

Does Financial Cycle Exist in India?

The paper, for the first time in the Indian context, aims to provide an aggregate measure of financial cycle considering bank credit, equity prices, house prices and real exchange rate. The cyclical properties of the financial variables are examined to identify the existence of financial cycle. The overall analysis suggests that there is a well-defined financial cycle in India and the expansionary phases of financial cycle, particularly the peak, provides an early warning signal about rising stress in the banking sector and weakening of economic activity in the future. The

analysis also indicates that the ongoing downturn in financial cycle seems to have reached its trough by 2018:Q4. The paper finds a longer duration financial cycle with the average length of about 12 years vis-à-vis a shorter duration business cycle with the average length of about 5 years. The dominance of medium-term cycles in overall variation of financial variables has been found to have increased since mid-1990s coinciding with the rise in the pace of financial liberalisation. While both credit and equity prices drive financial cycles in India, the contribution of house prices has increased since mid-2000s. The paper suggests that a close monitoring of financial cycle on a regular interval is essential to enhance macroeconomic and financial stability.