Economic Activity and its Determinants: A Panel Analysis of Indian States

This paper assesses the impact of both monetary and fiscal policy along with other macroeconomic determinants on economic activity using state-level Indian data. Since economic activity can vary across states due to local factors and state government policies, a state-level empirical analysis, by providing more variability in both the dependent variable and the potential explanatory variables, can help better identify the underlying economic relationships. The empirical analysis confirms the role for a countercyclical monetary policy in stabilising economic activity. Bank credit expansion supports economic activity, suggesting the operation of credit channel of transmission in addition to the interest rate channel. Public investment is found to crowd-in economic activity, while other fiscal spending crowds out economic activity. Thus, a prudent fiscal policy, in conjunction with spending oriented towards capital outlays, can boost output.