

India's Potential Output Revisited

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In India, the debate on 'potential growth and output gap' has been intensified due to revision in the GDP estimates with change in base year and its underlying methodology. This paper provides the estimates of potential growth and output gap, for the first time in India, on a quarterly basis using production function approach in addition to revisiting the estimates of potential output by conventional statistical methods for the period 1980Q2 – 2015Q4. The results

from different methods suggest that output gap, *i.e.*, the percentage deviation of actual output from its potential level, has been negative since Q3 of 2012, though the gap is closing slowly. According to different estimates, India's potential growth had increased steadily from its low level of around 5 per cent in 1980s to about 6 per cent during 1992-2002 and accelerated to around 8 per cent during 2003-2008. However, the potential growth fell significantly in the aftermath of global financial crisis to around 7 per cent during 2009-2015. The production function analysis further confirms that the potential growth has fallen in the recent years mainly due to decline in the contribution of capital stocks and total factor productivity. The semi-structural technique, *viz.*, multivariate Kalman filter, suggests that India's potential growth for the most recent period is about 6.8 per cent with a band of (+/-) 50 bps at 95 per cent confidence interval. Key to accelerate India's potential growth lies with higher level of capital formation as its contribution dominates *vis-à-vis* the contribution of labour and total factor productivity.

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