

5th December 2022

What to expect in the credit policy

The credit policy to be announced on the 7th of December is important for several reasons. The most obvious is the decision taken on interest rates. However, the outlook on the economy would be something that the market would be looking at. This is so because there are mixed signals coming from various economic indicators.

On the positive side:

- PMIs continue to be buoyant indicating steady activity in manufacturing and services.
- Non-oil imports are increasing indicating that industrial activity is in order.
- Tax collections through GST in particular continue to be good which is indicative of high consumption till November.
- Fiscal deficit is largely under check and it does look like that despite the higher outlays on food and fertilizer subsidy, the fiscal deficit target will be met.
- Growth in credit seems to be up though tilted more to retail and services.
- Banking system in a fairly strong state today in terms of quality of assets and capital.

The area of concerns are

- Inflation continues to be above 6% and while respite is expected in November with the number coming in at probably 6%, would increase in the coming months. While global oil prices have come down, the lever is in the hands of the government which has to take a call on taxes. Otherwise, retail inflation will be impervious to declining crude prices.
- Exports growth has slowed down and will continue to do so as the world steps into recession like conditions.
- Core sector growth came in flat for October which was largely due to base effect, but is also indicative of some slowdown in infra activity.
- GDP growth in second quarter has slowed down and it does look like that growth will be lower in Q3 and Q4. RBI's call on GDP growth will be eagerly watched.
 - o In particular negative growth in manufacturing raises an antenna.
- There are some signs of slowing down of FDI this year.
- Savings are coming down as seen in slower growth in deposits. This also means higher CAD at 3-3.5%.

There are issues where there is still no clarity:

- FPIs have alternated between being bullish and bearish, though for November have been positive.
- The rupee has stabilized largely due to the dollar weakening rather than fundamentals improving.
- Forex reserves have shown some improvement of late though are \$ 57 bn down since March 2022.
- Kharif output for rice and pulses to be lower. Can affect prices at one end and rural demand at the other.

Under these conditions we do believe that the MPC will continue with rate tightening though will reduce the intensity to 25-25 bps increase this time. This will be followed with another 25/35 to make

the terminal rate 6.5% in March 2023. This is premised on inflation remaining above 6% till Feb-March and probably coming down below this mark.

With liquidity being even presently in a surplus, there may be no overt need to announce a liquidity inducing scheme and we may expect OMOs when needed. As the stance will continue to be withdrawal of liquidity, a GSAP looks unlikely.

RBI's forecasts on inflation and GDP will be eagerly waited.

We in Bank of Baroda are looking at inflation to be 6.7-6.8% for the year while GDP growth would be 6.8% with a downward bias.

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