ABSTRACT

Theories of development economics suggest that growth in any economy can be accelerated through a strong banking system. Financial Institutions are required to channelize savings into investment. A strong financial system improves the resource allocation in any economy by channelizing and providing credit to producers, consumers and the Government. When credit is efficiently used growth accelerates. On the other hand a fast growing economy provides profit possibilities to financial institutions providing a strong incentive for bank credit to expand. To understand the causation, this paper examines the nexus of economic growth and bank credit in India for the period 1972-2010. The two key variables for observation are growth rate of GDP and bank credit, the latter is divided according to the sector where the credit is employed. A time series framework is used in the research. Augmented Dickey fuller test suggests that all these series are stationary in their first difference. The Johansen Cointegration test suggests the existence of 2 long run cointegrating equations between the series. Further Granger Causality and vector error correction model provides evidence that agricultural and industrial credit growth causes or leads economic growth in India.

Keywords: Economic Growth, Bank Credit, Granger Causality,Vector Error Correction Model