2012-2013	(2) 2013-2014	(3) 2014-2015	(4) 2015-2016	(5) 2016-2017	(6) 2017-2018	(7) 2018-2019	(8) 2019-2020
Dummy for the first quarter, Q1	7.00*** (16.71)	6.87*** (13.77)	6.72*** (14.25)	6.64*** (13.42)	6.60*** (15.65)	6.82*** (13.36)	6.85*** (13.75)	7.20*** (15.35)
Dummy for the second quarter Q2	7.37*** (11.32)	7.24*** (11.45)	7.09*** (11.91)	7.01*** (11.25)	6.97*** (13.38)	7.19*** (11.68)	7.22*** (11.52)	7.57*** (15.28)
Dummy for the third quarter Q3	6.40*** (11.45)	6.27*** (10.97)	6.12*** (10.51)	6.04*** (10.88)	6.00*** (13.11)	6.22*** (10.76)	6.25*** (10.95)	6.60*** (18.33)
Dummy for the fourth quarter Q4	6.40*** (8.63)	6.27*** (8.02)	6.12*** (7.85)	6.05*** (8.82)	6.00*** (7.39)	6.22*** (8.38)	6.25*** (7.92)	6.60*** (10.53)
Dummy for years as indicated in the top row	-1.28* (2.13)	-0.24 (0.57)	0.93 (1.84)	1.54* (2.69)	1.91** (3.14)	0.15 (0.15)	-0.08 (0.18)	-2.92*** (6.36)
Number of observations	32	32	32	32	32	32	32	32

Source: Data has been collected from NAS. *Note:* t statistics in parentheses. * p<0.05, ** p<0.01, *** p<0.001. Quarterly data has been included for 2012-13 to 2019-20. Standard errors are robust. The annual dummy in each regression is a dummy for each financial year from 2012-13 to 2019-20.

III. Accounting for the Growth Slowdown in 2019-20

We analyze the disaggregated economic growth in 2019-20 and compare it with the average of the period 2012-13 to 2018-19. There are two different ways in which we can disaggregate the National

¹¹ In Figure 1, we took the decade of 2010-11 until 2018-19 as the reference period. GDP growth from 2012-13 is available for the base year 2011-12, while the GDP series prior to that is available for the base year 2004-05. Even though splicing the GDP series with different base years should be a straightforward exercise, and even a back-casted series is available at annual frequency, splicing these series for disaggregated sectors and activities at quarterly frequency gets more complex, and at times, incompatible. Thus, in our analysis hereon, we use the period 2012-13 to 2018-19 as our reference period. Since the mean and standard deviation of the GDP growth rate is similar for the period 2010-11 to 2018-19 and for 2012-13 to 2018-19, this choice is immaterial.

¹² Growth drifted slightly below the decadal mean minus one standard deviation in the last quarter of 2018-19. While we could have included this quarter into the period of analysis, we deemed it simpler to only focus on one year, rather than five quarters over two different fiscal years.

Accounts data: from the sectoral side, also known as the ‘production side’, and from the demand or what is known as the ‘uses side’. On the production side, we examine the contribution of different activities, such as agriculture, industry, and services to the growth of GVA. We further decompose industry into manufacturing, mining, construction, electricity, gas and water supply. Likewise, the services sector can be analyzed by dividing it into more detailed activities.

On the uses side, GDP is accounted for by personal consumption expenditure, government consumption expenditure, investment, and exports, net of imports. For both GVA and GDP, the year started on a weak note, and the pace of deceleration picked up as the year progressed. It remained more than one standard deviation below the average of the last seven years in all the four quarters of the year.

(i) Growth Slowdown of the GVA, from a Sectoral Perspective

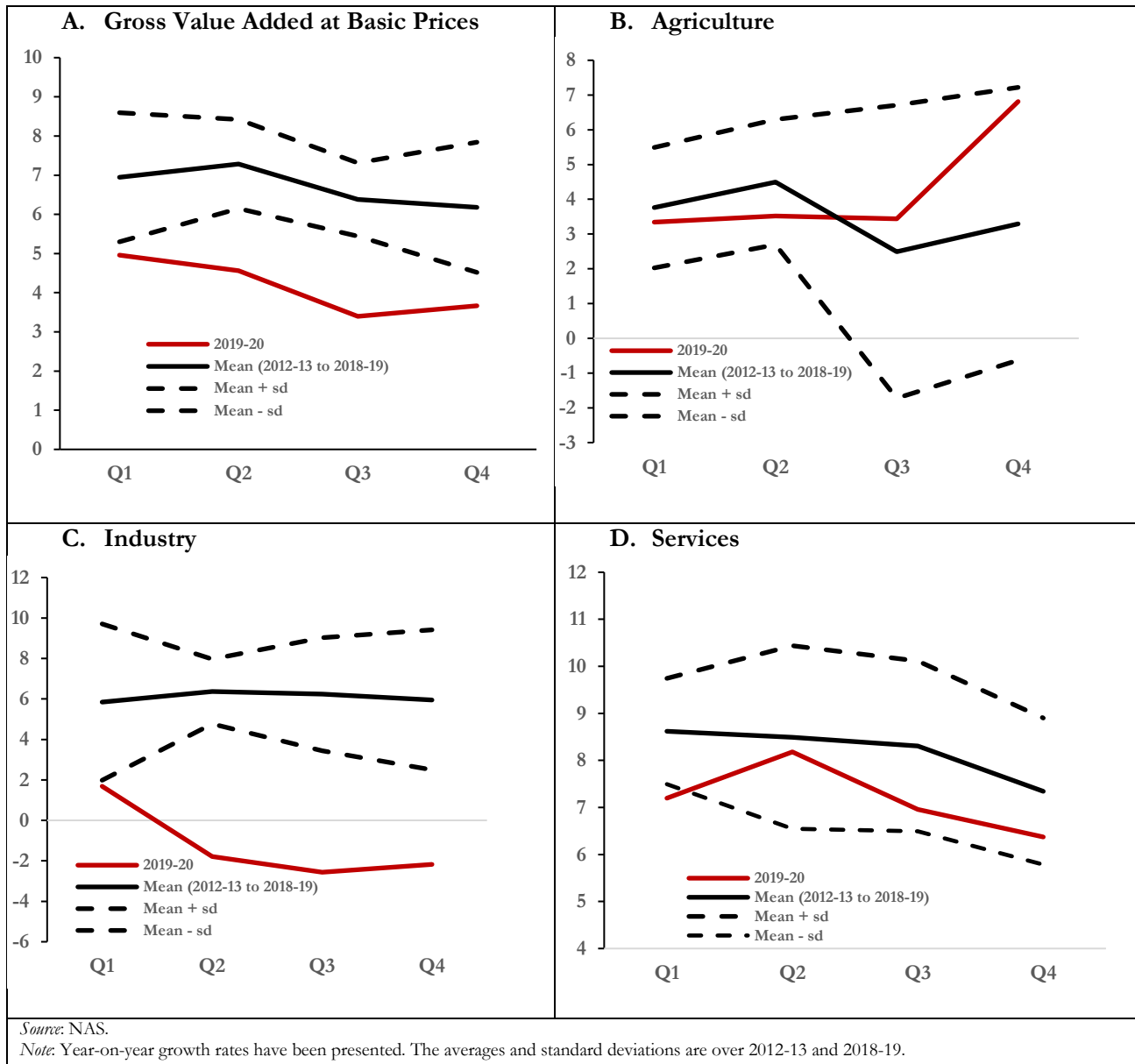
Within GVA, the agriculture sector grew remarkably well, at 4.3 percent in 2019-20, as compared to 3.7 percent during the preceding years (Table 2). Services decelerated mildly in 2019-20, growing at 7.2 percent as compared to 7.9 percent during the reference period. The sector that contributed to almost the entire slowdown is industry. Within industry, while all activities grew at a slower rate, manufacturing was the largest contributor to the slowdown, both because of its large weight and because of the sharpest deceleration it experienced, followed by construction.

Table 2: Contribution of the Sectors, Agriculture, Industry and Services, to Real GVA Growth

Variables	2019-20			Average over 2012-13 and 2018-19		
	<i>Growth</i>	<i>Weight</i>	<i>Contribution</i>	<i>Growth</i>	<i>Weight</i>	<i>Contribution</i>
Gross Value Added	4.14			6.68		
Agriculture, Forestry, Fishing	4.31	0.15	0.64	3.35	0.16	0.54
Industry	-1.23	0.31	-0.38	6.07	0.31	1.91
Services	7.19	0.54	3.88	8.18	0.52	4.23
<i>Source:</i> Data downloaded from CEIC, original source is NAS. <i>Note:</i> * Weights have been calculated as the share of a component in national GDP in the previous financial year. The average growth and average weight, in Columns 5 and 6 are over 2012-13 and 2018-19.						

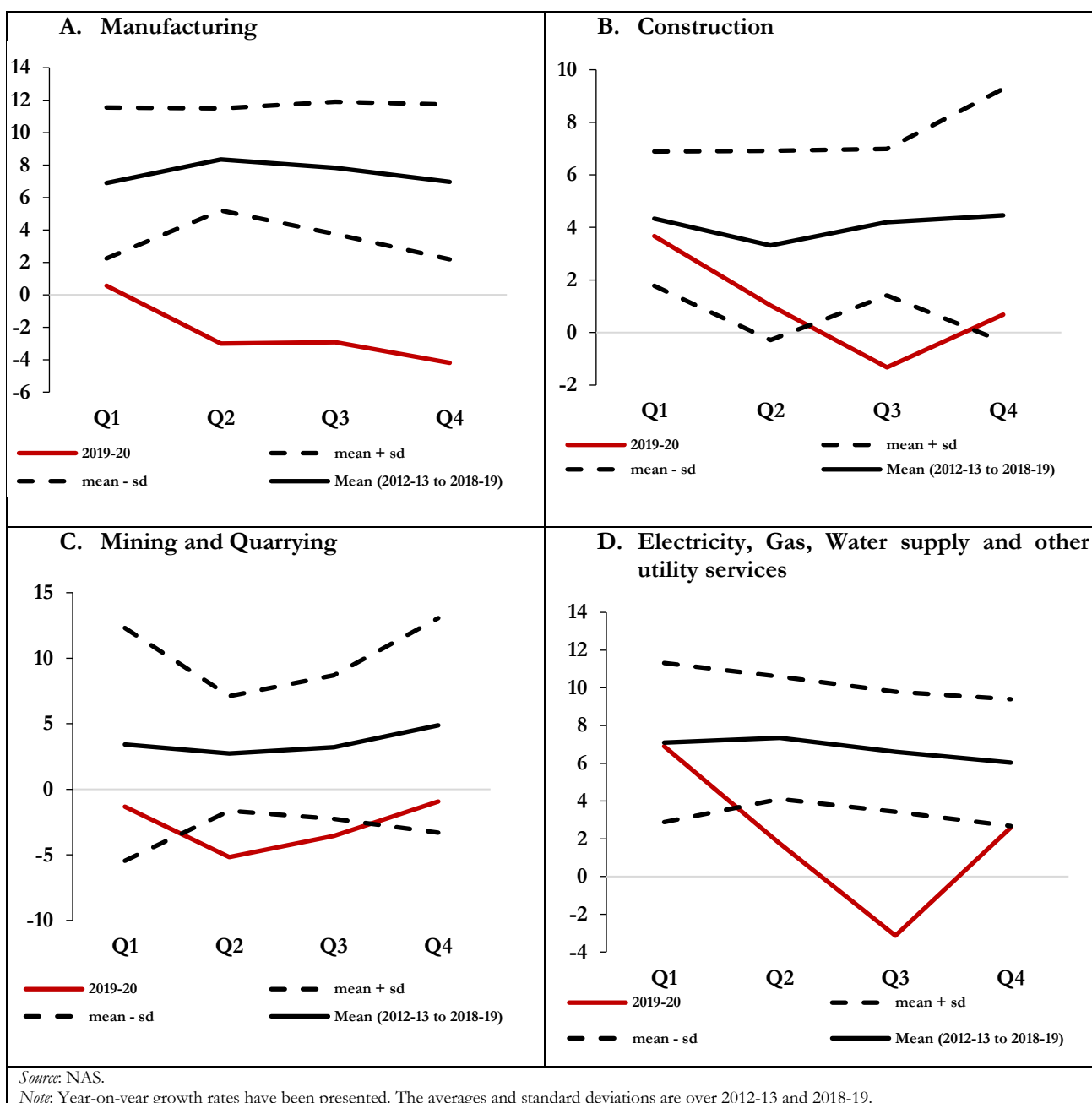
The pattern for the pace of slowdown seen in the quarterly data is useful too. It shows that while industry decelerated in all the four quarters, the slowdown in the services sector was most evident in the last two quarters, even as agriculture remained buoyant throughout the year, and especially so in the last quarter (Figure 3).

Figure 3: Sectoral Gross Value Added Growth



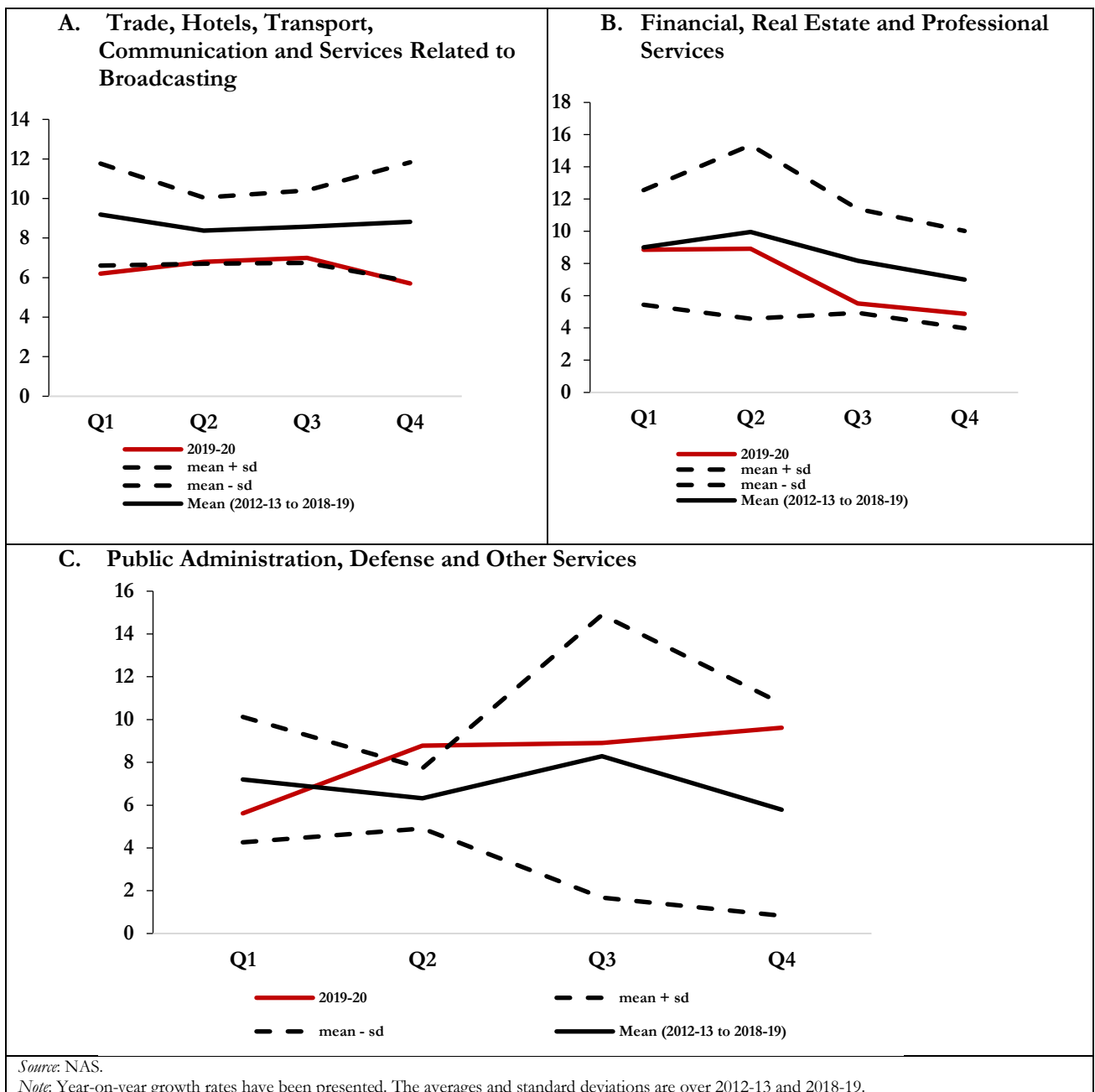
Within industry, manufacturing contributed the most to the decline. Even so, significant deceleration was witnessed in all the other activities too, including construction, mining and the utilities (electricity, gas, and water); and in all the four quarters of the year (Figure 4).

Figure 4: Growth in Various Industry Activities



Within services, public administration, defense, and personal services grew well throughout the year. The trade, hotels, transport and communication category grew slowly throughout the year, and weakened further in the last quarter. On the other hand, finance, real estate, and professional services started the year well, and remained strong during the first half of the year, but weakened in the last two quarters (Figure 5).

Figure 5: Growth in Various Service Activities



(ii) Growth Slowdown of the GDP

A decomposition of GDP indicates that government consumption expenditure grew faster during 2019-20 than before, and contributed a larger amount to growth than in the years before. Consumption grew at a somewhat slower pace, contributing 3.1 percent to GDP growth during 2019-20, as compared to 3.9 percent during the period 2012-13 to 2018-19. Investment grew at 5.4 percent (as compared to 5.9 percent), and its contribution to GDP growth was broadly stable. Exports, on the other hand, contracted by 3.3 percent, as compared to a growth of 4.6 percent in previous years, thus resulting in a growth turnaround of nearly -8 percentage points. While in earlier years, it contributed 1 percentage point to GDP growth, during 2019-20, its contribution was negative 0.69 percent. Imports too contracted, but by a smaller amount (Table 3).

Table 3: Contribution of Expenditure-side Components to Real GDP Growth

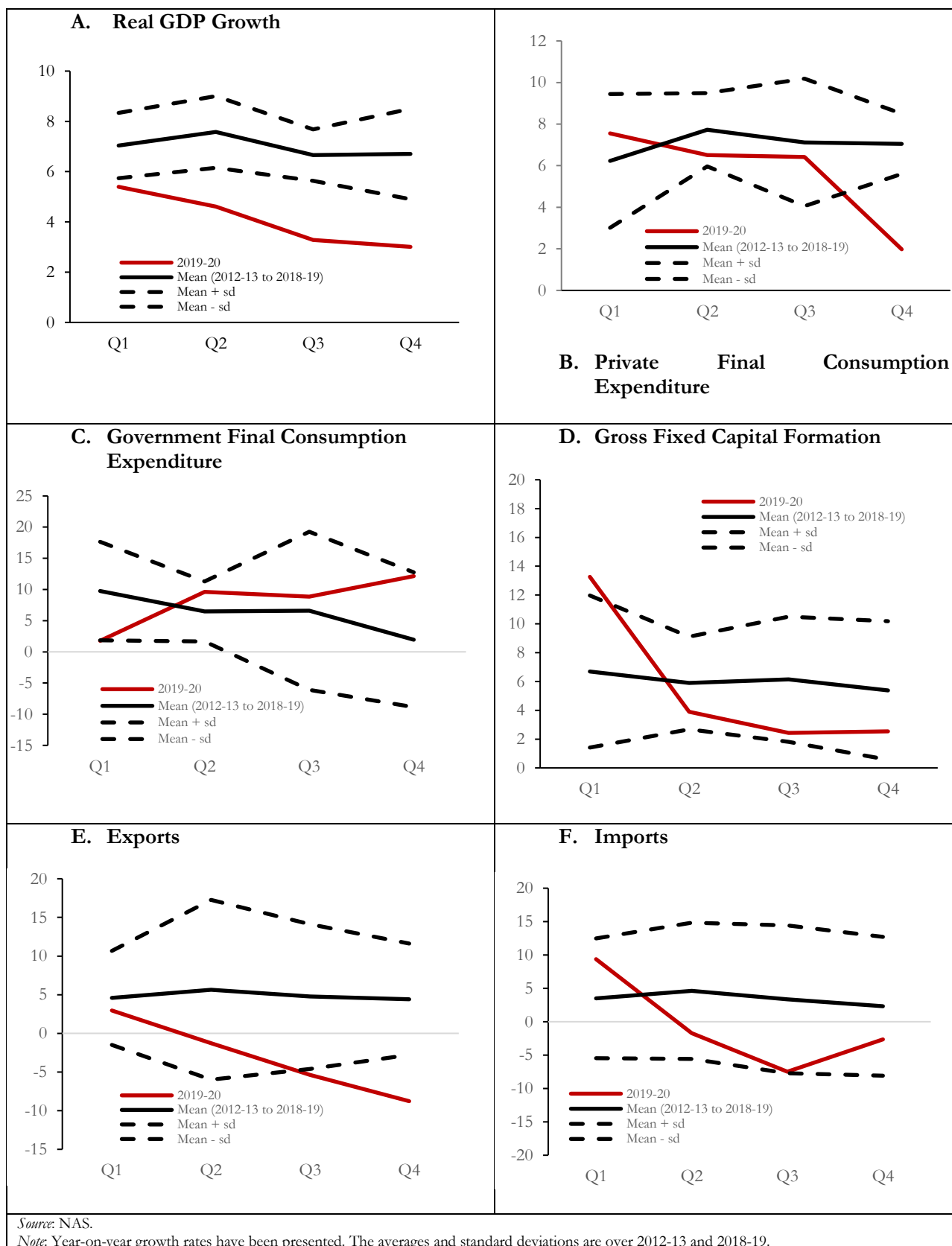
Variables	2019-20			Average over 2012-13 to 2018-19		
	<i>Growth</i>	<i>Weight</i>	<i>Contribution</i>	<i>Growth</i>	<i>Weight</i>	<i>Contribution</i>
Consumption	5.55	0.56	3.12	7.00	0.56	3.93
Investment	5.44	0.32	1.74	5.97	0.32	1.88
Government expenditure	7.89	0.10	0.80	5.78	0.10	0.58
Exports of goods and services	-3.31	0.21	-0.69	4.66	0.22	1.02
Imports of goods and services	-0.78	0.24	0.19*	3.33	0.25	-0.68*

Source: Data downloaded from CEIC, original source is NAS.
Note: *Contribution of imports of goods and services enter with a negative sign. Weights are calculated as the share of a component in national GDP in the previous financial year. The average growth and average weight in Columns 5 and 6, respectively, are over 2012-13 and 2018-19. The last column presents the average contribution of each component over 2012-13 and 2018-19.

An analysis of the growth rates of the expenditure-side components for each quarter during the year indicates that personal consumption held up well for three quarters, and then declined sharply in the last quarter. Investments, on the other hand, started the year strong, but slowed down during the last three quarters, while exports started the year on a subdued note and contracted sharply during the last three quarters. Slowdown in exports (throughout the year) and private consumption (during the last quarter) together accounted for nearly the entire deceleration during 2019-20.¹³

¹³ The deceleration in GVA in 2019-20, as compared to the average growth in 2012-13-2018-19, was 250 basis points; and the deceleration in GDP was 290 basis points, of which nearly 40-50 basis points were contributed by statistical discrepancy. After netting it, traditional components such as consumption, government expenditure, fixed investment, and exports, account for 240 basis points of the deceleration, similar to that in the GVA.

Figure 6: Expenditure-side Components of GDP



IV: Factors that Contributed to the Slowdown

To the extent that both tradable and non-tradable activities decelerated during 2019-20, potentially both domestic and external factors could explain the slowdown. We sift through a host of variables and a timeline of political events and policy announcements to assess whether the economic slowdown could be attributed to any specific economy or policy shocks. As explained below, 2019-20 was a year of political stability and no geopolitical uncertainties, when fiscal and monetary policies were largely accommodative, and macroeconomic stability prevailed.

The year 2019-20 started off with the General Elections taking place from April 11 2019 to May 2019, in seven phases. On 23 May 2019 the results announced a clear win for the ruling party, the Bharatiya Janata Party (BJP).¹⁴ The Finance Minister, Nirmala Sitharaman, presented her Union Budget on 5 July 2019, highlighting an increase in government expenditures by 13.4 percent over the previous year. This increase benefitted the Ministry of Agriculture, Ministry of Petroleum and Natural Gas, and Ministry of Railways the most, with the three Ministries recording high percentage increases of 82.9 percent, 32.1 percent, and 23.4 percent, respectively. The Budget noted an expected increase of nominal GDP growth rate to 12 percent. While the revenue deficit was estimated to be 2.3 percent of GDP, and the fiscal deficit was targeted at 3.3 percent of GDP.¹⁵

The Union Budget also proposed modifications to corporate tax rates and laws in the Finance Bill, which that was initially presented in September 2019, and an amendment to which was made on November 25. Termed as the “mother-of-all direct tax reforms”, it proposed a cut in the corporate tax rate for domestic companies to 22 percent and for new domestic manufacturing companies to 15 percent from the prevailing 30 percent in lieu of the exemptions that were provided for. It brought down the effective corporate tax rate by about five percentage points.

Thus while the fiscal policy in general was accommodating, monetary policy was adequately supportive of growth too. As is customary, the RBI’s Monetary Policy Committee (MPC) held six bi-monthly meetings during the fiscal year and lowered its key policy rate by a cumulative 110 basis points, lowering them in four of the six meetings. The first meeting, which was held on 4 April 2019, announced a reduction in repo rates from 6.25 percent to 6.0 percent, with the reverse repo and marginal standing facility rate (MSF) remaining unchanged at 5.75 percent and 6.25 percent, respectively. During the second meeting on 6 June 2019, the repo rate was further reduced to 5.75 percent, with the reverse repo rate and MSF rate following suit by being reduced to 5.50 percent and 6 percent, respectively. The third meeting on 7 August 2019 decreased the repo rate by 35 basis points, and revised the reverse repo rate and MSF rate by an equivalent amount. On 4 October 2019, the RBI decided to cut repo rates to 5.15 percent, reverse repo rates to 4.9 percent, and MSF rates to 5.4 percent. In the last two meetings in December 2019 and February 2020, the MPC decided to keep the rates unchanged with the repo rate at 5.15 percent, reverse repo rate at 4.90 percent, and the MSF rate at 5.40 percent.

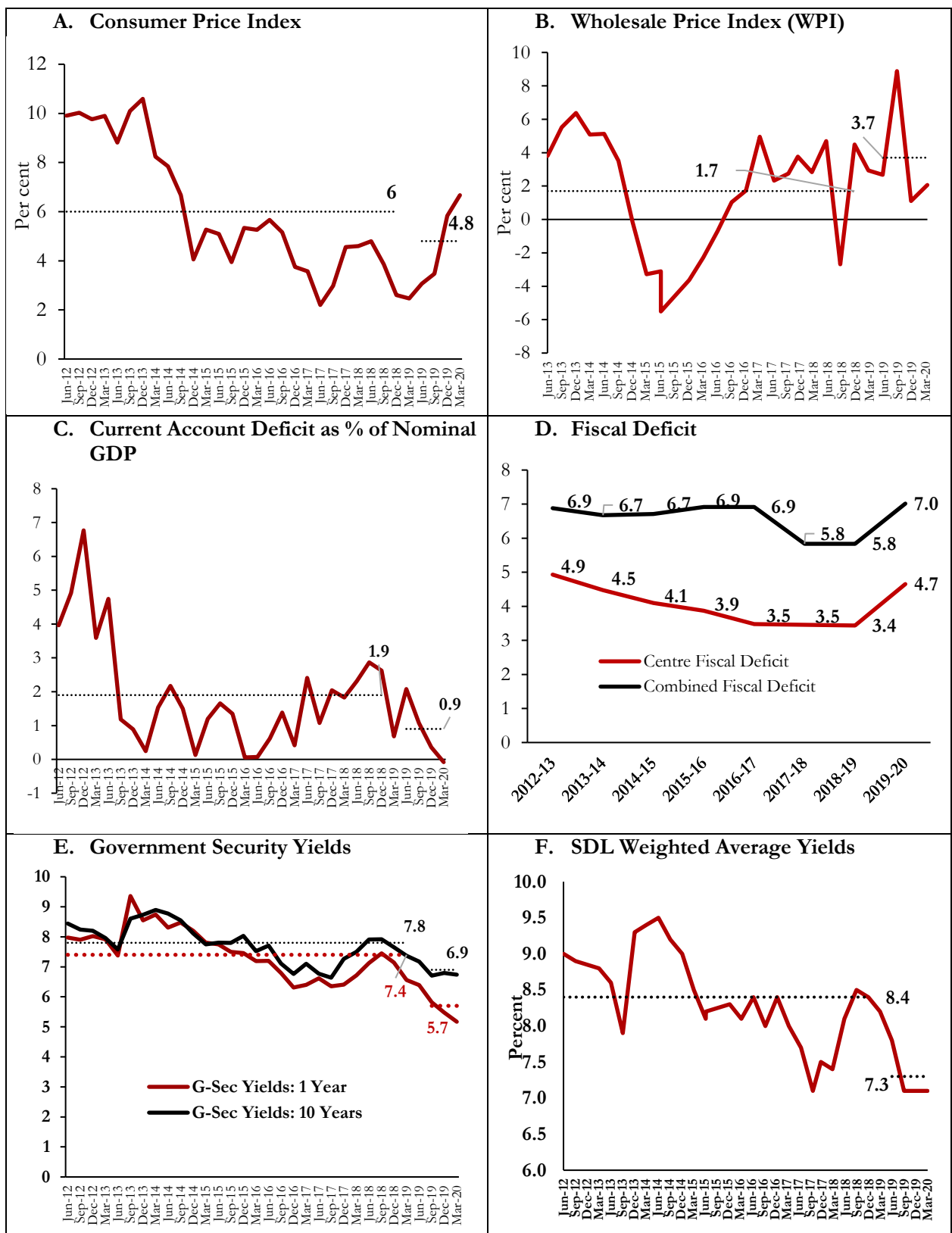
Besides, the GST tax design and tax revenues had started stabilizing; and macroeconomic stability was maintained throughout the year and was not a cause for concern as far as growth is concerned. Inflation was range-bound, current account deficit was below one percent of GDP; fiscal deficit was in line with the average obtained in the past; bond yields on government debt declined; equity markets were buoyant;

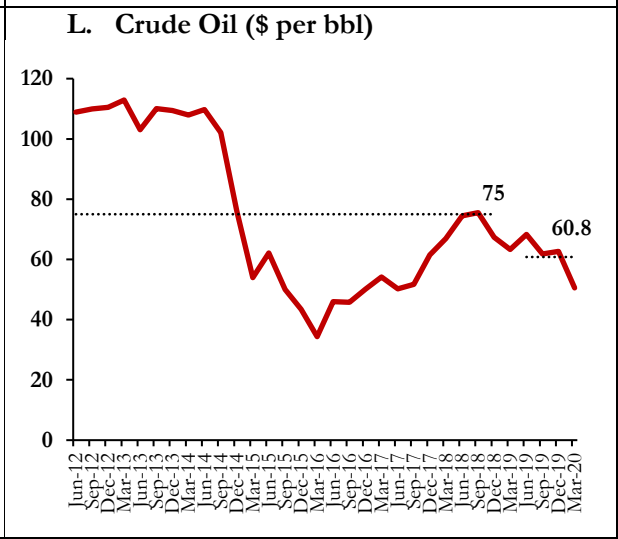
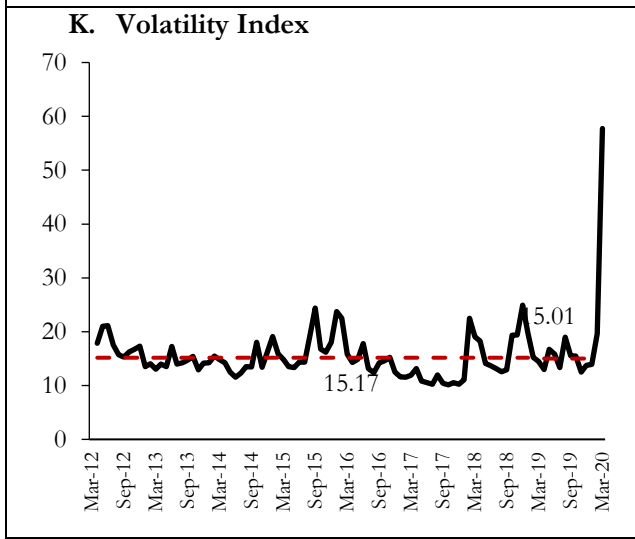
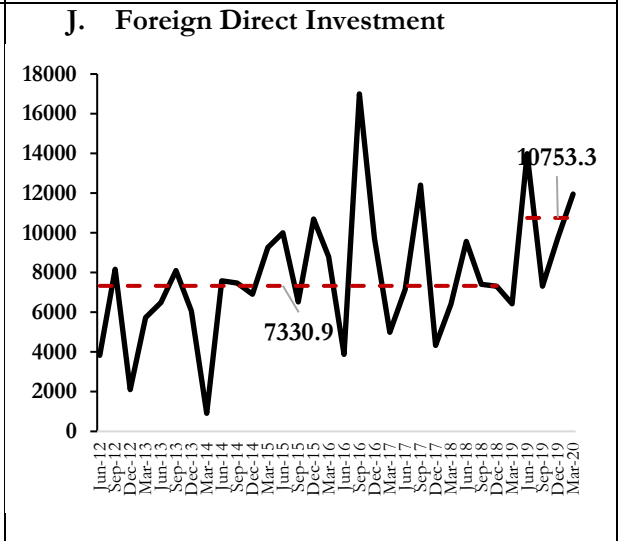
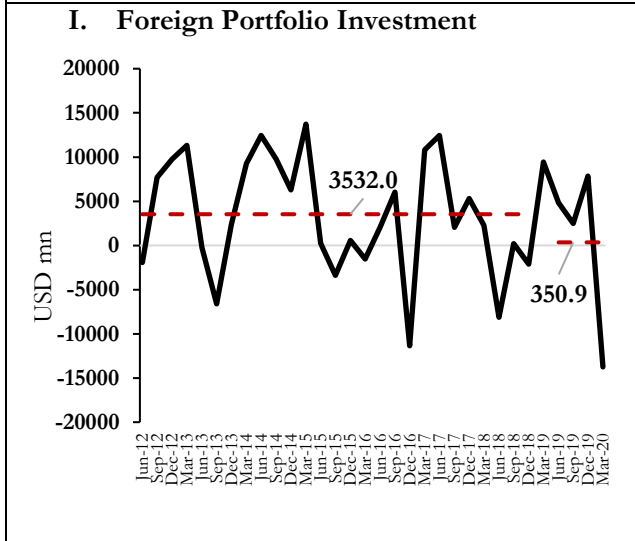
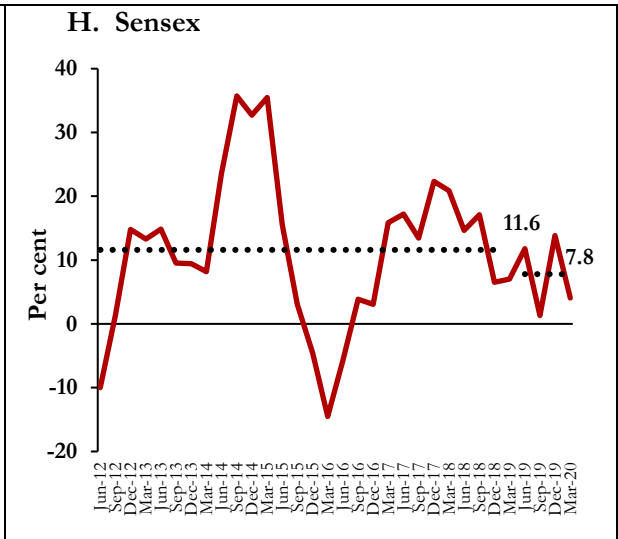
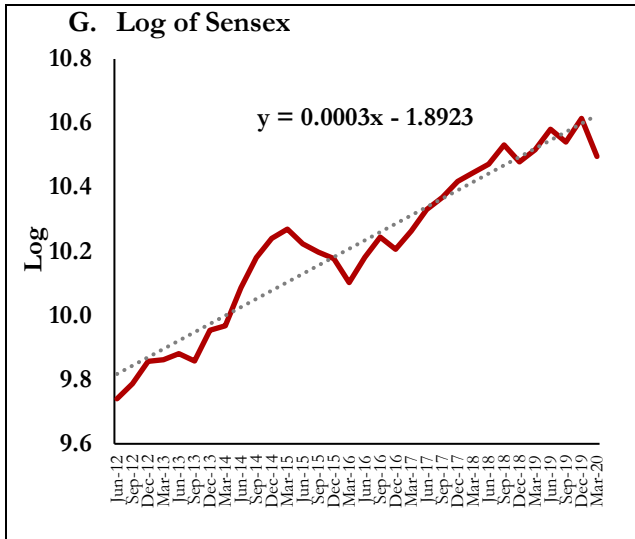
¹⁴ “Lok Sabha Election Results 2019.” *Elections in India*, <https://www.elections.in/indian-general-election/2019/>. Alongside the General Elections, the Legislative Assembly elections also took place during April to December 2019 for certain States: on 11 April 2019, the States of Andhra Pradesh, Arunachal Pradesh, Odisha, and Sikkim held their respective assembly elections; in October 2019, Haryana and Maharashtra followed suit; and Jharkhand held its legislative assembly elections during November-December 2019.

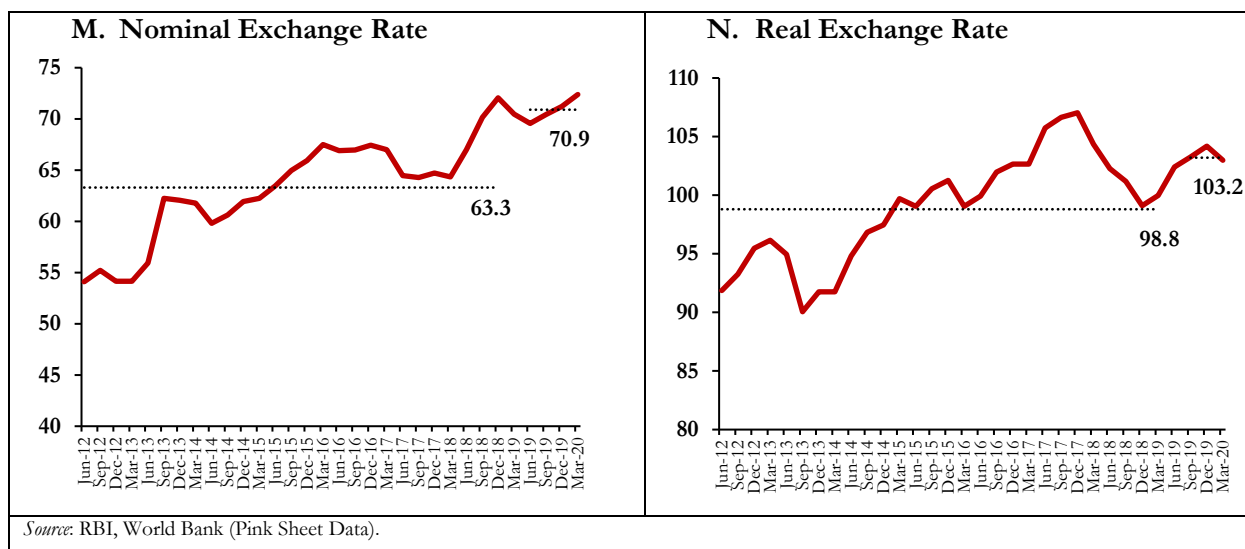
¹⁵ “Budget 2019-2020.” *Union Budget*, 5 July 2019, https://www.indiabudget.gov.in/budget2019-20/doc/budget_speech.docx.

foreign capital flows were stable; exchange rates were in line with the part trend; and oil prices were below the levels seen in the past years (Figure 7).

Figure 7: Macro-financial Indicators







Having sifted through many possible explanations: macroeconomic excesses, terms of trade shock, tightening of fiscal or monetary policy, a sudden stop in capital flows, aggravated policy, or political uncertainty, among other things, we narrow our focus to three factors that can help explain a large fraction of the economic slowdown during 2019-20. These include a slowdown in global trade, in which India struggled to even maintain its low market share; COVID-induced disruption in activity; and a sharp slowdown in credit from banks, NBFCs, and HFCs.

(i) Global Trade and Exports from India

The literature on growth has broadly identified the following factors as the correlates of high and sustained economic growth (among several specific others): openness to trade and knowledge, macroeconomic stability, high investment and savings rates, efficient market allocation of resources, and an enabling institutional, administrative, and governance environment. Several of these factors have likely been instrumental in India’s growth experience over the past decades.¹⁶

With most of these correlates improving in India, the economic growth rate has accelerated and become more stable over the past three decades. Exports too grew consistently during the 1990s and for most part of the 2000s, but have under-performed and under-contributed to growth since the Global Financial Crisis. This is as much due to the slowing of global trade as to India’s stagnant or even a declining share in it.

Much has also been written about the fact that the pace of global trade has been slowing down since the Global Financial Crisis, and most notably since 2011. After increasing from 15 percent of the global GDP in 2001 to 31 percent in 2008, the global exports to GDP ratio moderated to 28 percent in 2019 (Figure C2, in the Appendix). Put differently, after growing at about 10 percent a year during 2001-2012, global exports grew by only 1.5 percent a year between 2013 and 2019, and further contracted by 1.5 percent in 2019. This slowdown has been commonly attributed to the maturing of the global supply chains, slowing down of trade credit after the Global Financial Crisis, and the implementation of inward-looking policies by some of the largest trading countries, including the US and China. This phenomenon, referred to as “Slowbalization”, has been more prominent in the global trade of goods, though the trade of services too slowed down during the last decade (Irwin, 2020)

The World Bank (GEP, January 2020) summarized these developments well, when it noted that manufacturing exports have been contracting since late 2018, and the contraction continued through 2019.

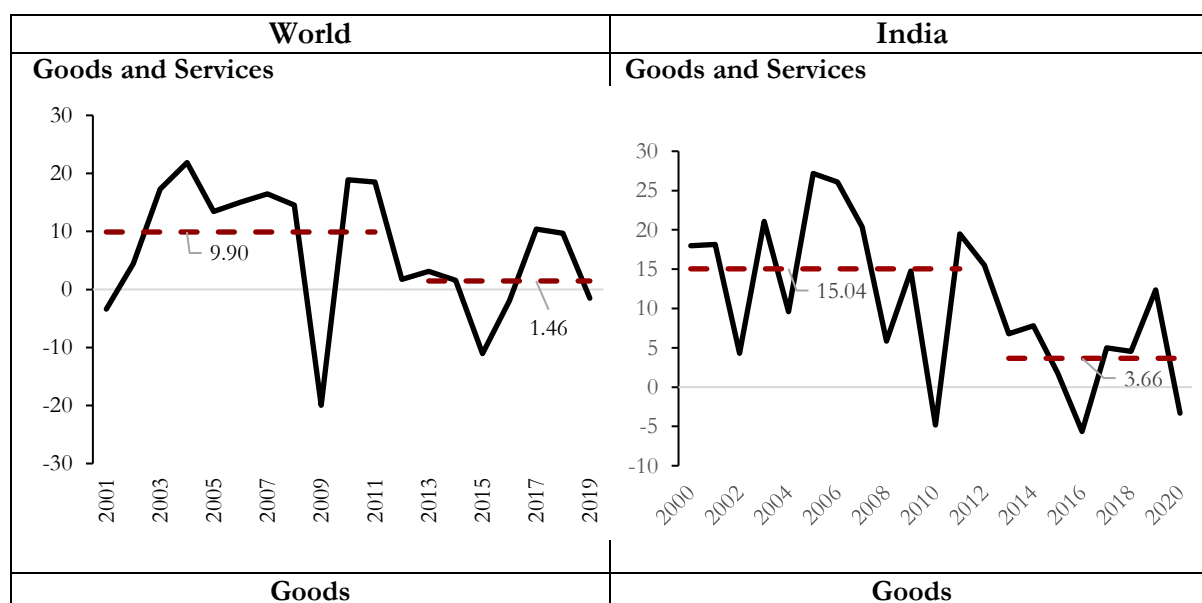
¹⁶ See for example, Commission on Growth and Development (2008).

It further noted that the slowdown in trade stemmed from weakening demand in Europe and Asia, protectionist measures implemented by the G20 countries, and elevated global trade policy uncertainty. Trade tensions between the US and China, and the implementation of new tariffs on a majority of their bilateral trade components further impacted the trade flows. While these trade tensions generated some positive impact for a few emerging markets and developing economies, through trade diversion, India was not one of them.¹⁷

The exports of goods and services from India co-moves with the world trade. Using the annual data on exports of goods and services from the WDI for the last twenty years, we calculate the elasticity of Indian exports to world exports to be larger than one. The elasticity is slightly smaller for exports of goods, and higher for exports of services.

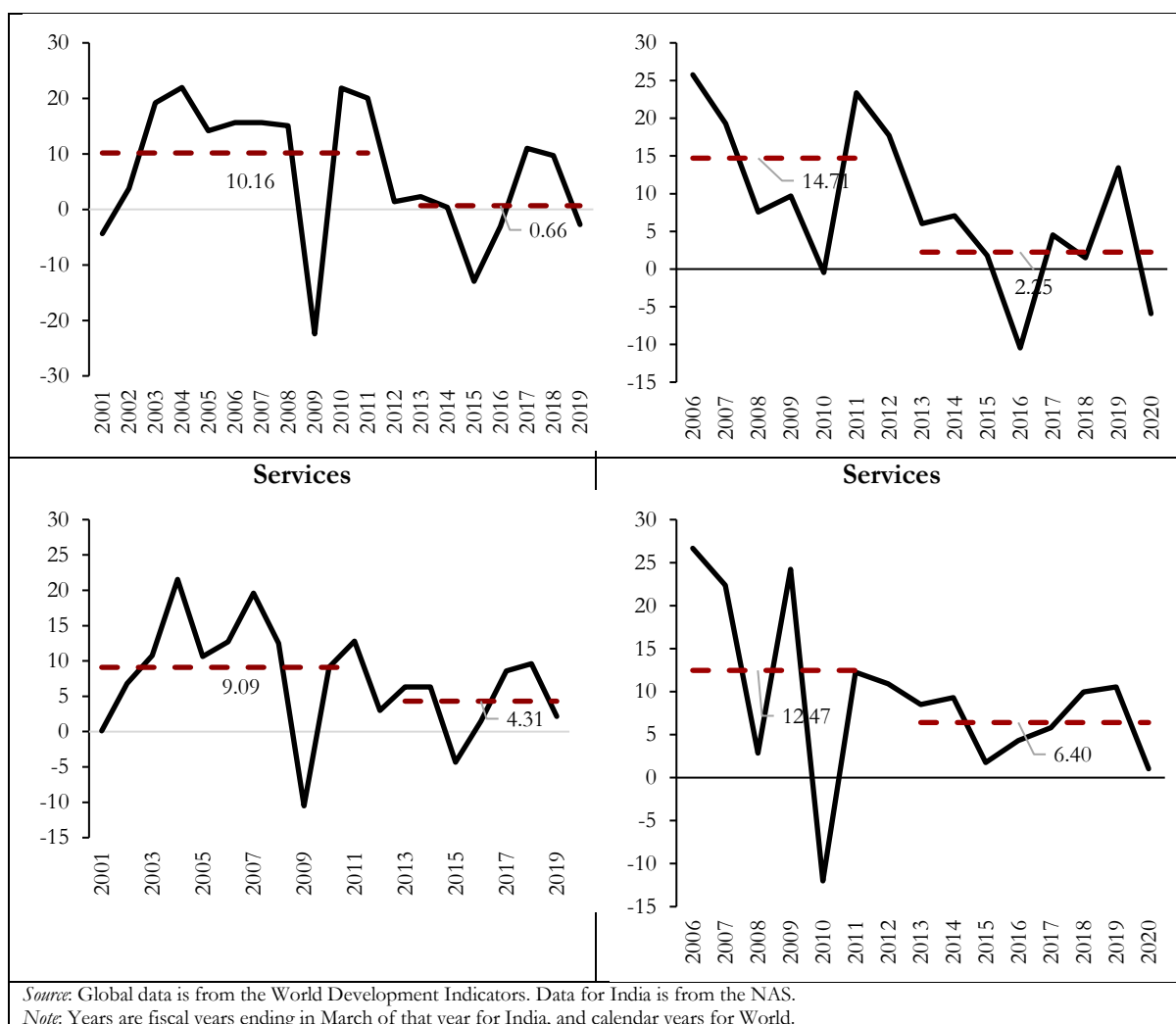
With global trade slowing down sharply, growth of exports for India turned negative in 2019-20. The momentum for exports started slowing down from the last quarter of 2018-19, and decelerated all through 2019-20. The exports of goods (accounting for 60 percent of India’s exports basket) contracted by 6 percent, as compared to an annual growth rate of 3.4 percent in previous years. The slowdown in exports of services was less steep, but still significant, with these exports slowing down to 1 percent from a growth of 7 percent achieved in previous years. Together they contributed negative 70 basis points to growth in 2019-20, as compared to a positive 100 basis points in previous years, resulting in a turnaround of 170 basis points in economic growth.¹⁸

Figure 8: Growth of Exports of Goods and Services in India and the World



¹⁷ Slow global growth, along with persistent trade tensions and increased economic and policy uncertainty, are likely to have fueled the decline. One of the factors that contributed was the long running dispute between the US and China, leading to tariff hikes and trade policy uncertainty. An analysis by the World Bank Group in July 2018 estimated that a US-China tariff escalation could reduce global exports by up to 3 percent (\$674 billion). Other country-specific factors such as the government shutdown in the US in 2018-19, UK’s exit from the European Union, and changes in monetary policy in some major economies, are also likely to have played a part. Declining business confidence and tightening of financial conditions were also likely to have contributed to the slowdown (IMF, 2018; World Bank, 2019).

¹⁸ It can be argued that since exports are import-intensive, we ought to only account for the contribution of exports net of imports. We assume a 33 percent import intensity of exports. The overall import intensity of India’s GDP being 20 percent, the assumed 33 percent import intensity of exports seems reasonable. Besides, since the exports of services are not import-intensive, this number reflects a much larger import intensity of good exports. Even so, nearly 120 basis points of the turnaround in contribution to growth can be attributed to the collapse in exports.



The importance of global trade and Indian exports in GDP growth is borne out in simple growth regressions, as summarized in Table 4. We regress India’s annual GDP growth on the growth rate of the global exports, and on global merchandise growth separately using the data for 2000-2020. We separately include the dummy for the year 2019-20 in these regressions.

Results show that global trade is correlated significantly with Indian GDP growth. Both the growth of the global exports and the growth of merchandise exports correlate positively and significantly with India’s GDP growth (Columns 1 and 2 in Table 4). Results (Column 3) show that GDP growth during 2019-20 was 2.5 percentage points below the average growth rate 6.6 percent recorded during the past two decades. However, once we control for any of the two global trade variables, the extent of the slowdown in 2019-20 is much smaller, implying the important role played by these variables in explaining a large part of the slowdown.

Table 4: Global Exports and India’s Economic Growth

	(1) GDP Growth	(2) GDP Growth	(3) GDP Growth	(4) GDP Growth	(5) GDP Growth
Global Exports Growth	0.090** (3.10)			0.083* (2.66)	
Global Merchandise Exports Growth		0.084** (3.03)			0.077 (2.68)

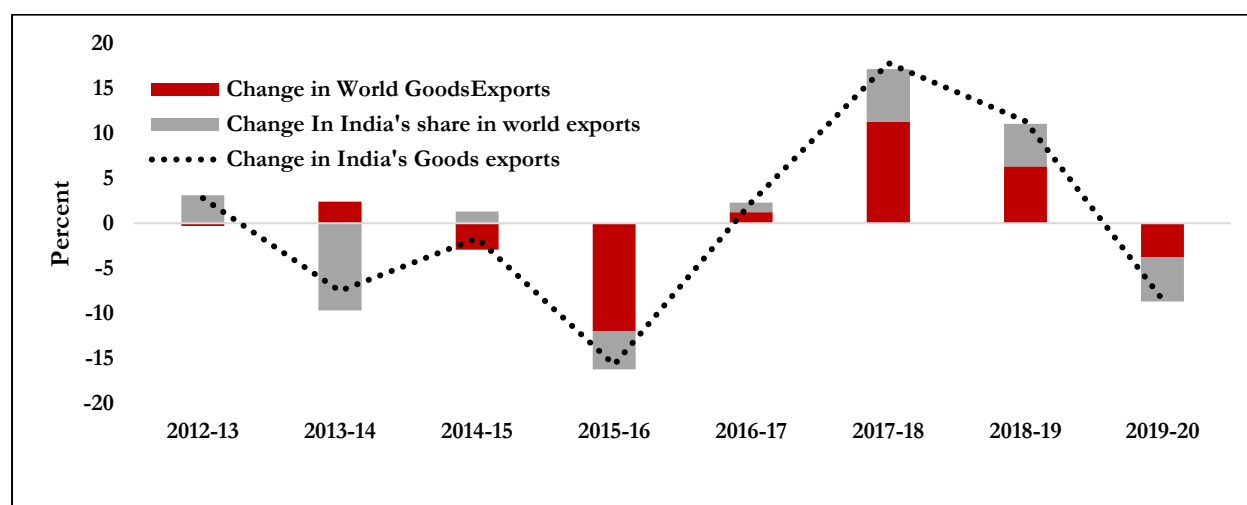
Dummy for 2019-20			-2.56 (1.45)	-1.19 (0.74)	-1.49 (0.95)
Constant	5.93*** (16.00)	5.98*** (16.26)	6.60*** (16.76)	6.04*** (15.05)	6.10*** (15.69)
Number of observations	20	20	20	20	20

Source: Figures for global exports growth for goods and services are from WDI, and for merchandise exports growth are from WTO. *Note:* t statistics are in parentheses, * p<0.05, ** p<0.01, *** p<0.001. Data in the regressions runs for the period 2000-2020. Global exports growth and world merchandise exports growth are measured in US\$, whereas GDP growth is in constant INR.

The next question to ask is whether the sharp deceleration in Indian exports can be attributed just to the slowing of global trade, or whether domestic impediments too impacted exports during the year. We decompose the growth of exports of goods from India into growth in global exports, and India's market share in it. As depicted in Figure 9, the slowdown in exports of goods from India was larger than the slowdown in global exports. Of the decline of 6.3 percent in exports during 2019-20, 2.6 percentage points can be attributed to the decline in the global trade for goods, and the rest 3.7 percentage points to the decline in India's share in global trade, and is thereby attributable to India-specific factors.¹⁹

The analysis of quarterly data in Figure 10 shows that the exports slowdown magnified in the last three quarters, and in each one of the quarters, the loss in market share accounted for a large part of the contraction in exports from India.

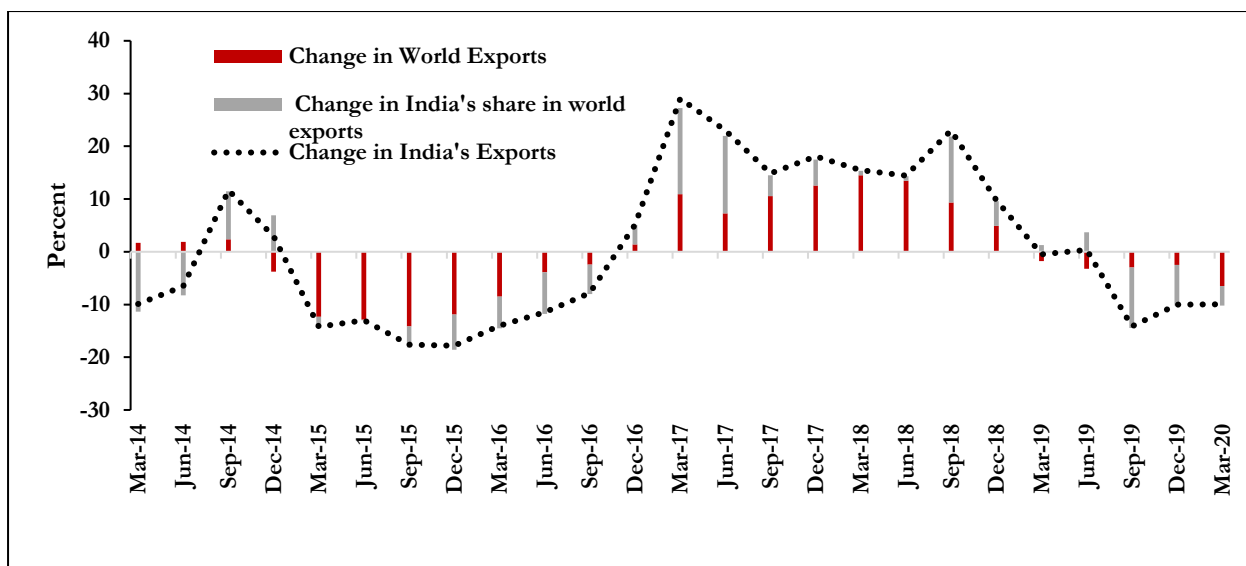
Figure 9: Global and Indian Exports for Goods (Annual Data)



Source: Data on Trade Statistics, IMF. *Note:* Years refer to Indian fiscal years. We have converted the monthly data into annual data in order to calculate the growth rates and share in the world market.

Figure 10: Global and Indian Exports for Goods (Quarterly Data)

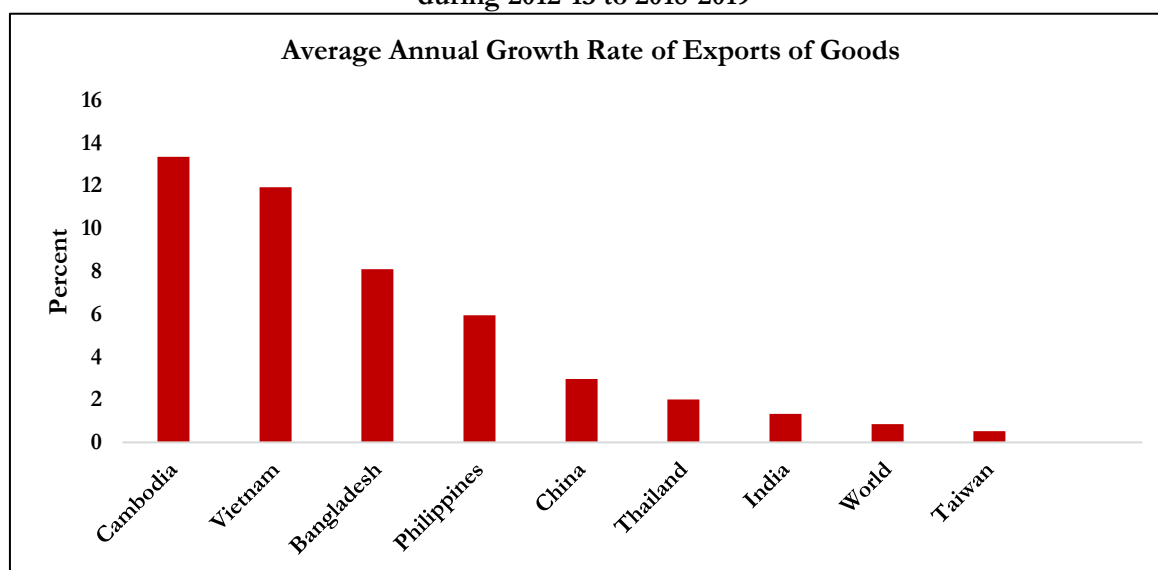
¹⁹ While we do not show the data for 2020-21 in Figure 9, exports growth slowed by 22 percent during the year; of which about one-third or 7 percentage points was due to the global slowdown in goods exports, and the rest, that is, 16 percentage points is attributed to the decline in India's share in goods exports.



Source: Data on Trade Statistics, IMF.

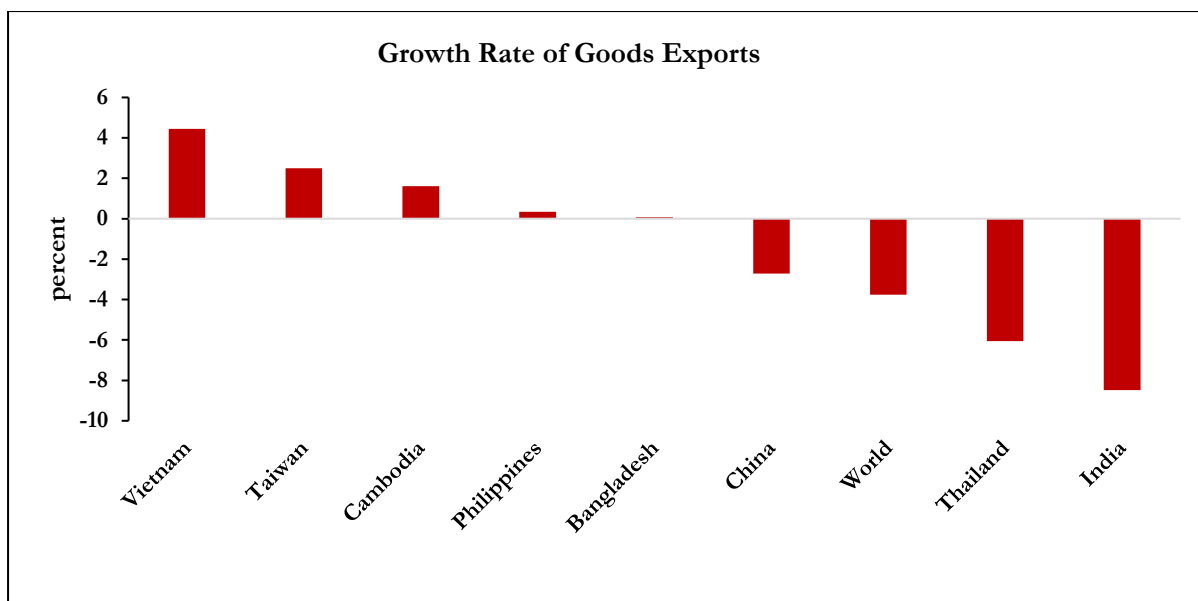
The implication is that there are other emerging markets and developing economies whose exports grew at a pace much faster than the exports from India even as the total global exports were slowing down. Gupta et al. (2018) analyzed the dynamics of exports from India during the post-Global Financial Crisis period. They showed that the slowdown during this period was quite broad-based. The slowdown in growth of exports was reflected in most items in the manufacturing exports basket, in the exports to most partner countries, and was accounted for by both the slowdown in the value and volume of exports. The decline in India's trade volume was larger in comparison to the global decline in trade volume, resulting in India's reduced share in global exports. Indeed, as seen in Figure 11, the growth of exports from select Asian countries was much higher than the global average and the pace of growth from India. Further, as confirmed in Figure 12, even during 2019-20, when global exports contracted sharply, a handful of countries did much better than the global average and India. If anything, India was among the worst performers throughout the decade.

Figure 11: Growth of Exports of Goods from Select Asian Countries during 2012-13 to 2018-2019



Source: Data is from the Data on Trade Statistics, IMF. Note: Years refer to the Indian fiscal years.

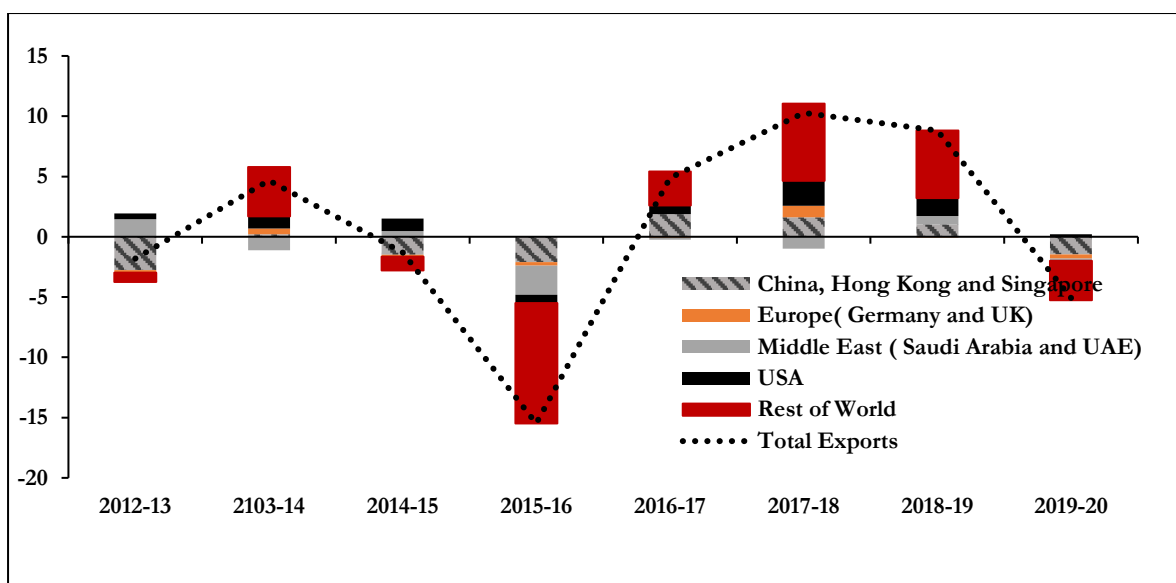
Figure 12: Growth of Exports of Goods from Select Asian Countries during 2019-20



Source: Data is from Data on Trade Statistics, IMF. Note: Years refer to the Indian fiscal years.

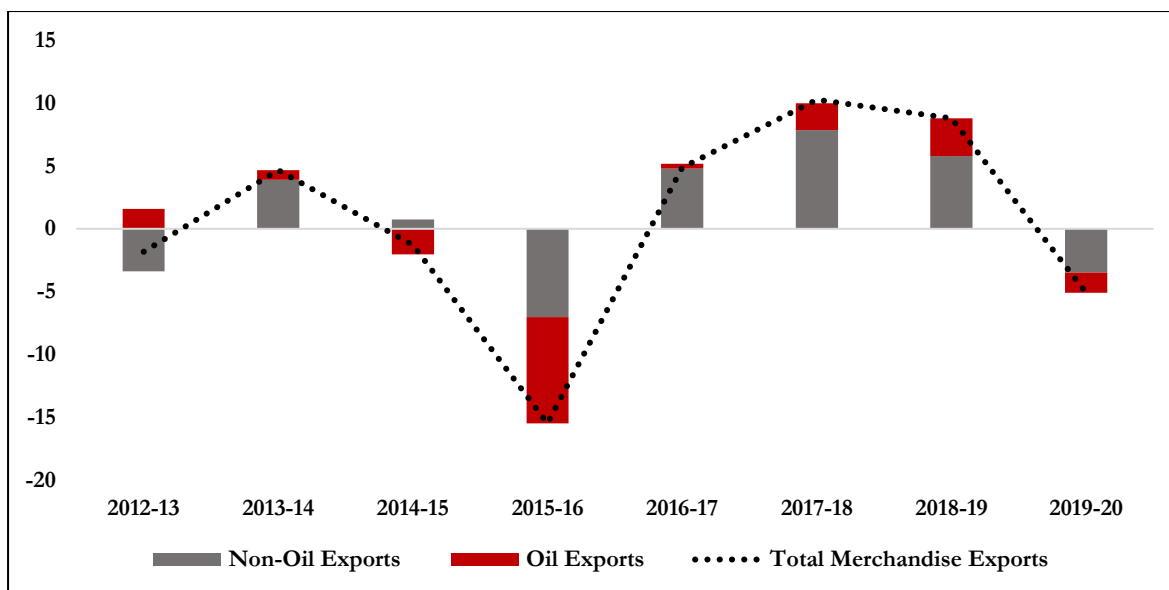
India's export destinations are diversified. The largest share of exports from India is destined for the United Arab Emirates and the US. Together they account for a quarter of India's merchandise exports. China (including Hong Kong) accounts for almost 10 percent, followed by several countries in Asia, Africa, and Europe, which account for smaller percentages of India's exports basket. In Figure 13, we disaggregate Indian exports across eight main trading partners and the rest of the world. We note that the slowdown in exports experienced during 2019-20 (or for that matter during the prior decade) was across destinations.

Figure 13: Contribution of Different Destinations to Merchandise Exports from India



Source: Data are from Ministry of Commerce and Industry, Directorate General of Commercial Intelligence and Statistics. Note: Years denote Indian fiscal years. The growth of exports is for merchandise exports, expressed in nominal USD.

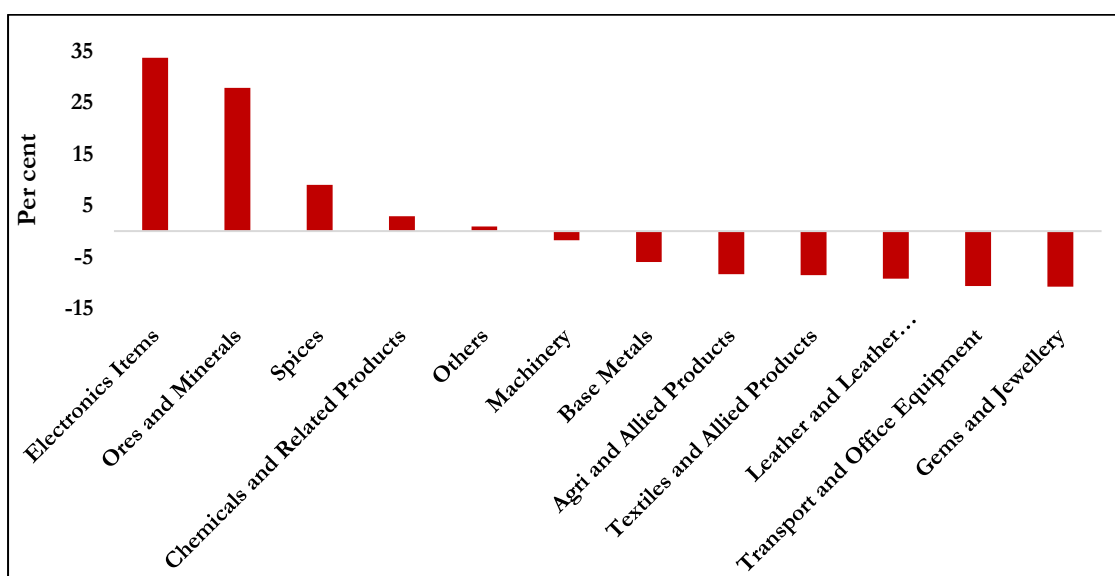
Figure 14: Contribution of Oil and Non-Oil Exports to Total Merchandise Exports



Source: Data are from Ministry of Commerce and Industry, Directorate General of Commercial Intelligence and Statistics. *Note:* Exports growth is for merchandise exports, expressed in nominal USD.

A further decomposition of merchandise exports (Figure 15) reveals that the slowdown was pervasive across many different items, including labor-intensive textile and apparels, leather goods, and gems and jewelry

Figure 15: Merchandise Exports Growth Rate in 2019-20



Source: Data are from Ministry of Commerce and Industry, Directorate General of Commercial Intelligence and Statistics. *Note:* The growth of exports is for merchandise exports, expressed in nominal USD.

How may a country such as India tap into a larger slice of the global market? A 2005 report by United Nations Conference on Trade and Development (UNCTAD), drawing from the successful experiences of the Asian economies, suggests that both foreign market access and the domestic supply capacity matter for achieving faster growth of exports. Countries that have achieved successful exports have a more diverse and differentiated portfolio of goods on offer and also indulge in intra-firm and intra-industry trade. The domestic capacity, in turn, is determined by the transport infrastructure, macroeconomic and institutional environments, and the FDI received. The other factors that matter include businesses having the flexibility and the means to adjust capacity and re-allocate resources, as required by the global demand dynamics, a

competitive exchange rate, and the availability of working capital, which gets determined by the pace of tax refunds, easier credit flows, and a competitive exchange rate.

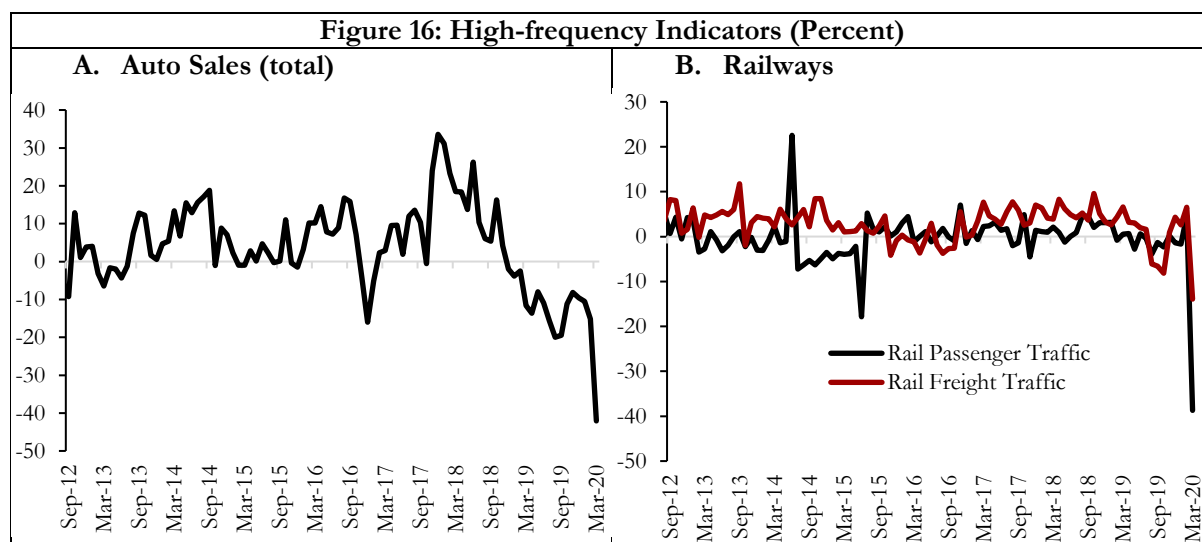
(ii) How Much Can COVID Account for the Slowdown in 2019-20?

With the kind of deceleration witnessed in consumption in the last quarter of 2019-20, it seems quite conceivable that COVID impacted GDP growth in the last few days of the fiscal year. India imposed its first curfew for 14 hours on 22 March 2020, followed by a full-fledged nation-wide lockdown starting on March 25, which eventually lasted until 31 May 2020.²⁰ While these lockdowns impacted economic activity precipitously, certain activities had perhaps already started weakening prior to the lockdowns, as COVID took hold in parts of China, Europe, and the US.

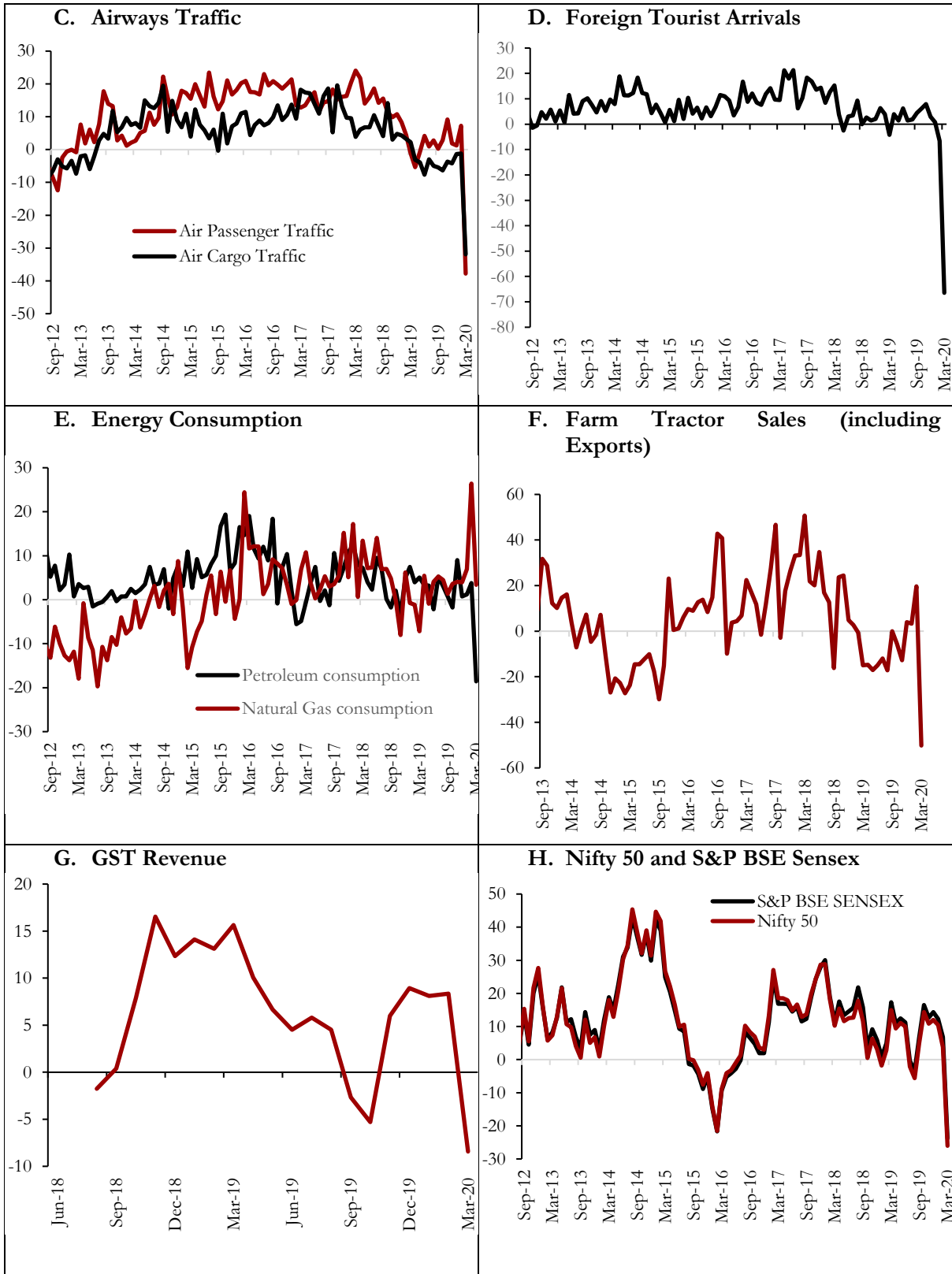
High-frequency monthly data, delineated in Figure 16, show a very sharp decline across a number of activities. The decline is of a magnitude that has come to be associated with the COVID-induced lockdowns. For example, the sale of automobiles contracted by 42 percent in March 2020, while railway passenger traffic contracted by 39 percent during the month.

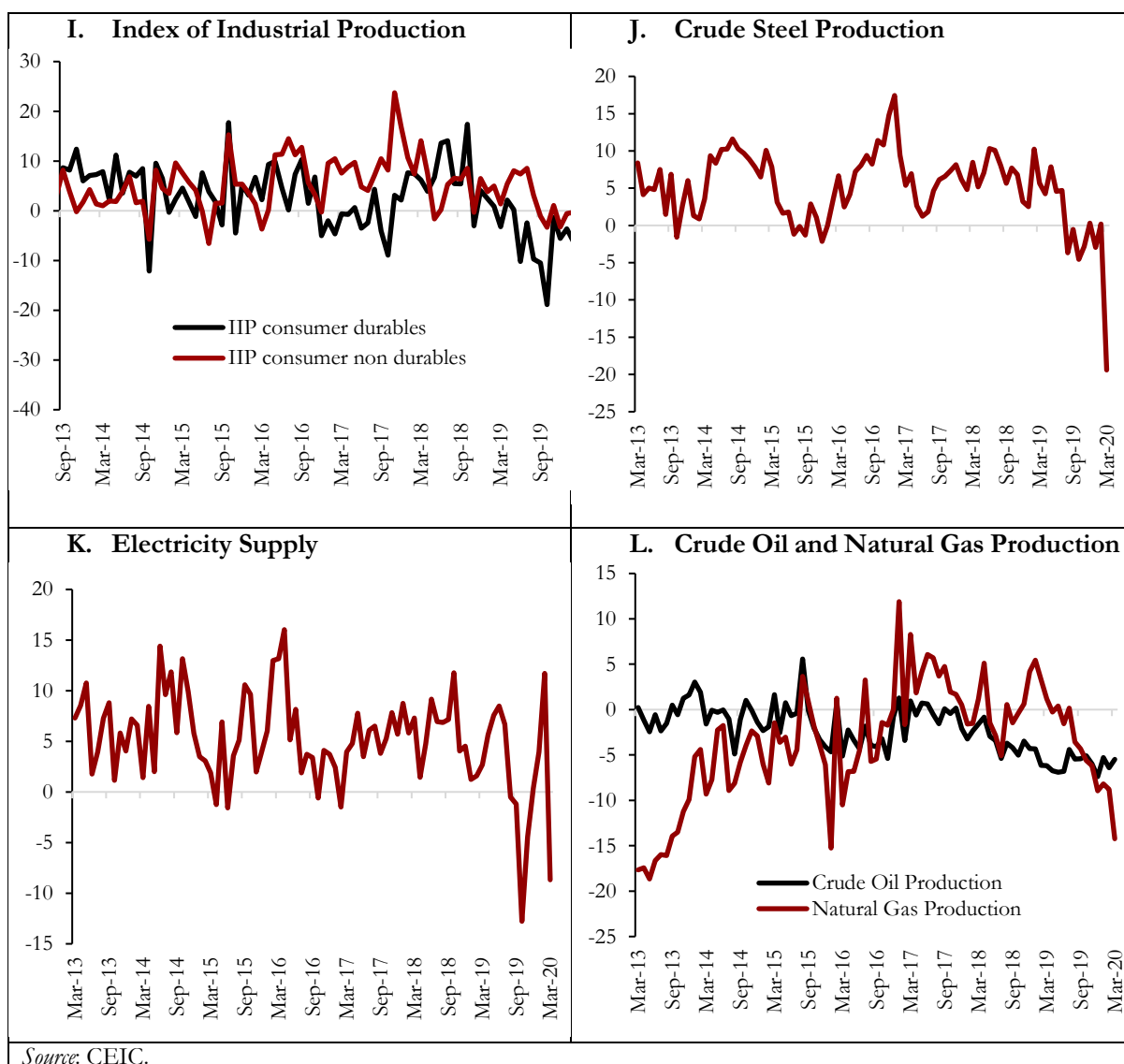
Indeed, in the first quarter of the following year, when the country was under a similar lockdown for two of the three months, as in the last week of March, the economy contracted by 24 percent. Using this as the benchmark, we estimate the impact of the lockdown on GDP growth in the last week of 2019-20.

Roughly about 2 percent of the annual economic activity is generated in any typical week of the year. We assume a 24 percent decline in economic activity in the last week of March 2020 when the country was under a lockdown. This resulted in a contraction of 48 basis points in annualized GDP growth. Put differently, the economy could have added 8 basis points to growth in that last one week (400 basis points of growth in 52 weeks) but instead contracted by 48 basis points, thus contributing 56 basis points worth of slowdown.



²⁰ The first case of COVID was identified on 17 November 2019, in the Hubei province in China. During the subsequent days, it was observed in other parts of China and elsewhere in the world. The first case in India (in Kerala) was detected on 30 January 2020. The World Health Organization (WHO) declared COVID as a Public Health Emergency of International Concern on 30 January 2020, and as a pandemic on 11 March 2020.





(iii) The Role of Finance in the Economic Slowdown during 2019-20

Besides exports and COVID, another factor that stands out is the credit collapse from the banks, NBFCs, and HFCs (and possibly also from the cooperative banks) during the year.

There has traditionally been a predominance of banks in the Indian financial system, and particularly that of the public sector banks (PSBs) within the Indian banking sector. The last few years have been challenging for Indian banks, resulting in a stress on asset quality, regulatory actions in response to it, and the slow pace of credit growth. The bank credit growth slowed down to a new low in 2019-20, when it grew at 6.5 percent during the year, as compared to an average annual growth rate of 8.7 percent during the period 2013-14 to 2018-19, and an average annual growth rate of 23 percent during the decade of the 2000s. The credit slowdown was evident across sectors.

There has been a distinct difference in the trends for credit growth and asset quality for public sector banks and private banks. Credit growth has been slower, and the pace of bad assets has been higher for public sector banks during the last decade. Yet, during 2019-20, it was the credit growth from private banks that dropped sharply (Table 5).

Table 5: Credit Growth by Banks, NBFCs, and HFCs

	Average Annual Growth Rate during 2013-14 to 2018-19 (Percent)	Annual Growth Rate during 2019-20 (Percent)
Banks	8.7	6.5
Public Sector Banks	4.8	4.5
Private Banks	19.5	9.0
NBFCs	18	7.2
HFC	18.5*	0.7

Source: Trends and progress of banking in India report, RBI. Note: *For HFCs, the average annual growth rate has been depicted for the period 2016-17 to 2018-19 (percent).

Meanwhile, even as the public sector banks have retrenched, the NBFCs have gained prominence and visibility in the Indian financial system. The ratio of NBFC credit to GDP rose from 8.6 percent in 2012-13 to more than 12 percent in 2018-19. During the same period, the bank credit to GDP ratio declined from 59 percent to 51 percent.

After growing at 18 percent a year during the period 2013-14 to 2018-19, growth of credit from NBFCs too slowed down to 7 percent in 2019-20 (Table 6).²¹ In addition, growth of credit from the housing finance companies nearly stalled during the year.²² The RBI's Report on Trend and Progress on Banking in India attributed the collective slowdown of credit by these entities to risk aversion, impaired balance sheets, and liquidity squeeze and rating downgrades in the aftermath of the default by a prominent NBFC, Infrastructure Leasing and Financial Services (IL&FS). Issues related to asset quality and governance surfaced in a number of other NBFCs and HFCs too during the year.

Table 6: Credit Data of NBFCs and Banks

	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
NBFC Credit as a Percentage of GDP	8.6	8.8	8.9	9.6	9.6	11.5	12.2	12.1
SCB Credit as a Percentage of GDP	59.1	60.0	59.3	57.3	52.7	51.2	51.2	50.6
NBFC Credit Growth		15.7	12.7	18.5	12.5	32.8	16.7	7.2
SCB Credit Growth		14.5	9.7	6.9	2.8	7.8	10.6	6.5
Sectoral Deployment of Credit by NBFC (Percentage Growth)								
Agriculture					3.4	16.7	34.0	-21.9
Industry					6.9	29.1	-17.0	3.8
Services					27.3	37.1	27.8	-13.2
Retail loans					28.4	38.4	66.6	17.4
Housing Loans					10.5	-17.6	39.2	5.6
Consumer Durables					80.3	57.5	127.5	-2.3
Vehicle/Auto Loans					-6.7	55.0	85.0	9.3
Trade					14.5	8.7	30.3	-5.6
Sectoral Deployment of Credit by Banks (Percentage Growth)								
Agriculture	16.5	11.4	17.8	12.6	12.3	7.2	7.1	6.9
Industry	17.7	14.7	8.1	4.9	-1.6	0.00	3.2	3.1
Services	13.8	16.96	9.15	7.5	10.9	9.12	23.6	9.1
Trade	23.0	21.8	11.9	10.1	6.5	9.4	12.9	3.4

²¹ NBFCs are government, public, or private limited companies that specialize in delivering credit to a variety of specific segments, such as infrastructure, consumer durables, and vehicle financing. HFCs primarily extend housing finance to individuals.

²² Limited available data on cooperative banks show credit slowdown of a comparable magnitude.

Personal Loans	13.6	13.2	15.19	17.7	16.6	16.8	17.2	17.8
Consumer Durables	8.7	34.7	43.60	13.3	18.5	-30.9	-30.0	-27.6
Housing Loans	12	17.8	16.76	17.98	16.1	13.7	16.3	18.3
Vehicle	24.3	-1.6	19.58	16.4	19.5	9.96	9.6	14.6
Credit to the Housing Sector								
Growth of HFCs					16.8	25.9	12.9	0.7
Growth of SCBs					15.2	13.3	19.5	15.9
HFC Loans and Advance					20.4	27.9	26.1	1.8
HFC Total Assets					22.8	28.4	16.4	5.6

Source: Trends and progress of banking in India report, RBI

Infrastructure Leasing and Financial Services (IL&FS), a major infrastructure and among India's largest, well-established and highly rated (AAA) NBFC—defaulted on bonds in September 2018. It created panic in the bond markets and raised questions about the NBFCs' business model. A few months later, in April 2019, its former vice-chairman, Hari Sankaran, was arrested for lending to companies that had poor or dubious credit ratings, and subsequently, the Enforcement Directorate (ED) filed a charge sheet against IL&FS for money laundering (Shukla and Sinha, 2019).

Besides IL&FS, a couple of other high-profile cases of irregularities in the non-banking segment also came to the fore during the year, further aggravating the issue. These included the crisis in the Punjab and Maharashtra Co-operative (PMC) Bank, and in Dewan Housing Finance Corporation (DHF). On 6 June 2019, DHFL defaulted on loans, resulting in a 16 percent fall in its share prices, leading to the RBI removing its Board of Directors. The company was under investigation by the ED in January 2019 for siphoning around Rs. 31,000 crores of public money for the personal gains of individual stakeholders (RBI, 2019; Mahesh, 2019).

On 14 July 2019, it reported a net loss of Rs. 2,223 crore for the fourth quarter of 2018-19. The result was in stark contrast to that of net profit of Rs 134 crore reported in the same quarter of the previous fiscal year. The full-year results also showed a massive decline in net profit. In November 2019, RBI constituted a three-member committee to take over the insolvency process of DHF. The DHFL episode and the slowdown in the housing sector, in turn, led to a sharp deceleration in loans and advances by HFCs.

The Punjab and Maharashtra Co-operative (PMC) Bank was founded in 1984. The crisis at PMC came into light on 24 September 2019, when it was accused of lending money to Housing Development and Infrastructure Ltd (HDIL), a real estate company, through dummy accounts in the names of dead clients. HDIL accounted for almost three-quarters of the bank's loan, violating the RBI rule that no single group could borrow more than 15 percent from a bank. The HDIL promoters allegedly colluded with the bank's management to draw loans and the bank did not report these loans as Non-Performing Assets (NPAs) despite non-payment. It became evident later that the financial reporting was generally incorrect.

RBI placed curbs on the activities of the bank for six months. It also limited the amount customers could withdraw from their accounts during the next six months to Rs. 1000 at first and later to Rs. 25,000. In February 2021, Centrum Financial Services and BharatPe submitted a joint proposal to take over the PMC Bank, which the RBI cleared in June 2021).

Overall, 2019 was a bleak year for the co-operative banks too. The RBI reported that all urban co-operative banks faced a slump in the growth rates of deposits, from 6.1 percent in 2018-19 to 3.5 percent in 2019-20, and growth in loans and advances declined from 8 percent in 2018-19 to 0.8 percent in 2019-20 (RBI, 2020a).

While it is not possible to strictly ascribe the slowdown in credit growth to either a weak demand for credit or the weak supply of credit, a few indicators suggest that the lack of supply was a more important factor. First, credit declined across sectors, including in the sectors that grew more rapidly and hence were

likely to have generated the demand for credit. For example, bank credit to agriculture and services recorded a much slower growth rate during 2019-20 than in the past, despite their concomitant growth rates being broadly stable.

Second, a slowdown in demand would have resulted in a decline in the cost of credit disbursed and a decline in the net interest rate margins (Table 7 and 8). Instead, we see an increase in both these variables across financial institutions.

Table 7: Weighted Average Lending Rates

	All Banks	PSBs	PVBs
Average 2018-19	10.29	9.95	10.89
Average 2019-20	10.13	9.56	11.06

Source: RBI.

Table 8: Net Interest Margin

	2018-19	2019-20
All Banks	2.7	2.8
PSBs	2.33	2.37
PVBs	3.26	3.42
NBFCs	5.7	5.1
HFCs	3.1	3.4

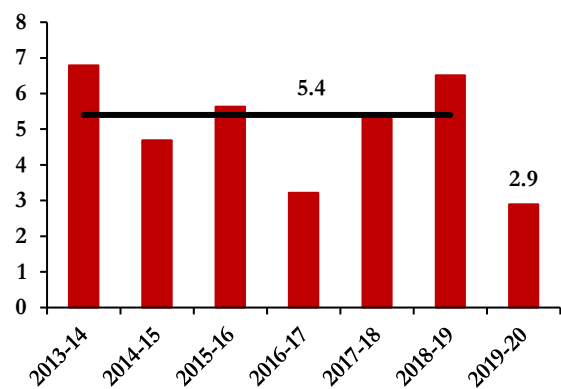
Source: RBI.

Finally, while both bank credit as a percentage of GDP and credit from the banks and NBFCs as a percentage of GDP declined sharply in 2019-20, all the other sources saw an increase.²³ Besides banks and NBFCs the corporates can raise resources from the issue of equity and debt, including private placement of debt and private equity and through the external commercial borrowings. All of these diverse sources of finance have shown healthy growth over the past few years, and most have grown faster than the bank credit, Figure 17. As a result, the share of Banks credit; and that of Bank plus NBFC credit has declined in the total resource pool. During 2019-20, credit from banks and NBFCs declined as percent of GDP, while the resources raised from all other sources increased, further signifying the fact that it was supply side issues which stemmed credit growth from banks and NBFCs.

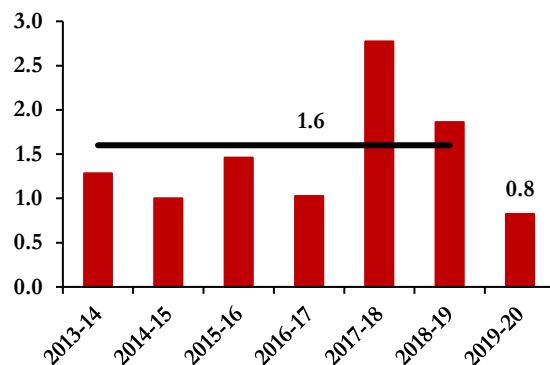
²³ [“How did balance sheets become healthier?”. Business Standard. February 20, 2022.](#)

Figure 17: Flow of Resources to the Commercial Sector

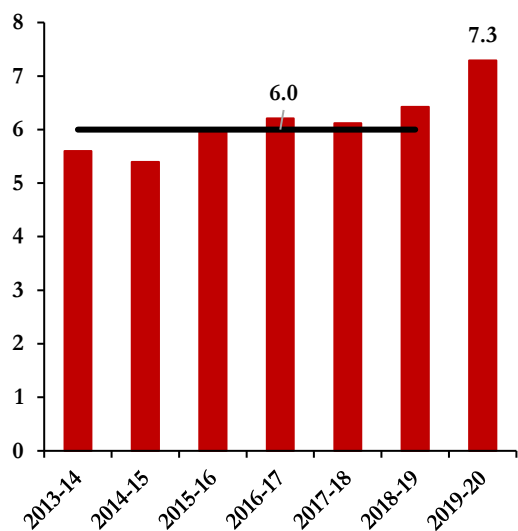
A. Bank Credit as % of GDP



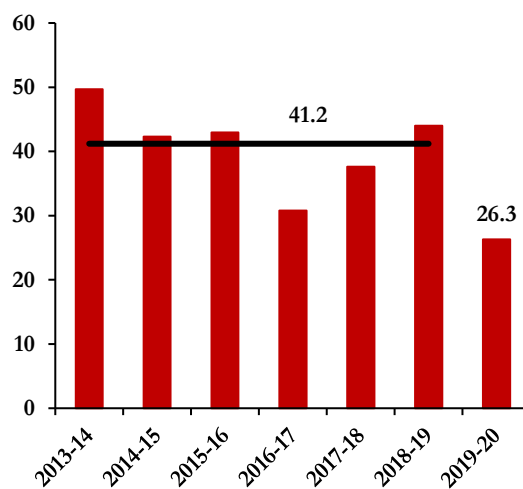
B. NBFC Loans and Advances as % of GDP



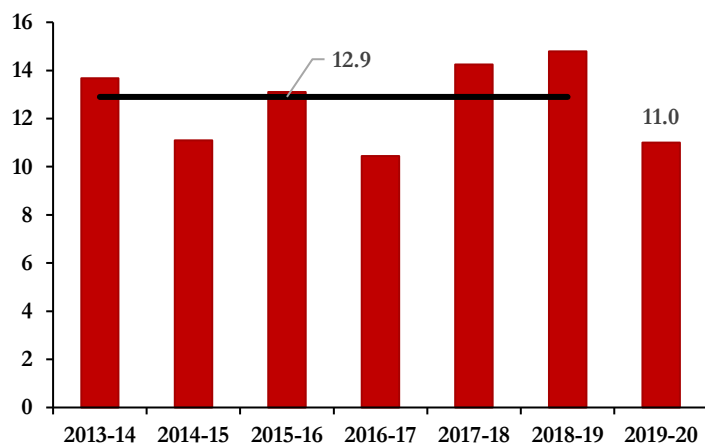
C. All Others as a % of GDP



D. Banks and NBFC Credit as % of Total Funds



E. Banks+ NBFC+ All Other's credit as % of GDP



Note: All others includes flow from total equity (public and rights issue), total debt (public and rights issue, private placement of debt), External Commercial Borrowings and private equity. Line indicates period average from 2013-14 to 2018-19.

(iv) Further Quantifying the Impact of Slowdown of the Exports and Financial Sector

In order to further quantify the role of finance and exports in the growth deceleration, we adopt the approach pioneered by Rajan and Zingales (1998) to better understand the role of finance in growth. It relies on calculating the dependence of each industry on external finance and assessing the growth of industries which rely more on external finance across countries which have a relatively more or less developed financial sector.

We use three different indices of the external finance dependence of industries, one from Rajan and Zingales (1998) and two from Choi (2020).²⁴ In the former, external finance dependence of different industrial sectors is calculated from 1986-1995 for the United States. Choi calculates external finance share for a later time period (1997-2006), and the actual and median external finance share for a number of countries including the US, China, France, Hong Kong, India, Japan, South Korea, Malaysia, Singapore and Thailand. These three indices are highly correlated. Though we have presented the results below with the average (median) values of external dependence of different industries across countries, similar results are obtained for the other two indices.

In a similar vein, we calculate the export intensity of the industries as the ratio of the value of exports to the value of output. By mapping commodity-wise exports into the national accounts data using National Industrial Classification (NIC 2008) categories, we are able to calculate export intensity for 12 industrial sectors from 2011-12 to 2019-20. We then divide industries into above and below median, calling them as more or less export intensive sectors.

We compare the growth turnaround during 2019-20 (defined as growth rate during 2019-20 minus average annual growth rate during 2013-2019) of industries that were more dependent on external finance (above median) with that of industries that were less dependent (below median). Industries that were more dependent on external finance, contracted by 2.5 percent during 2019-20, compared to a growth rate of nearly 10 percent in prior years, thus resulting in a growth turnaround of 12.5 percent. This is a much larger growth turnaround compared to industries that were less dependent on external finance. Industries less dependent on external finance grew at about 8 percent prior to 2019-20 and contracted by 1.5 percent during 2019-20, thus exhibiting a growth turnaround of about 9.5 percent (Table 9).

The results are even starker for industries that are more export oriented. Industries with an above average exports to output ratio contracted by 4.2 percent during 2019-20, compared to a close to 10 percent growth rate in prior years, resulting in a growth turnaround of about 14 percent. Comparable number for industries less dependent on exports is 5 percent (these industries grew at 6 percent prior to 2019-20, and at a much slower pace of 1 percent during 2019-20).

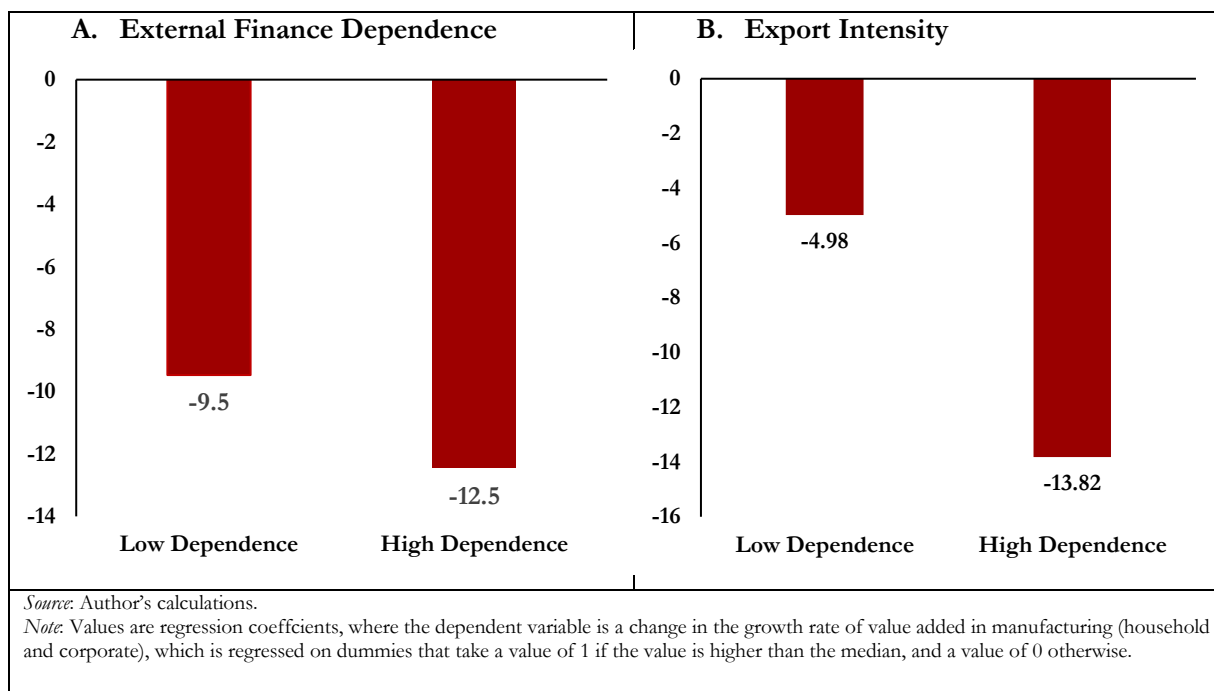
Table 9: Growth turnaround, finance dependence and exportability

²⁴ We restrict our attention to manufacturing industries for which value added data is available from the NAS (value added from manufacturing in household sector and corporate sector). We map these industrial sectors from National Industrial Classification (NIC 2008) with the International Standard Industrial Classification (ISIC) codes, as in Rajan and Zingales (1998).

	Growth in prior years (i)	Growth during 2019-20 (ii)	Deviation (ii-i)
Low External finance dependence	7.89	-1.59	-9.48
High External finance dependence	9.8	-2.5	-12.4
Low Exportability	5.93	0.95	-4.98
High exportability	9.66	-4.16	-13.82

Source: Author's calculations.

Figure 18: External Finance Dependence and Export Intensity



VI. Conclusion

In this paper, we analyze the deep and anomalous economic slowdown in the Indian economy during 2019-20, when the economy decelerated by about 250 basis points, growing at 4 percent. The main findings are delineated below.

The slowdown was largely confined to one year, 2019-20. The growth rate in the prior years averaged at 7 percent a year, and in none of the other years was it significantly below this average rate of growth.

Notwithstanding the alternative narratives, the slowdown did not permeate to each sector and each activity. It was concentrated primarily in the manufacturing sector. The agriculture sector grew faster than before, and the services sector experienced only a mild deceleration in the latter half of the year. On the demand side, it was primarily reflected in a sharp contraction in exports and some moderation in consumption. Investments and government expenditures were largely undented.

We attribute the slowdown to the following three factors: (i) About a 50 basis points worth of slowdown to the COVID-induced lockdown in the last week of March; (ii) More than 100 basis points

worth of slowdown to the collapse in exports, which was both due to a large global slowdown in trade, and due to the fact that India lost out to other countries in maintaining its market share in a slowing market; and (iii) Credit collapse from banks, NBFCs, and HFCs, due to issues related to asset quality and risk aversion, which likely made credit availability an impediment to production, investment, export, and consumption decisions.

The analysis, as such, does not point to any permanent damage to the sources of growth or any deep-rooted malaise, which cannot be mended through timely and focused policy attention.

Growth post- COVID will be contingent upon actively seeking greater integration in the global markets and maintaining this integration. Currently, India accounts for only 1.5 percent of the global market for goods, and 3.5 percent of the global market for services. We should aim to increase the country's shares in the global markets for goods and services to at least 5 percent each. All the three sectors of the economy, that is, agriculture, industry, and services, can contribute more to growth if they can access a larger foreign market. The government as well as the private sector can play an active role in expanding the market size, through new trade agreements, as well as commercial collaborations. We also want to look afresh into our mindset and approach towards exchange rate depreciation.

The time also seems ripe to rethink the role of the banking sector in financing growth, and in particular, the role and scale of public sector banks, and to enhance the role of well-regulated and well-capitalized private sector banks, while simultaneously facilitating healthy growth of all other segments of the financial markets. One possibility is to bring down the government's stake in public sector banks (rather than outright privatization). Research shows that even such a partial decline in State ownership results in improved performance. One possibility is to use the proceeds from such partial privatization as seed money to start new private banks or to help the existing ones grow; with a clear pathway to redeem this stake in a few years.

NBFCs and HFCs play a significant role in meeting the financing requirements of the MSMEs and households. Besides, after growing very rapidly for a few years, the NBFC segment has also slowed down. Even as the banks and NBFCs have grown erratically, all other sources of finance, including market equity, debt raised in the market, private equity, private debt, and external commercial borrowings, have grown steadily and helped bridge the financing gap. The contribution they make to the economy and the way their growth

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Data Appendix

Variable	Unit, Source, Frequency, Time Period
GDP at Market Prices (at 2011-2012 constant prices) and its components- Final Consumption Expenditure, Private; Final Consumption Expenditure, Government; Gross Fixed Capital Formation; Exports of Goods and Services; Imports of Goods and Services; GVA and its components	INR million; CSO Quarterly (ending March, June, September, December) and Annual (ending March of the fiscal year); 2011-12 to 2019-20
Global exports of goods and services	World Development Indicators (WDI), 2001-2020, (Calendar years)
Global and Indian exports of goods	Data on Trade Statistics (DOTS), IMF, Annual (monthly data converted into annual), Quarterly (monthly data converted into quarterly), 2011-12 to 2019-20
Exports of goods from India and other Asian countries	Data on Trade Statistics (DOTS), IMF, Annual, 2011-12 to 2019-20
Global merchandise exports	WTO, Annual, 2011-12 to 2019-20
Merchandise exports and destination-wise merchandise exports	USD million, Ministry of Commerce and Industry, DGCIS, Monthly (Quarterly growth rates calculated by averaging monthly growth rate for each quarter).
High-frequency indicators	
Auto sales total	Unit, Society of Indian Automobile Manufacturers, Monthly, June 2011 -March 2020
Air passenger traffic	Person, Airport Authority of India, Monthly, June 2011 to March 2020
Air cargo traffic	Ton, Airport Authority of India, Monthly, June 2011 to March 2020
Rail passenger (passenger originating)	Unit million, Indian Railways, Monthly, June 2011 to March 2020
Rail cargo (freight originating)	Ton million; Indian Railways, Monthly; June 2011 to March 2020
Foreign tourist arrivals	Persons, Ministry of Tourism, Monthly, June 2011 to March 2020
Petroleum consumption	Metric ton thousand, Petroleum Planning and analysis cell, June 2011-March 2020
Natural gas consumption	Cub m million; Petroleum Planning and analysis cell; Monthly; June 2011 to March 2020
Farm tractor sales (including exports)	Unit; Tractor and Mechanisation Association; Monthly; April 2012 to March 2020
Goods and Services Tax Revenue	INR million; Ministry of Finance; Monthly; August 2017 to March 2020
Nifty 50	03 November 1995=1000, National Stock Exchange of India Limited Monthly; June 2011 to March 2020.
S&P BSE Sensex	1978-1979=100, BSE limited; Monthly, June 2011 to March 2020
Crude steel production	Metric ton thousand, Joint Plant Committee; Monthly, March 2012 to March 2020
Electricity power supply	GWh, Central Electricity Authority, Monthly, March 2012 to March 2020
Crude oil production	Ton thousand, Ministry of Petroleum and Natural Gas, Monthly, March 2012-March 2020
Natural gas production	Cub n million, Ministry of Petroleum and Natural Gas, Monthly, June 2011- Mar 2020

Index of Industrial Production (consumer durables, non-durables)	Index of Industrial Production (consumer durables, non-durables), Monthly April 2012 to March 2020
Bank credit – Agriculture, industry and services	Y-o-y growth rate, RBI (Data on sectoral deployment of bank credit) Monthly. Year on year growth rates have been calculated using the last month of each quarter
International trade in services	USD million, Ministry of Commerce and Industry, Monthly (Quarterly growth rates calculated by averaging monthly growth rate for each quarter), 2011-21
World Trade (seasonally adjusted, 2010=100)	Index, Haver Analytics (Netherlands Bureau for Economic Policy analysis) Monthly. Year on year growth has been calculated first by averaging the index across months corresponding to a quarter., 2011-2021
Macro-financial Data	
Centre fiscal deficit	Per cent; Ministry of Finance; Annual; 2012-2020
FDI inflows, Portfolio flows	USD million, RBI, Quarterly, June 2012 to March 2020
Crude oil	\$ per bbl, World Bank (Pink Sheet), Quarterly (monthly data is converted into quarterly), June 2012- March 20
Nominal exchange rate	(INR/\$), RBI, Quarterly (monthly data is converted into quarterly) June 2012 to March 20
REER: Trade weight 40 currencies	Index, RBI, Quarterly (monthly data is converted into quarterly) June 2012 to March 20
G-sec yields	RBI; Quarterly (monthly data is converted into quarterly); June 2012 to March 20
Current Account Deficit as % of GDP	Per cent, MoSPI, Quarterly, June 2012 to March 20
Headline Inflation	Per cent, MoSPI, Quarterly (monthly data is converted into quarterly) June 2012 to March 20
NBFC credit and Bank credit Adjusted Non-Food Bank credit	Annual growth rate, RBI, 2013-14 to 2019-20. INR crores, Flow of resources to commercial sector in India RBI
Private equity	USD million, VCCC Edge data, Annual from 2013-14 to 2019-20. USD is converted into INR.
External Commercial Borrowings	USD million, Ministry of Finance. Annual from 2013-14 to 2019-20. USD is converted into INR.
Rights and public issue (debt and equity), Private placement of debt.	INR crores, SEBI Monthly Bulletin. From 2013-14 to 2019-20.

Appendix A: More Disaggregated Sectoral Decomposition

Table A1: Contribution of sub-sectors of Industry and Services to real GVA growth

Variables	2019-20			Average over 2012-13 and 2018-19		
	Growth	Weight	Contribution	Growth	Weight	Contribution
Industry						
Manufacturing	-2.44	0.18	-0.44	7.44	0.18	1.32
Electricity, Gas, Water Supply	2.05	0.02	0.05	6.77	0.02	0.15
Construction	0.98	0.08	0.08	4.05	0.08	0.34
Mining and Quarrying	-2.54	0.03	-0.07	3.59	0.03	0.11
Services						
Trade, Hotels, Transport, Communication	6.40	0.20	1.27	8.73	0.19	1.62
Financial Services, Real Estate, Professional Services	7.27	0.21	1.55	8.60	0.21	1.77
Public Administration, Defence, Other Services	8.29	0.13	1.06	6.80	0.12	0.84

Source: Data downloaded from CEIC, original source is NAS.

Note: Weights have been calculated as the share of a component in the national GDP in the previous financial year. The average growth and average weight in Columns 5 and 6, respectively, of the table are over 2012-13 and 2018-19. The last column presents the average contribution of each component over 2012-13 and 2018-19.

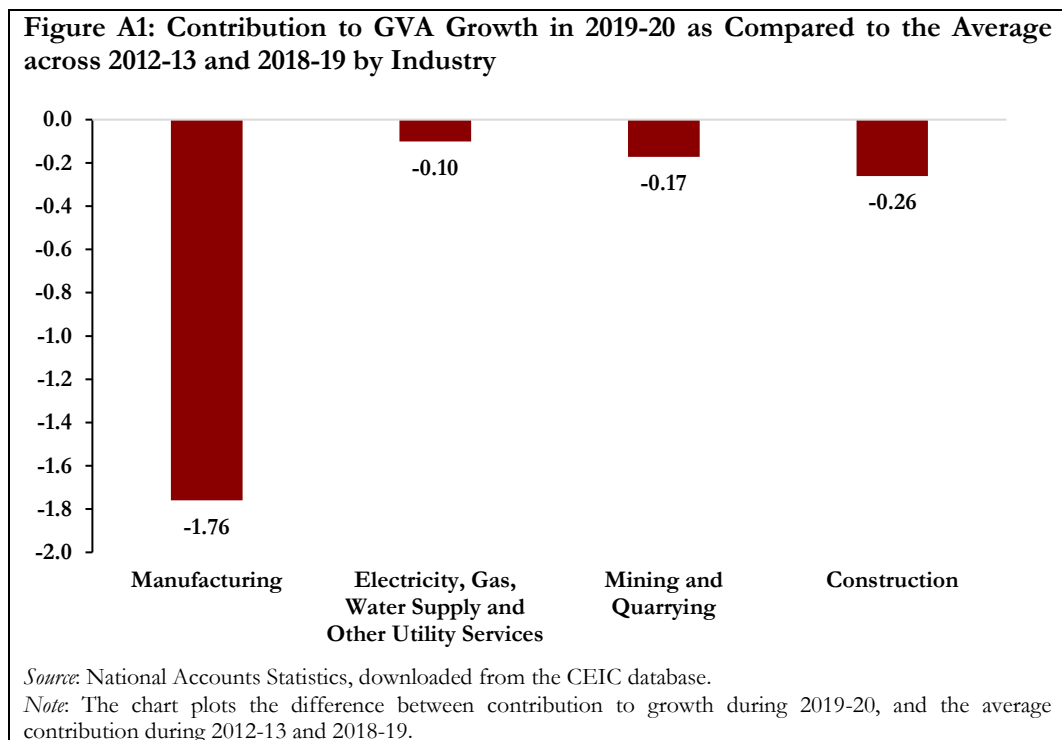
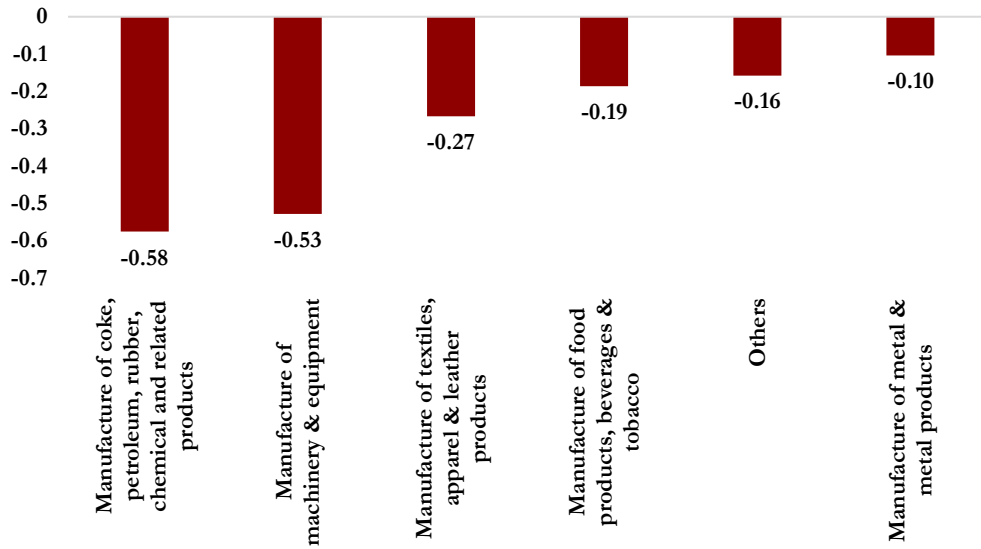


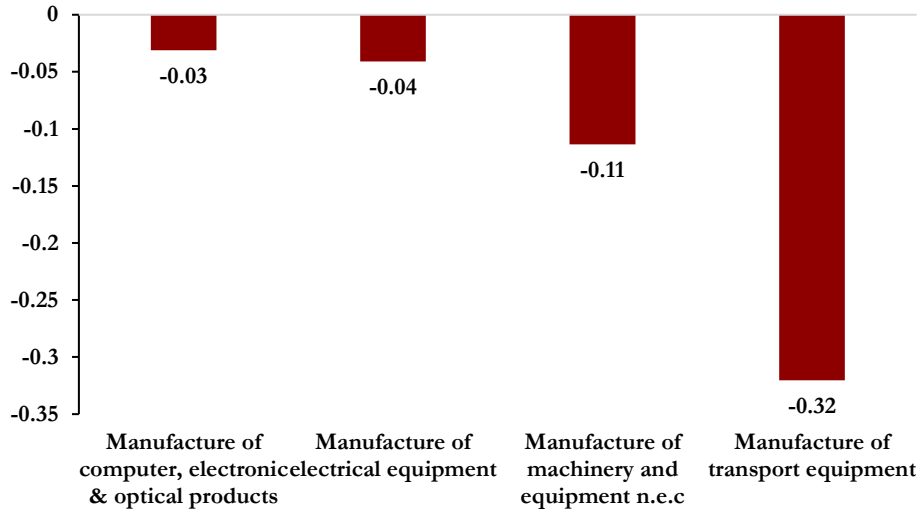
Figure A2 : Contribution to GVA Growth in 2019-20 as Compared to the average across 2012-13 and 2018-19 by Manufacturing



Source: NAS downloaded from the CEIC database.

Note: The chart plots the difference between contribution to growth during 2019-20, and the average contribution during 2012-13 and 2018-19.

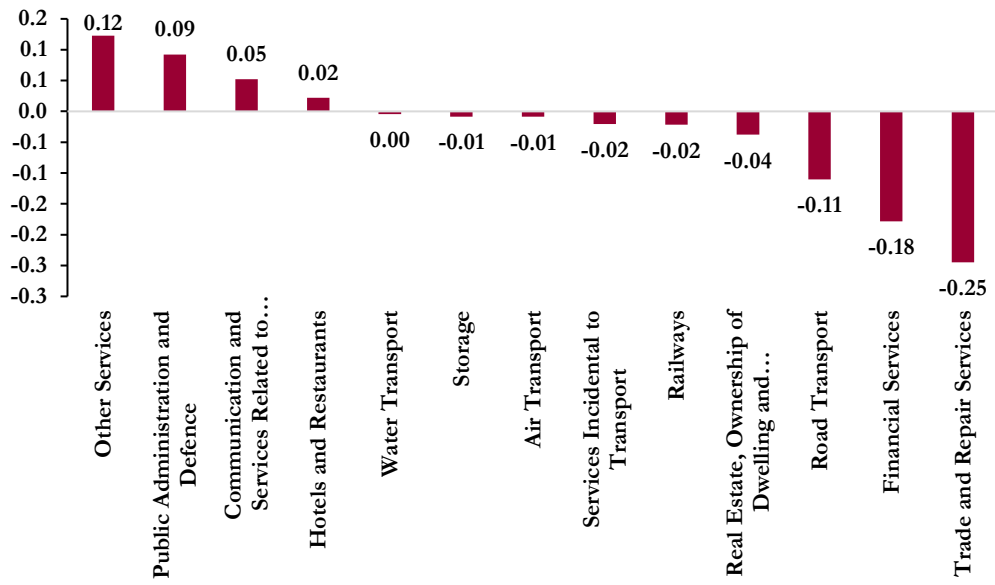
Figure A3: Contribution to GVA Growth in 2019-20 as Compared to the Average across 2012-13 and 2018-19 by Manufacturing of Machinery and Equipment



Source: NAS, downloaded from the CEIC database.

Note: The chart plots the difference between contribution to growth during 2019-20, and the average contribution during 2012-13 and 2018-19.

Figure A4: Contribution to Growth in 2019-20 as Compared to the Average across 2012-13 and 2018-19 (Services)



Source: NAS, downloaded from the CEIC database.

Note: The chart plots the difference between contribution to growth during 2019-20, and the average contribution during 2012-13 and 2018-19.

Appendix B: Policy Announcements, Political and Financial Events Timeline, 2019-20

April 2019

April 2: Former Vice-chairman of IL&FS arrested for fraudulent conduct in granting loans.

April 4: First bi-monthly MPC meeting held - reduced repo rate to 6.0 %

April 11: General Elections commence. Legislative assembly elections held for Andhra Pradesh, Arunachal Pradesh, Odisha and Sikkim.

May 2019

May 19: General Elections end.

May 23: Results of election announced – BJP-led NDA wins majority votes and seats.

June 2019

June 6: Second MPC meeting held – repo, reverse repo and MSF rate decreased to 5.75 percent, 5.50 percent, and 6 percent, respectively.

DHFL defaults on repaying debts; stock prices fall by 16 percent.

July 2019

July 5: Post-election Union Budget for 2019-20 released.

Public Sector Banks proposed to be provided Rs 70,000 crore capital to boost credit.

July 14: Dewan Housing Finance Corporation (DHFL), a housing non-banking financial company, reported a net loss of Rs 2,223 crore for the fourth quarter of 2018-19.

August 2019

August 5: Article 370 and 35A revoked from the Constitution that gave special status to the state of Jammu and Kashmir. The state is bifurcated into two union territories – Jammu and Kashmir, and Ladakh.

August 7: Third MPC meeting held – repo rate reduced to 5.40 percent; reverse repo and MSF rate revised to 5.15 percent and 5.65 percent, respectively.

August 9: Housing Finance Companies: Government of India transferred the regulation of Housing Finance Companies (HFCs) from the National Housing Bank (NHB) to the RBI.

August 16: Enforcement Directorate (ED) filed a charge sheet against IL&FS for money laundering.

September 2019

September 4: External benchmark-based lending: Guidelines were issued to banks on 4 September 2019 mandating banks w.e.f. October 1, 2019 to link all new floating rate personal or retail loans and floating rate loans to MSE to an external benchmark.

September 20: Taxation Laws (Ordinance) Bill to reduce corporate income tax rate to 22 percent for existing domestic company and to 15 percent for new domestic company making investment in manufacturing from 1 October 2019.

September 24: FIR filed against PMC bank by Economic Offences Wing and ED for money laundering and hiding bad loans.

October 2019

October 4: Fourth MPC meeting held – repo rate reduced to 5.15 percent; reverse repo rate and MSF rate cut to 4.90 percent and 5.40 percent, respectively.

October 21: Legislative assembly elections for Haryana and Maharashtra.

November 2019

November 8: Review of Limits for NBFC-Micro Finance Institutions (NBFC-MFIs) whereby the household income limits for borrowers of NBFC-MFIs raised from the current level of Rs. 1,00,000 for rural areas and Rs. 1,60,000 for urban/semi urban areas to Rs. 1,25,000 and Rs. 2,00,000, respectively, along with increase in lending limit from Rs. 1,00,000 to Rs. 1,25,000 per eligible borrower.

November 23: RBI constituted a three-member committee to take over the insolvency process of DHFL.

November 22: SEBI blacklists Karvy Stock Broking Ltd. due to illegally pledging client securities to raise personal funds.

November 30: Legislative Assembly election for Jharkhand.

December 2019

December 5: Taxation Law Bill (with amendment) passed. Fifth MPC meeting held – all rates remain unchanged.

December 11: Citizenship Amendment Act, 2019 (CAA) passed by the Parliament.

December 11: Cabinet approves the Insolvency and Bankruptcy Code (Second Amendment) Bill, 2019; approves the proposal for increase in authorized capital and equity support to India Infrastructure Finance Company Ltd. (IIFCL); and “Partial Credit Guarantee Scheme” for purchase of high-rated pooled assets from financially sound NBFCs/HFCs by public sector banks.

February 2020

February 6: Sixth and final MPC meeting held – all rates remain unchanged.

March 2020

March 22: A 14-hour Janata Curfew

March 24: Nation-wide lockdown which eventually lasted until 31 May 2020

March 26: Finance Ministry announces Rs. 1.70 lakh crore relief package for the poor due to the pandemic.

Appendix C: Global Trade Databases

A few different databases are available for global exports data and the data for individual countries. Annual data for goods and services is available from the WDI. The WDI reports data for the calendar year for most countries, and for its fiscal year for India. Quarterly data is available for merchandise exports in the Direction of Trade Statistics database of the IMF and in the WTO database. Both databases correlate closely with each other even if the data series do not match perfectly. Figure 11 shows these different series, as well as their co-movements with the Indian exports' figures. The Indian trade data is available in three different sources. The national accounts data is available at quarterly frequency in Indian rupees. It is available separately for goods and services. The data is for value added in exports. Data at monthly frequency, in USD, for merchandise exports is available from the Ministry of Commerce. The trade data from the Balance of Payments is available from the RBI.

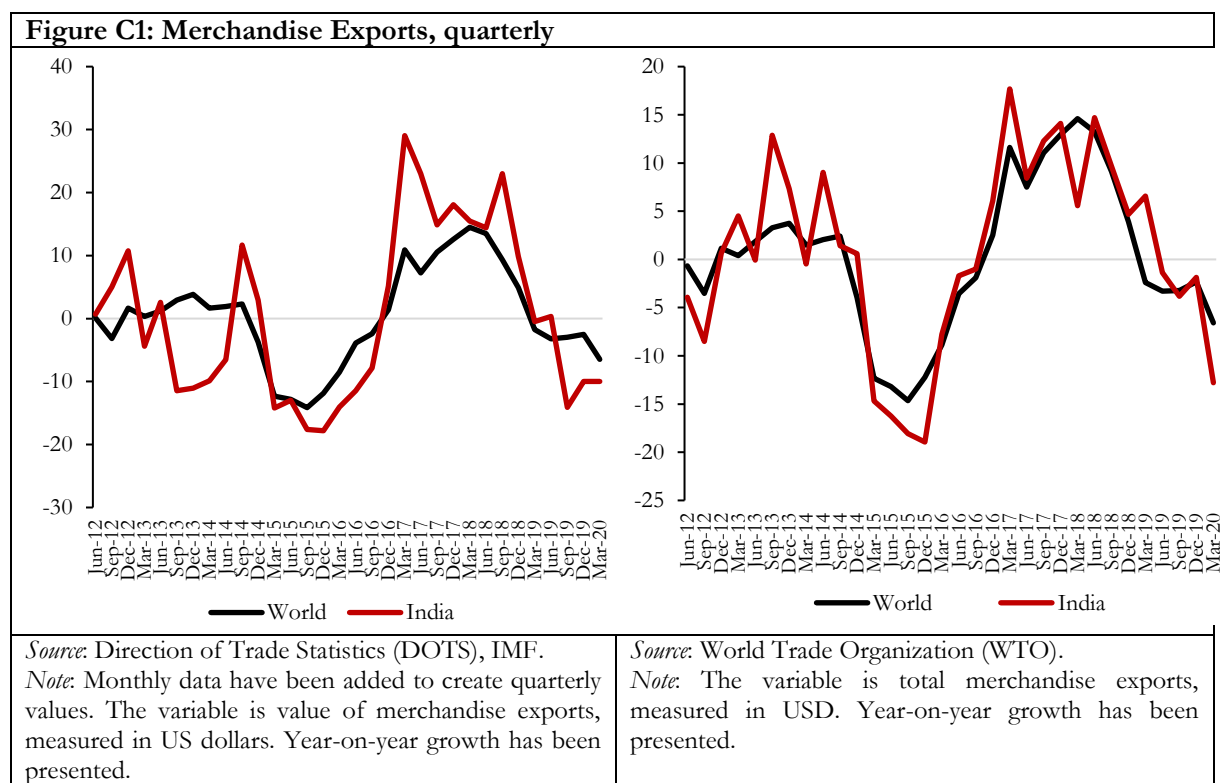


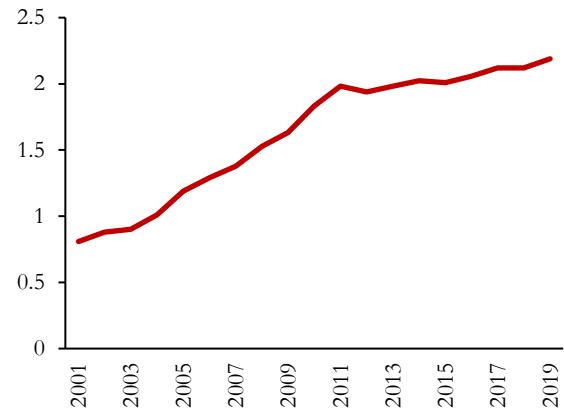
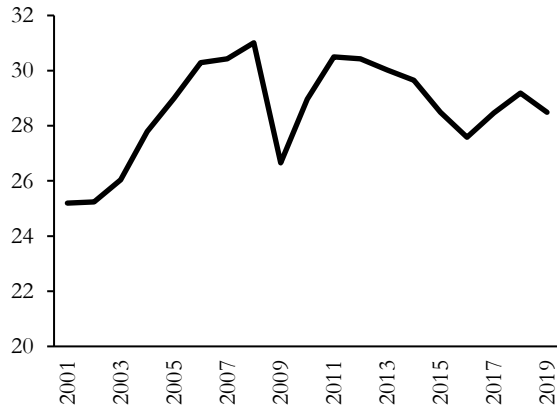
Figure C2: Global Trade and India's Share in it

World Exports in Percent of Global GDP

India's Share in World Exports (percent)

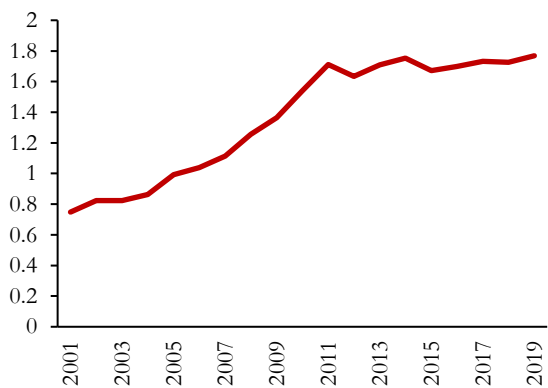
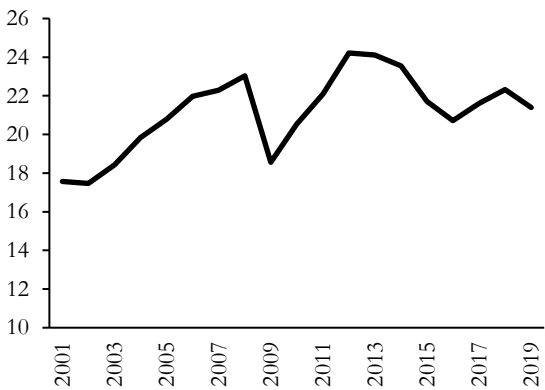
Goods and services

Goods and services



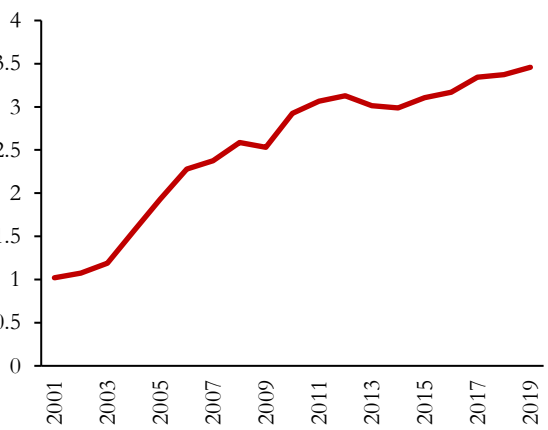
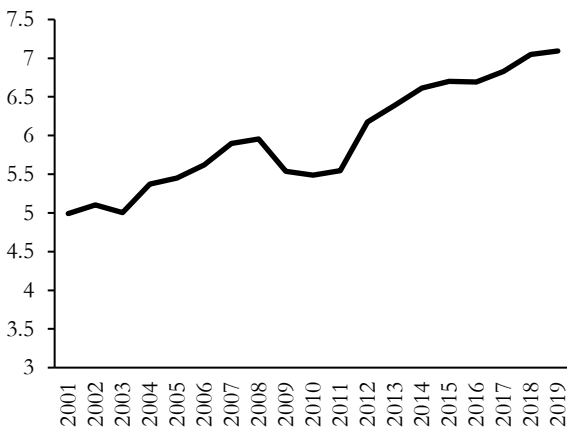
Goods

Goods



Services

Services



Source: World Development Indicators, World Bank.

Table C 1: India's Major Export Destinations for Merchandise Exports

	Share in 2010		Share in 2019	
1	United Arab Emirates	13.4	United States	15.9
2	Exports United States	10.9	United Arab Emirates	9.1
3	China	6.5	China	5.1
4	Hong Kong SAR (China)	4.4	Hong Kong SAR (China)	3.9
5	Singapore	4.2	Singapore	3.5
6	Netherlands	3.6	United Kingdom	2.8
7	United Kingdom	3.5	Bangladesh	2.8
8	Germany	3.0	Germany	2.7
9	Saudi Arabia	2.2	Netherlands	2.7
10	Japan	2.0	Nepal	2.4
11	South Korea	1.9	Malaysia	1.9
12	Indonesia	1.7	Saudi Arabia	1.7
13	Malaysia	1.6	Indonesia	1.6
14	Bangladesh	1.4	Japan	1.5
15	Brazil	1.4	South Korea	1.4
16	South Africa	1.2	South Africa	1.2
17	Nepal	0.9	Brazil	1.2
	Share of all other Countries	36.0	Share of all other Countries	38.0

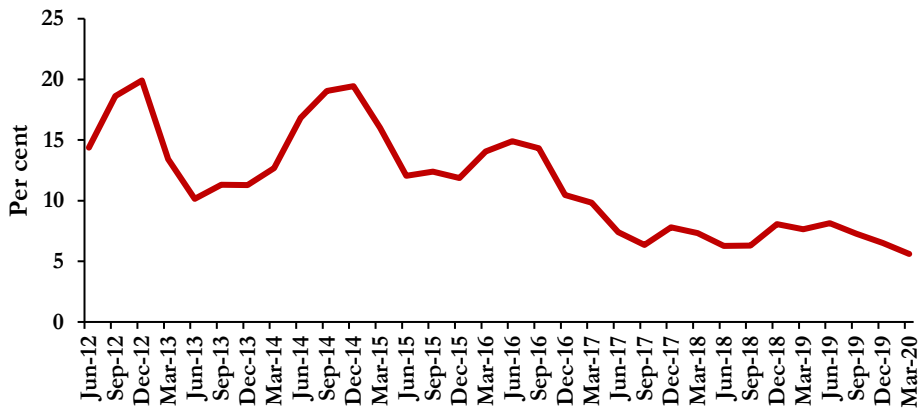
Source: Ministry of Commerce and Industry

Merchandise exports have been buoyant during 2021-22, growing at nearly 15 percent. The pace of growth is somewhat higher than the pace seen globally. It augurs well for growth during the current year, and if the global trade continues to keep pace, for growth in the coming years.

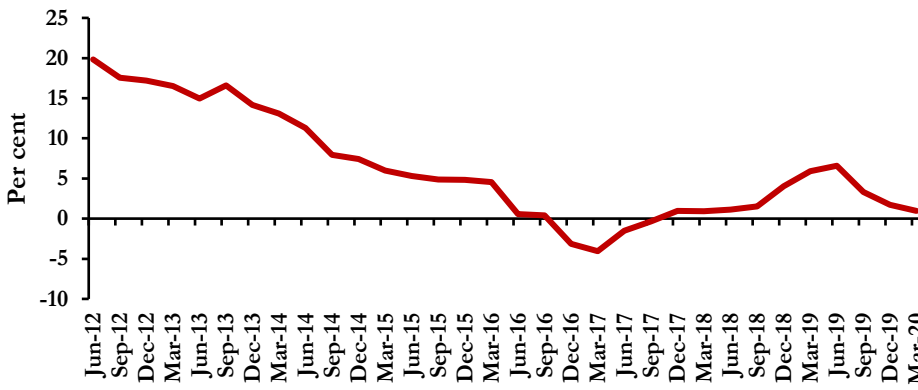


Appendix D

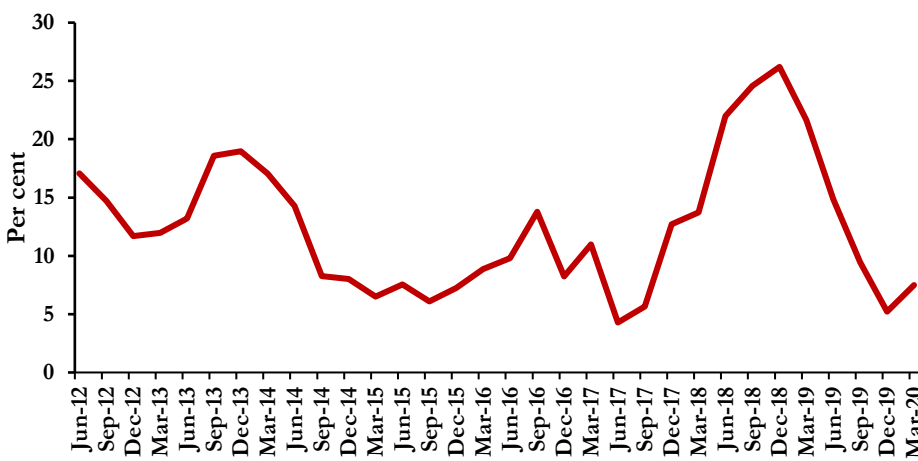
Bank Credit to Agriculture



Bank Credit to Industry



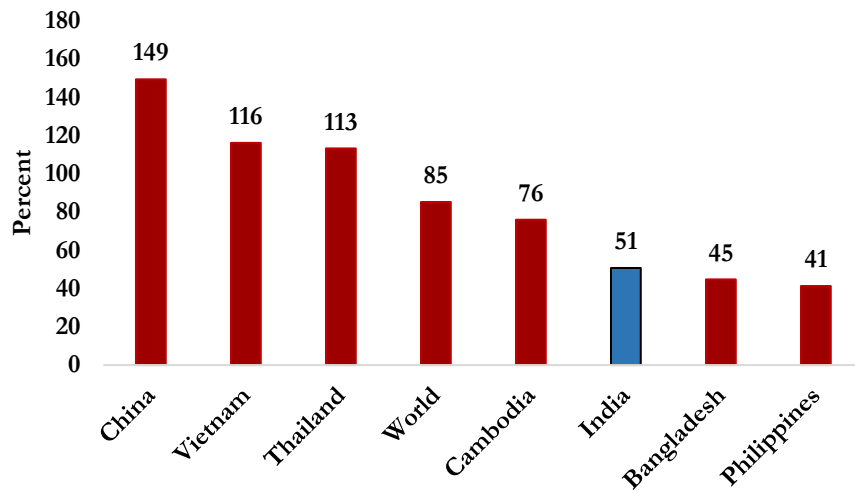
Bank Credit to Services



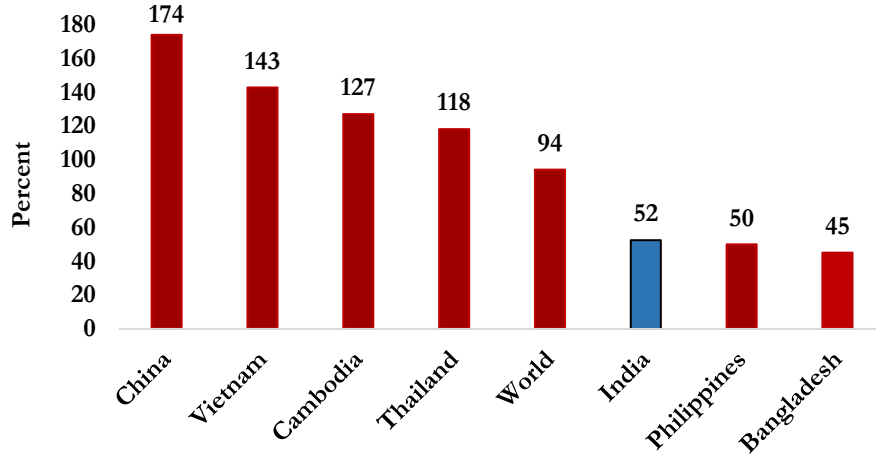
Source: RBI.

Appendix E

Bank Credit to GDP Ratio (Average of 2013-18)



Bank Credit to GDP Ratio (Average of 2019-20)



Change (Average 2019-20 – Average 2013-18) Bank Credit ratio of 2013-18 and 2019-20

