Directors' Report

I. Economic Backdrop and Banking Environment

1. Global Economic Scenario

The recovery of the global economy was hampered in Q4 of 2021, due to the resurgence of omicron variant which led many countries to re-impose lockdowns, travel restrictions and other containment measures which disrupted economic activities and supply chains. The domestic economic scenario has also been affected by geo-political events. RBI has lowered the FY23 GDP growth forecast to 7.2% from the earlier guidance of 7.8%. While possible upside could emanate from sustained domestic demand, Government's thrust on capex, a normal monsoon and healthier corporate balance sheets, the heightened geo-political tensions do pose downside risks to GDP growth.

Towards the end of FY 2022, the Russia-Ukraine conflict has led to heightened financial volatility. Price of crude and other commodities spiralled to multi-year highs. Amidst unsettled financial market conditions, demand for safe havens increased, thereby increasing the price of gold while diversification of reserves by central banks anchored other assets and currencies too. Meanwhile, emerging markets continue to witness capital outflows, as the US Fed accelerated its tapering of asset purchases, recently raised the Fed funds rate twice, and signalled aggressive rate hikes. Against this backdrop, global growth is expected to moderate to 3.2% in 2022.

Meanwhile, inflation is likely to remain elevated in the near term, and inflationary pressures are likely to subside in the later part of the year. The recent lockdown in China is a grim reminder of the brittle recovery and the necessity of adhering to appropriate measures to check the unabated spread of the virus.

The Russia-Ukraine conflict and lockdowns in China as part of its zero-tolerance approach towards the pandemic are weighing down on the global trade dynamics. This has led the WTO to slash the global goods trade growth forecast to 3% in 2022 from its previous forecast of 4.7%.

Prolonged situation in Ukraine along with unanchored inflation expectations and supply disruptions pose a significant downside risk to global growth prospects. With growth clouded by risks and uncertainty, it is imperative for countries, especially the developing ones, to continue to strengthen their digital and health infrastructure. All countries also need to focus on tackling climate change and growth-enhancing policy interventions to promote inclusive development and reforms that broaden economic activity.

2. India's Economic Scenario

The recovery in real GDP growth with the ebbing of the second wave lost some momentum in H2FY2022 with the emergence of the Omicron variant which was fortunately short lived. However, India's economy grew by 8.7% in FY2022 as against the NSD's earlier estimate of 8.9%.

Gross Value Addition in agriculture and allied activities expanded by 3.3% in FY2022, supported by adequate monsoon, good reservoir levels and improved soil moisture, which helped rabi acreage increase by 1.5% over the previous year. Food grain production touched a new record in FY2022, with both Kharif and Rabi output exceeding the final estimates for the year.

Industrial activity lost some momentum in the second half of FY2022, as manufacturing was affected by supply-side shortages and input cost pressures. Mining activity was supported by coal and natural gas, offsetting the contraction in crude oil production. Hence, industrial GVA decelerated sharply from 23.1% in H1 to 0.9% in H2.

Services sector activity grew by 7.1% in H2 and crossed its pre-pandemic level. The contact-intensive services, viz., trade, hotels, transport, and communication, inched towards normalisation, though their rebound was held back by the Omicron variant.

Merchandise exports and imports remained buoyant in FY2022. Exports at $42.2 billion in March 2022 touched a new record and remained above $30 billion for the 13th consecutive month. During FY2022, merchandise exports at $419.6 billion surpassed the target of $400 billion. The $300 billion mark in exports was achieved in FY12, and it took almost a decade to add an incremental $100 billion in exports.

Merchandise imports reached an all-time high of $60.7 billion in March 2022 and remained above $50 billion for the seventh consecutive month. Overall, India's merchandise exports increased by 43.8% in FY2022 vis-à-vis a decline of 6.9% in FY2021, while imports grew by a whopping 55.1% in FY2022 compared to a 16.9% contraction in FY2021. India recorded a current account deficit of 1.2% of GDP in April-December 2021 against a surplus of 1.7% in April- December 2020.

Though CPI inflation is projected to average below 6.0% in FY2023 by RBI, there remain several risks to this forecast. The risks could emanate from a further hardening of global crude and other commodity prices due to geopolitical tensions, longer supply chain disruptions, a larger pass-through of input cost pressures and volatility in the global financial markets induced by an affirmative normalisation of monetary policy by the advanced economies. An early end to supply chain disruptions, a muted pass-through to output prices, correction in global commodity prices and, an easing of geopolitical tensions would help in containing inflation within the projected levels.

As per RBI estimates, real GDP is expected to grow by 7.2% in FY2023. Upside to growth could emanate from sustained expansion in domestic demand, a boost in private investment activity, buoyed by the Government's thrust on capital expenditure, a normal monsoon and healthier corporate balance sheets.

3. Banking Environment

The COVID-19 pandemic was the first significant test of the global financial system since the global financial crisis of 2008. Globally and in India, the banking and non-banking sectors have weathered the COVID-19 disruptions reasonably well, supported by cogent policy measures, which helped maintain the soundness of the banking and financial system. The timely policy interventions both by the Government and the RBI helped alleviate the stress experienced by individuals, MSMEs, corporates and lenders by making credit available on easy terms.

With the gradual return of normalcy, signs of recovery became visible in H1 of FY2022 during the festive season. ASCB credit grew by 9.6% in FY2022, compared to 5.6% growth in FY2021. Retail loans have emerged as the primary driver of bank credit in FY 22 and have now the largest share (28.4%) in the outstanding credit of ASCBs, displacing industrial loans (26.7%).

However, ASCB's aggregate deposits growth slowed to 8.9% in FY2022, compared to 11.40% in FY2021, due to the base effect, lower interest rates and a flight to capital markets / digital asset classes in the expectation of higher returns. Amidst improving credit offtake, growth in banks' holdings of G-secs decelerated, pulling down their excess SLR investments to 9.6% of net demand and time liabilities (NDTL) as of March 25, 2022, from 11% as at the end of March 2021.

The asset quality of ASCBs improved during FY2022, with the non-performing assets (NPA) ratio declining to 6.5% in December 2021 from 6.8% a year ago.

Digital transactions continued to register robust growth in FY2022. Retail payments expanded strongly across the payment modes. UPI witnessed near 100% growth in volume and value of transactions. RTGS, NEFT, IMPS, and NACH also demonstrated remarkable growth. Transactions under the Bharat Bill Payment System (BBPS) clocked a triple-digit increase in volume.

4. Outlook

Towards the end of FY2022, the build-up of tension between Ukraine and Russia and the subsequent sanctions have led to supply chain risks becoming more pronounced. Increase in prices of agricultural commodities, energy products, metals and other essential commodities have had a cascading impact on the global economy and consequently the banking sector. The build-up of inflation has prompted aggressive rate hikes in advanced economies.

Considering these developments, the Monetary Policy announcement by RBI in April 2022 highlighted considerable risks that need constant monitoring and warrant concrete actions while keeping rates unchanged. This was, however followed by an off-cycle policy rate and CRR hike by RBI in early May 2022.

The normalisation of LAF corridor through the introduction of Standing Deposit Facility (SDF) and subsequent rate hike in May 2022 clearly indicate that the interest rate cycle is turning. In the G-Sec market, yields have gone up since the rate hike announcement in May 2022.

India's GDP growth for FY2023 has been projected at 7.2%, which is among the highest in the world. Nonetheless, there is uncertainty on how the demand will pick up during this financial year. Private final consumption is still below the pre-pandemic year and may see some erosion in the current year due to higher inflation. However, investment demand has picked up gradually and there has been substantial increase in new investment announcements amounting to ₹19 trillion in FY2022. Further, sectors benefiting from Production Linked Incentive (PLI) scheme are also expected to see an increase in capex in FY2023. Going forward, good prospects of Rabi output augur well for rural demand. The recent opening of precautionary vaccine dose for all segments of the population is also a positive development.

In this backdrop, the Bank's business needs careful assessment. Your bank has calibrated its business strategy in tandem with evolving needs, constantly adopting best practices while prioritising the safety of hundreds of millions of customers and our people, without compromising on delivery of uninterrupted services since the outbreak of the pandemic. Yet the emergence of geopolitical risks alongside the recurrent bouts of COVID-19 infections have again underscored the need to be on guard and re-evaluate the adequacy of contingency buffers to cover unanticipated losses.

The conflict in Ukraine has also opened up opportunities for India notably in agriculture sector. Further, free trade agreements with Australia and the UAE are also expected to create a number of growth opportunities. Reordering of global supply chains also presents a unique opportunity to India, a proposition that holds tremendous potential.

To sum up, the outlook on the economy and the Bank's business will depend upon the evolving geopolitical situation and its impact on global commodity prices and logistics. Opening up of the economy has reduced the need for a fresh stimulus package and the current momentum appears sustainable. Thus, for the Bank it is imperative that business keeps adapting to the new operating environment.