# Tight monetary regime, global turmoil to slow growth: EAC

**Economy Bureau**
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Projecting a challenging year ahead for the economy, the Prime Minister's Economic Advisory Council (EAC) has said that growth could slow to 7.7% in 2008-09, while worrisome inflation may decline to 8-9% by March 2009.

Tight monetary policy and turmoil in global financial and commodity markets would moderate growth, the EAC said in its 'Economic Outlook for 2008-09', released on Wednesday. Consumers and companies can expect continued high interest rates as the EAC feels the tight monetary regime would remain in the face of a 13-year high inflation rate of 12.01%.

While slackening consumer demand and exports would hurt industrial growth, pegged at 7.5% in 2008-09 (down from 8.5% the previous fiscal), agriculture growth is expected to more than halve to 2% from 4.5% in the same period due to scanty rainfall in several parts of the country in July and the high base effect of last year. The overall slowdown would impact the services sector, too, where growth is seen moderating to 9.6% from 10.8%.

Despite high interest rates and a weakened equities market, the EAC expects the investment rate to remain buoyant at 37.5% of GDP in 2008-09, marginally higher than the previous year's 37.4%. However, the savings rate is projected to dip—for the first time in the past seven years—to 34.5% from 36.2%, as high interest rates and compressed demand whittles away at corporate profits, and government savings decline on account of increased spending.

Although the EAC expects the government to contain the fiscal deficit at 2.5% of GDP in 2008-09, it says that substantial fiscal risks remain on account of off-balance liabilities. Liabilities on account of food and fertiliser subsidies, as well as fuel bonds, combined with impact of the Sixth Pay Commission hikes, farm loan waiver and the government's flagship national rural employment guarantee scheme, could push up the actual fiscal deficit to a massive 7.5% of GDP.

However, EAC outgoing chairman C Rangarajan said this was unlikely to warrant a change in India's sovereign ratings. With oil bonds adversely impacting the government's fiscal health, the council indicated the need for a further hike in petrol, diesel and cooking gas prices. "Fuel price adjustment need to be urgently completed to preserve fiscal order and transmit the right signals to dampen the market demand for automotive fuels," it said.

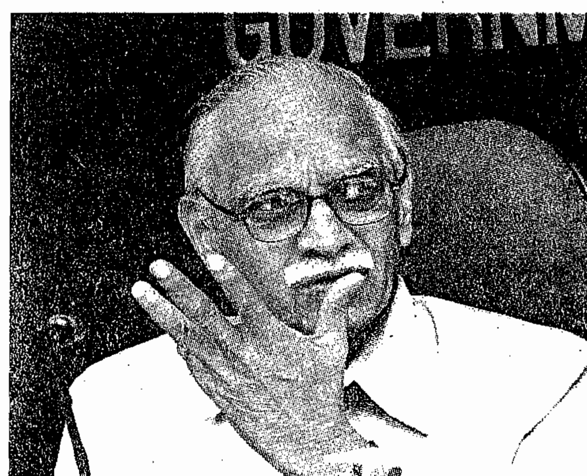
The good news, however, that direct tax collections i[ncreased] by a robust 47% Rs 71,648 crore until the end July this year. But the econom[ic] slowdown is beginning to i[m]pact indirect tax collectio[ns] excluding service tax, whi[ch] rose by a mere 11.5% to [Rs] 54,341 crore during the fi[rst] quarter of the fiscal.

Reacting to the low growth forecasts, the be[ll]wether Sensex of the BSE en[d]ed 119 points lower at close [on] Wednesday, while bonds yie[lds] closed 11 basis points high[er] on expectations of continu[ed] monetary tightening.

Adverse global econom[ic] conditions were also expect[ed] to widen the current accou[nt] deficit to 3.2% of GDP [in] 2008-09 from 1.5% in the pr[e]vious fiscal. However, capi[tal] inflows—which are expect[ed] to decline by 34% to $70.9 b[il]lion in 2008-09 from $108.[...] billion the previous year[—] would be sufficient to finan[ce] the enlarged deficit on t[he] current account.

The EAC also suggested t[he] government relax its extern[al] commercial borrowing poli[cy] as the earlier massive capit[al] inflows have since wan[ed] considerably.

A silver lining for investo[rs] is the expectation of a sto[ck] market recovery by the end [of] the year and a pick-up in FII i[n]vestment in the third a[nd] fourth quarters of the fisc[al]. The EAC has cautioned, "Po[li]cymakers may have to be pr[e]pared to face a situation [of] greater volatility in capital i[n]flows on account of the unce[r]tain external environment



EAC's chairman Suresh Tendulkar addressing a press conference, in New Delhi on Wednesday *Raaj Dayal*

**Tough times**

- GDP growth is likely to slow to 7.7% in FY09
- Inflation may also dip to 8-9% by March 2009
- Interest rates to stay high & savings rate to fall
- Off-Budget liabilities will push deficit to 7.5%
- Capital a/c surplus to cover current a/c shortfall
- Capital inflows seen moderating to $70.9 bn

## S&P keeps close watch on fisc to review sovereign rating

Leading credit rating agency Standard Poor's (S&P) said it is keeping a close watch on India's fiscal and monetary position to take a decision on whether to review the country's sovereign rating. In an exclusive interaction with *FE*, Takahira Ogawa, director, sovereign & international public finance, S&P, noted that measures like the farm debt waiver, the high oil and fertiliser subsidies and the implementation of the Sixth Pay Commission recommendations during the fiscal year could further add to inflationary pressures and worsen the country's fiscal deficit.

"India's credit profile has worsened in the past 12 months, but we believe the upside and downside risks to its 'BBB-' rating are currently balanced," said Ogawa. "This assumes, however, that the reasons for credit deterioration are temporary. If we conclude that they are longer lasting, India's credit ratings could be lowered again to speculative grade," he said.

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