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**IMPACT OF FINANCIAL DISTRESS ON CORPORATE LEVERAGE  
IN INDIA – AN EMPIRICAL ANALYSIS**

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**ABSTRACT**

*An empirical analysis has been performed to analyse the association between annual growth of corporate debt and recent rise in the distressed assets, keeping in view the overall economic growth as a control variable. Long-term time-series data of twenty-three years, has been considered and analysed using multivariate regression analysis, from 1997-98 to 2019-20. The rationale behind the analysis has been the rise in distressed assets, and its consequent effects on the leverage structure of the non-financial Indian corporates. Findings suggest that, the rise in distressed assets has a significant negative impact on the annual growth of corporate borrowings, with  $\beta = -0.172$ . On the contrary, economic growth has a significant positive impact on the annual growth of corporate borrowings with  $\beta = 2.224$ . However, in the presence of annual economic growth as a control variable, a significant  $R^2$  change of 0.784 has been observed.*

**KEYWORDS:** *Financial Distress, Economic Growth, Stressed Assets, Corporate Finance.*

*Jel Classification: G01, G30*

**Abbreviations:**

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BIS	Bank for International Settlements
CC_GWTH	Annual year-on-year growth of corporate borrowings
GDP_GWTH	Annual year-on-year growth of Gross Domestic Product
EPW Data	Economic and Political Weekly Database
GNPA	Gross Non-Performing Assets
HP filter	Hodrick-Prescott (HP) filter
NPA_GWTH	Annual year-on-year growth of Non-Performing Assets
RBI	Reserve Bank of India
Y-o-Y	Year on Year growth rate

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**I. INTRODUCTION**

A significant rise in the stressed assets, even before pandemic, particularly in public sector banks, has been overwhelming. Regulatory bodies have been doing continuous efforts to

mitigate the risk. In addition, cause of the rise may be attributed to certain macro variables such as, global slowdown and uncertain market conditions. Furthermore, certain micro variables such as, procedural deficiencies in monitoring credit and other factors like misuse/misconduct by the borrowers, and collusion of the bank staff may have caused the situation (Singh and Brar, 2016).

Public sector banks have been under constant pressure, due to the rising stressed assets, which has been affecting their operations and profitability. There has been a significant negative relationship between stressed assets and profitability of banking sector. Considering this, there may be an urgent need to reduce the stressed assets in the banking sector (Pandey, 2017).

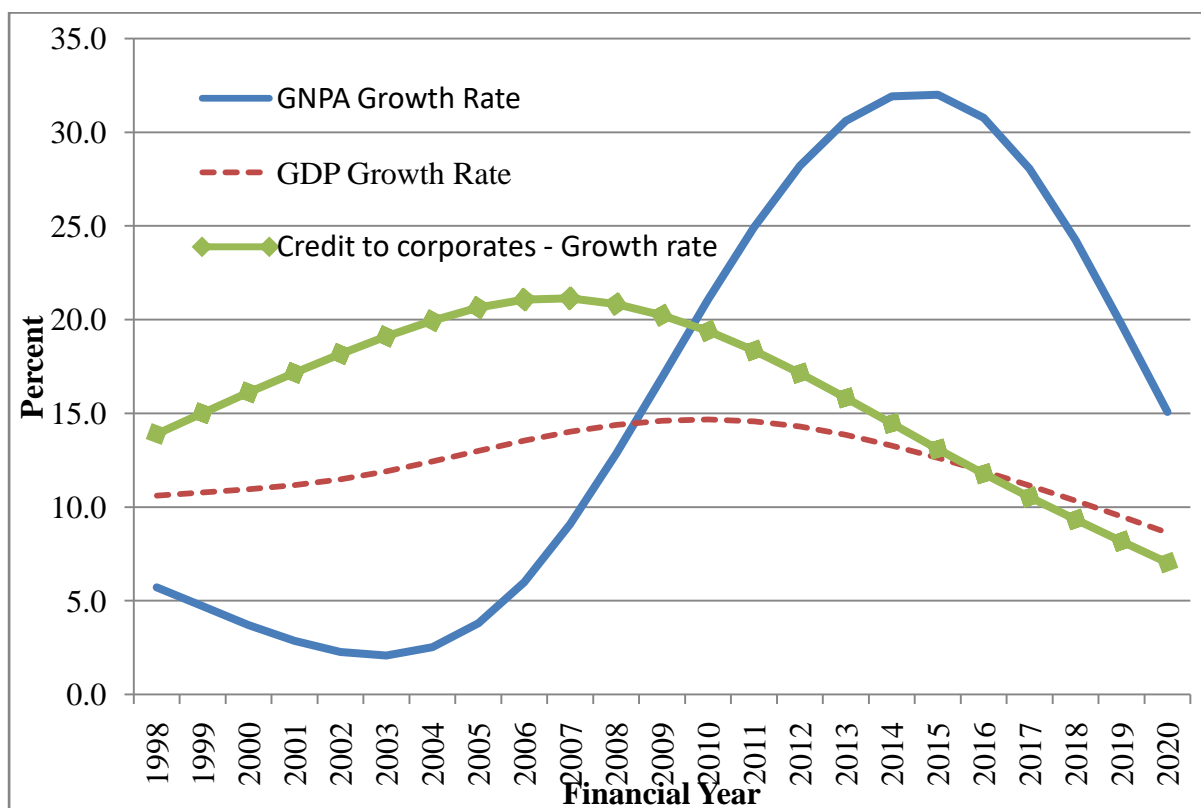
Since 2011, with the introduction of BASEL norms, banks become bound to disclose their stressed assets and restructuring process. Consequently, the corporate debt restructuring gained pace in 2015, considering a significant correlation between corporate debt restructuring and stressed assets (Das and Dey, 2018). Moreover, in both advanced and emerging economies, stress caused by corporate borrowing has more severe effects on output. Thus, policy makers may closely monitor the corporate debt structure (Park et al., 2022).

Presently, the corporate sector alone accounted for 53.0 percent of all the bad loans and 78.0 percent of the gross NPAs. Although after 2019-20, process of deleveraging has initiated. Furthermore, to prevent NPAs, measures such as, enhancing corporate/banking governance, and increasing monitoring/regulation may be adopted. Moreover, at present, since the economy is progressing towards high growth levels, it may be resource full for the banks to revive the stressed assets and recover the losses (GOI, 2022).

In Indian context, there has been a significant spike in the growth of stressed assets, during financial year 2015-16. However, the problem still persists, and has been enhanced by the pandemic. Moreover, economic growth and growth of corporate borrowings have followed a similar trend. Additionally, for long-term growth analysis, data smoothening has been attempted using HP-filter and long-term trend has been presented in Chart I.1.

*Chart I.1: Annual growth rates of GNPA, GDP at current prices and credit to non-financial corporates for the period 1997-98 to 2019-20 (HP-filtered series)*

(percent-y-o-y growth)



Source: Appendix I. Compiled by author.

As evident in Chart I.1, stressed assets have been experiencing year-on-year growth from 2003-04, and peaked in 2015-16. Similarly, growth of credit lending to non-financial corporates peaked during 2006-07, followed by the rise in stressed assets in the banking sector. Growth of GDP followed a similar trend, likewise corporate borrowings. Thus, the borrowing behaviour of Indian corporates impacts business and overall economic growth.

The paper has been organised into five sections starting with introduction and the brief review of literature, presented in section II, followed by Section III, which covers the research methodologies adopted for the analysis. Furthermore, Section IV covered the data analysis, and finally, a conclusion and recommendations has been presented in Section V, followed by bibliography and relevant appendices. Data for the paper has been sourced from sources EPW and BIS databases.

**II. Literature Review**

Rajan and Dhal (2003) examined the association between NPAs and other independent indicators such as, terms of credit, bank size and macro-economic shocks. Panel data regression analysis indicated that terms of credit have a significant association with NPAs, subject to the presence of other variables in the model.

Ufo (2015) examined the association between corporate leverage and financial distress in eleven Ethiopian manufacturing firms from 1999 to 2005. Results indicated that leverage and financial distress has a significant negative relationship, and the firms may optimize their debt by minimizing bank loans and equity financing.

Pradhan (2018) indicated that stressed assets are a major problem in the Indian banking sector, with majority loans classified as NPAs. Moreover, restructuring guidelines have been misused. Also, other emerging BRICS economies are better as compared to India. Moreover, NPAs adds more work load on judiciary, and huge number of cases still in process. Given the backdrop, besides continued steps to clear NPAs, recapitalization of banks is a difficult task.

Abraham et al. (2020) studied the expansion of global corporate debt after the 2008 global financial crises. Results indicate the need to carefully monitor the growth of corporate debt and its potential risks, especially in emerging economies where the growth has been particularly rapid. The paper suggested promoting better risk management practices and enhancing the monitoring and regulation of corporate debt markets.

Shi et al. (2021) analyzed the efficiency of banking sector in China from 2012 to 2018, taking into account external economic factors as well as internal factors of the banks. The results indicate that the efficiency of commercial banks is greater at financing stage rather in the investment stage.

Haralayya and Aithal (2021) studied the association between banking sector and per capita gross domestic product (GDP) in India during 1981 to 2019. Results indicated that broad money to total reserve ratio, domestic credit to private sector, final consumption expenditure and literacy rate have a significant positive impact on GDP per capita, whereas consumer price inflation and real interest rate have negative impacts. Moreover, financial activities of banking sector contribute mainly in economic development of India.

Xiao and Kim (2022) examined the association between debt delinquency and financial distress and the moderating role of financial capability. Results indicated that payment delinquencies of mortgage, credit card and student loans were positively associated with financial distress, whereas, financial capability was negatively associated.

Soyres et al. (2022) examined the association of public debt and real GDP using data on 178 countries over the period 1995-2020. Results indicate that, the impact of public debt on real GDP is not uniform across countries and depends on a range of factors. However, increase in public debt generally has a negative impact on real GDP. The negative impact is greater for countries that have a high initial debt level or a rising debt trajectory over the five preceding years.

### **III. Research Design**

Based on the review of literature, select issues have been incorporated in the objectives of this paper, presented as follows:

- I. Analysing the association between growth of corporate sector borrowings and stressed assets in the country.
- II. Analysing how economic growth of the nation impacts the association between growth of corporate sector borrowings and stressed assets?

For analysing the desired objectives, secondary data has been collected from EPW and BIS databases. Furthermore, for analysing the first objective, '*Growth of corporate borrowings*' has been taken as dependent variable, whereas, '*Growth of stressed assets*' has been taken as independent variable. Similarly, for analysing the second objective, '*Growth of corporate borrowings*' remained as dependent variable, whereas, '*Growth of stressed assets*' and '*Growth of Indian GDP at current prices*' has been taken as independent variables. In addition, annual frequency data points for each variable, starting from 1997-98 to 2019-20<sup>1</sup>, have been sourced and analysed using bivariate and multivariate linear regression,

respectively. Following expressions has been considered during the analysis;

$$Y = \alpha + \beta_1 X_1 + e, \text{ for analysing the first objective, and;}$$

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + e, \text{ for analysing the second objective}$$

Where, DV = ‘Growth of corporate borrowings’ and IDVs are  $X_1$  = ‘Growth of stressed assets’ and  $X_2$  = ‘Growth of Indian GDP at current prices’

Furthermore, for analysing the long-term impact, data smoothening has been attempted using HP-filter, which addressed the trend and cyclicity, using the following expression;

$$\min_{\tau} \left( \sum_{t=1}^T (y_t - \tau_t)^2 + \lambda \sum_{t=2}^{T-1} [(\tau_{t+1} - \tau_t) - (\tau_t - \tau_{t-1})]^2 \right).$$

Where,  $\lambda = 100$ , taken as smoothing parameter

In addition, SPSS software has been used for data analysis, and information corresponding to all variables has been placed in the relevant appendices, as mentioned.

#### IV. Data analysis.

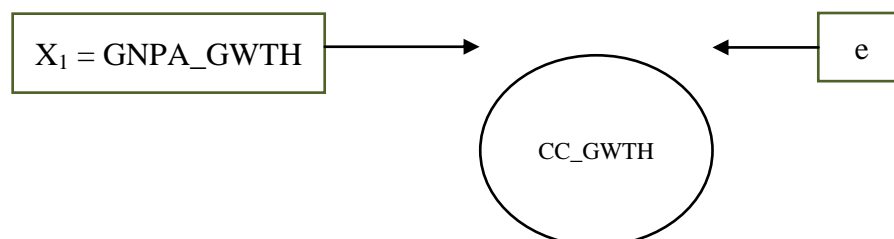
Table IV.1: Descriptive statistics of the variables considered in the analysis

	GNPA - Growth Rate	GDP (Current Prices) - Growth Rate	Credit to Corporates - Growth rate*
Mean	015.614	012.337	016.029
Median	015.078	012.443	017.149
Standard Deviation	011.377	001.765	004.341
Sample Variance	129.443	003.115	018.841
Kurtosis	-001.661	-000.865	-000.632
Skewness	000.176	-000.311	-000.661
Minimum	002.083	008.634	007.044
Maximum	031.997	014.673	021.150
N	23	23	23

Source: Computed by the author.

#### IV.1 Analysis of the association between growth of corporate borrowings and stressed assets in the country

As discussed in the earlier sections, data from 1997-98 to 2019-20 comprised of 46.0 data points related to the variables has been sourced and analysed using the model diagram presented as follows:



Where, GNPA\_GWTH = ‘Annual growth of stressed assets’, and CC\_GWTH = ‘Annual growth of corporate borrowings’

Also, the following underlying hypothesis has been assumed for performing bivariate linear

regression on HP-filtered time-series using SPSS.

*H1: There is a significant negative impact of 'annual growth of stressed assets' on 'Annual growth of corporate borrowings' with  $B_1$  and  $B_2 \neq 0$ .*

Results indicate that the independent variables  $X_1$  has significantly predicted the dependent variable,  $F(1, 330.284) = 5.387$ ,  $p < 0.05$ . Moreover,  $R^2 = 0.204$  indicated that the model explained just 20.4 percent of the variations in annual growth of corporate borrowings. (Table IV.2).

Table IV.2: Brief results of the bivariate linear regression model summary using DV = Annual growth rate of corporate borrowings (CC\_GWTH) and IDV = Annual growth of stressed assets (GNPA\_GWTH)

Hypothesis	Regression Weights	$\beta$	T	p
$H_1$	GNPA_GWTH <sup>#</sup> CC_GWTH	-0.172	-2.321	0.030**
$F(1, 330.284)$	5.387			
R	0.452			
$R^2$	0.204			

Results =  $H_1$  supported

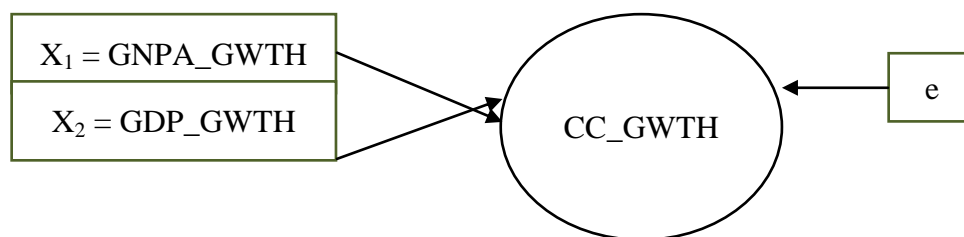
\*\* $p < 0.05$ . #GNPA\_GWTH = 'Annual growth of stressed assets', and CC\_GWTH = 'Annual growth of corporate borrowings'

Source: Appendix II. Computed by the author.

Therefore, results validate the hypothesis that annual growth of stressed assets has a significant negative impact on the growth of corporate borrowings. However, the model has not explained all the variations in dependent variable. The complete results of the model have been placed in Appendix II.

**IV.2 Analysis of the association between growth of corporate sector borrowings and stressed assets in the country – in the presence of economic growth**

In section IV.1, results were significant; however, model prediction efficacy has been low. Therefore, annual economic growth has been added to the analysis. Consequently, 69.0 data points related to following three variables has been analysed for the period 1997-98 to 2019-20 using the model diagram presented as follows:



Where, GNPA\_GWTH = 'Annual growth of stressed assets'; GDP\_GWTH = Annual growth of GDP at current prices and CC\_GWTH = 'Annual growth of corporate borrowings' Similarly, the following hypothesis has been assumed for performing multivariate linear regression.

*H1: There is a significant impact of  $X_1$  and  $X_2$  on 'Annual growth of corporate borrowings' with  $B_1$  and  $B_2 \neq 0$ .*

Results indicate that the independent variables  $X_1$  and  $X_2$  has significantly predicted the dependent variable,  $F(2, 5.175) = 791.94$ ,  $p < 0.05$ . Moreover,  $R^2 = 0.988$  indicated that the model explained 98.8 percent of the variations in annual growth of corporate borrowings.

(Table IV.3).

TableIV.3: Brief results of the bivariate linear regression model summary using DV = Annual growth rate of corporate borrowings (CC\_GWTH) and IDVs = Annual growth of stressed assets (GNPA\_GWTH) and Annual GDP growth at current prices (GDP\_GWTH)

Hypothesis	Regression Weights	$\beta$	T	p
$H_1$	GNPA_GWTH <sup>#</sup>	$B_1 = -0.249$	-25.477	0.000**
	CC_GWTH <sup>#</sup>			
	GDP_GWTH <sup>#</sup>			
$F(2, 5.175)$	791.94	$B_2 = 2.224$	35.446	0.000**
R	0.994			
R <sup>2</sup>	0.988			

Results =  $H_1$  supported

\*\*p<0.05. #GNPA\_GWTH = ‘Annual growth of stressed assets’; GDP\_GWTH = GDP growth rate at current prices and CC\_GWTH = ‘Annual growth of corporate borrowings’

Source: Appendix III. Computed by the author.

Thus, with an addition of economic growth as an independent variable, overall predictability of the model has been enhanced. Growth of stressed assets has a significant negative impact on the growth of corporate borrowings; however, GDP growth has a significant positive impact on the growth of corporate borrowings. The complete results of the model have been placed in Appendix III.

### CONCLUSION

In the last 25 years, even before the pandemic, the rise in stressed assets has been concerning. Considering the fact that corporates have the major chunk of borrowings from the banking sector, the rise of stressed assets may have linkages with corporate borrowings and overall economic growth of the nation.

Furthermore, the analysis indicated that the annual growth of stressed assets has a significant negative impact on the annual growth of corporate borrowings. However, bivariate analysis has not explained all the variations in dependent variable. Thus, economic growth has been incorporated as an additional independent variable. Consequently, multivariate analysis enhanced the overall predictability of the model. Therefore, results indicate that, in the presence of economic growth as an additional independent variable, annual growth of stressed assets has a significant negative impact on the growth of corporate borrowings; however, GDP growth has a significant positive impact on the growth of corporate borrowings.

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**Appendix**

*Appendix I: Annual data related to the following variables used in the paper (Rupees Crore)*

<i>Financial Year</i>	<i>GNPAs*</i>	<i>GDP at current prices (2011-12 base)*</i>	<i>Credit to non-financial corporates by banking sector**</i>
1997	47300	1394816	363698.3
1998	50815	1545294	403321.7



1999	58722	1772297	470101.8
2000	60408	1988262	548263.1
2001	63741	2139886	648385.4
2002	70861	2315243	733932
2003	68717	2492614	874907.4
2004	64812	2792530	992744.5
2005	59373	3186332	1211603
2006	51097	3632125	1572710
2007	50486	4254629	2030522
2008	56309	4898662	2440758
2009	68328	5514152	2890794
2010	84698	6366407	3420352
2011	97900	7634472	4155061
2012	142326	8736329	4785324
2013	193509	9944013	5571133
2014	263372	11233522	6403108
2015	322916	12467959	6982057
2016	611607	13771874	7695035
2017	791791	15391669	8373068
2018	1039679	17090042	8993635
2019	936473	18899668	10030999
2020	899802	20074856	10785216

Source: \*EPW Database. <https://epwrfits.in/> \*\*<https://www.bis.org/statistics/totcredit.htm>

**Appendix II: Bivariate linear regression model summary using DV = Growth of Credit to corporates (CC\_GWTH) and IDV = Growth of stressed assets (GNPA\_GWTH)**

<b>Correlations</b>			
		CC_GWTH	GNPA_GWTH
Pearson Correlation	CC_GWTH	1.000	-.452
	GNPA_GWTH	-.452	1.000
Sig. (1-tailed)	CC_GWTH		.015
	GNPA_GWTH	.015	
N	CC_GWTH	23	23
	GNPA_GWTH	23	23

<b>Variables Entered/Removed<sup>a</sup></b>			
Model	Variables Entered	Variables Removed	Method
1	GNPA_GWTH <sup>b</sup>		Enter

a. Dependent Variable: CC\_GWTH  
b. All requested variables entered.

<b>Model Summary<sup>b</sup></b>									
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F	df1	df2	Sig.
1	.452	.204	.166	3.9658	.204	5.387	1	21	.030

a	3
a. Predictors: (Constant), GNPA_GWTH	
b. Dependent Variable: CC_GWTH	

ANOVA <sup>a</sup>					
Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	84.729	1	84.729	5.387	.030 <sup>b</sup>
Residual	330.284	21	15.728		
Total	415.013	22			

a. Dependent Variable: CC\_GWTH  
b. Predictors: (Constant), GNPA\_GWTH

Coefficients <sup>a</sup>						
Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	18.711	1.425		13.130	.000
	GNPA_GWTH	-.172	.074	-.452	-2.321	.030

a. Dependent Variable: CC\_GWTH

**Appendix III: Multivariate linear regression model summary using DV = Growth of Credit to corporates (CC\_GWTH) and IDVs = Growth of stressed assets (GNPA\_GWTH) and GDP growth (GDP\_GWTH) at current prices (2011-12 base)**

Correlations					
		CC_GWTH	GNPA_GWTH	GDP_GWTH	
Pearson Correlation	CC_GWTH	1.000	-.452	.763	
	GNPA_GWTH	-.452	1.000	.221	
	GDP_GWTH	.763	.221	1.000	
Sig. (1-tailed)	CC_GWTH		.015	.000	
	GNPA_GWTH	.015		.156	
	GDP_GWTH	.000	.156		
N	CC_GWTH	23	23	23	
	GNPA_GWTH	23	23	23	
	GDP_GWTH	23	23	23	

Variables Entered/Removed <sup>a</sup>			
Model	Variables Entered	Variables Removed	Method
1	GDP_GWTH, GNPA_GWTH <sup>b</sup>		Enter

a. Dependent Variable: CC\_GWTH  
b. All requested variables entered.

Model Summary <sup>b</sup>									
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change of R Square	F	df1	df2	Sig. F Change
1									

					Change			
1	.994 <sup>a</sup>	.988	.986	.50868	.988	791.945	2	20 .000

a. Predictors: (Constant), GDP\_GWTH, GNPA\_GWTH

b. Dependent Variable: CC\_GWTH

**ANOVA<sup>a</sup>**

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	409.838	2	204.919	791.945	.000 <sup>b</sup>
Residual	5.175	20	.259		
Total	415.013	22			

a. Dependent Variable: CC\_GWTH

b. Predictors: (Constant), GDP\_GWTH, GNPA\_GWTH

**Coefficients<sup>a</sup>**

Model	Unstandardized Coefficients		Standardized Coefficients		Sig.
	B	Std. Error	Beta	t	
1 (Constant)	-7.524	.762		-9.869	.000
GNPA_GWTH	-.249	.010	-.652	-25.477	.000
GDP_GWTH	2.224	.063	.907	35.446	.000

a. Dependent Variable: CC\_GWTH