FIRST LIGHT

06 December 2022

RESEARCH

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Impact of monetary policy on rates

BOB ECONOMICS RESEARCH | MONETARY POLICY

What to expect in the credit policy

SUMMARY

INDIA ECONOMICS: INTEREST RATES

A nagging issue when conducting monetary policy is to ascertain whether or not the transmission mechanism is effective. This is important because if the central bank keeps raising or lowering the control rates, and interest rates on deposits and advances do not follow suit with adequate responses, then the efficacy gets affected and purpose may not be achieved.

Click here **for the full report.**

INDIA ECONOMICS: MONETARY 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.

Click here **for the full report.**

Daily macro indicators

Indicator	01-Dec	02-Dec	Chg (%)
US 10Y yield (%)	3.50	3.49	(2bps)
India 10Y yield (%)	7.21	7.22	1bps
USD/INR	81.22	81.32	(0.1)
Brent Crude (US$/bbl)	85.4	85.3	(0.1)
Dow	34,395	34,430	0.1
Hang Seng	18,736	18,675	(0.3)
Sensex	63,284	62,869	(0.7)
India FII (US$ mn)	**30-Nov**	**01-Dec**	**Chg ($ mn)**
FII-D	40.2	8.2	(32.1)
FII-E	1,092.3	(181.8)	(1,274.1)

Source: Bank of Baroda Economics Research

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INTEREST RATES

05 December 2022

Impact of monetary policy on rates

Sonal Badhan
Economist

A nagging issue when conducting monetary policy is to ascertain whether or not the transmission mechanism is effective. This is important because if the central bank keeps raising or lowering the control rates, and interest rates on deposits and advances do not follow suit with adequate responses, then the efficacy gets affected and purpose may not be achieved.

2022 has been the year when almost all central banks have started raising their policy rates in a bid to control inflation which has received a boost post the Ukraine war where disruptions have contributed to the acceleration in price movement. In this brief study, we have analysed monetary policy actions of global central banks in CYTD22 and their impact on domestic lending rates and sovereign bond yields.

Data indicates that countries such as US, Canada, Australia, Mexico, S.Africa have relatively more effective transmission mechanisms, i.e. lending rates have changed almost in portion to change key policy rates. Government Debt market is seen to be more responsive in case of countries like France, Germany, Brazil, Australia and UK. In case of India, transmission into increase in both lending and G-Sec rates seems to be slower relative to the other countries studied. However, debt market interest yields have risen more (than lending rates) in proportion to policy rates.

Global monetary policy:

Since the outbreak of the Russia-Ukraine war, global commodity prices shot up much earlier than anticipated. As a result, global central banks began tightening their respective monetary policies by hiking key policy interest rates.

- Amongst our sample of 17 major economies, Mexico, S. Korea and UK were amongst the first ones to hike policy rates as economic activity started rebounding post Covid-19 pandemic and inflation was rising.
- While Mexico began its rate hike cycle way back in Jun'21, S. Korea began tightening since Aug'21 and UK since Dec'21. RBI started the rate hikes from May onwards in a surprise policy announced between two scheduled policies.

For the purpose of this study, we have evaluated cumulative hikes in CYTD22 (Jan-Nov'22) alone and their subsequent impact on bank lending rates (Jan-Nov'22) and sovereign 10Y yields (Jan-Nov'22). In CY22, central banks of UK, S. Korea, Argentina, Mexico, and South Africa had commenced monetary policy tightening even before the outbreak of Russia-Ukraine war. Post the war, Brazil Canada, US (Mar'22), India, Australia (May'22) also started increasing policy rates. ECB (Jul'22) and Indonesia (Aug'22) were last ones to hike.

MONETARY POLICY

05 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.

Aditi Gupta
Economist

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.
    - 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%.

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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