DIRECTORS' REPORT

I. ECONOMIC BACKDROP AND BANKING ENVIRONMENT

GLOBAL ECONOMIC SCENARIO

Global growth moderated to 2.9% in 2019 vis-à-vis 3.6% in 2018. At regional level, the growth was dragged down primarily by slowdown in India, Russia and Mexico with overall emerging economies growing by 3.7%. China's gross domestic product grew 6.1% in 2019, the country's slowest rate of economic growth since 1990, due to prolonged trade war with US and broader economic slowdown. India, too, saw a loss in growth momentum, with investment activity falling and slow industrial growth.

Meanwhile, advanced economies grew by 1.7%. Euro area growth was sluggish owing to weak export demand. While Germany experienced tepid manufacturing activity, economic activity in Italy suffered owing to weak external environment and domestic policy uncertainty. Even the US economy witnessed moderation in growth as the support from tax cuts faded.

Global merchandise trade suffered a serious setback in 2019 due to strains in US-China trade relations and Brexit related uncertainty. Moreover, the trade activity (both goods and services) is likely to remain weak in at least the first nine months of 2020 as, the lockdown amidst the Covid-19 pandemic will significantly impact trade dynamics this year.

As far as financial stability is concerned, the world was already grappling with rising corporate debt burdens, higher holdings of riskier and illiquid assets by institutional investors and increased reliance on external borrowing by many countries. The Covid pandemic has further raised the financial stability challenges with falling prices of assets and elevated market volatility.

The outbreak of Covid-19 has dampened the global growth outlook with IMF projecting real GDP growth of -3.0% in 2020. However, the uncertainty around the growth numbers is unprecedented and we could see changes in either positive or negative direction, depending on the actions taken by various Governments.

INDIA'S ECONOMIC SCENARIO

Even before the outbreak of COVID-19, India's growth rate was expected to moderate in FY2020 as the Indian economy was grappling with both local and global demand slow-down and sector specific issues. As per the provisional estimates, the overall GDP growth came in at 4.2% in FY2020 vis-a-vis 6.1% in FY2019.

In the industrial sector, the GVA growth decelerated to 0.9% in FY2020 from 4.9% a year ago. It was the deceleration in the manufacturing sector that deepened this slowdown, due to weak domestic and external demand. The mining sector growth picked up, but electricity generation and construction activity weakened.

Services sector GVA also moderated from 7.7% in FY2019 to 5.5% in FY2020, with travel, tourism and communication services growth coming down significantly and Financial, Insurance, real estate & professional Services growth also showing fatigue. Government expenditure, however, showed marginal growth.

Only in agriculture and allied activities growth accelerated in FY2020 to 4.0% from 2.4% in FY2019. The third advance estimates of crop production for 2019-20 placed Kharif and Rabi food-grain production higher by 1.7% and 5.6%, respectively.

The contraction in merchandise exports and imports during FY2020 is an indication of prolonged slowdown in world trade as well as in global demand. India's merchandise exports (Y-o-Y) contracted by 4.8% in FY2020 vis-à-vis growth of 8.75% in FY2019 while Imports shrank by 9.1% in FY2020 compared to 10.42% growth in FY2019. However, the larger decline in imports supported the external outlook and the Current Account Deficit narrowed to 1.0 % of GDP in April-December of FY2020 from 2.6 % in April-December of FY2019.

On the price side, the favourable conditions generated by below target inflation numbers till the first half of FY2020 were dispelled as vegetable prices rose in the later half and an unusually prolonged south-west monsoon and unseasonal rains ravaged the later part of the Kharif harvest and produced an unprecedented rise in prices of onions. Fuel prices too moved out of five months of deflation into positive territory in Dec'19 and increased sharply thereafter. These factors pushed the CPI inflation to a higher trajectory and the average CPI inflation for FY2020 stood at 4.77% compared to 3.43% in FY2019.

The outlook for growth for FY2021 was looking up prior to the outbreak of COVID-19 owing to (i) the bumper Rabi harvest and higher food prices during 2019-20 providing conducive conditions for the strengthening of rural demand, (ii) improvement in the transmission of past reductions in the policy rate to bank lending rates, with favourable implications for both consumption and investment demand, and (iii) reduction in the GST rates, corporate tax rate cuts in Sep'19 and measures to boost rural and infrastructure spending directed at boosting domestic demand more generally. Preliminary forecasts indicating an 'above normal' monsoon this year due to La Nina conditions, also supported the growth outlook.

However, the COVID-19 pandemic has drastically altered this outlook. The global economy is expected to slump into recession in 2020. The sharp reduction in international crude oil prices, if sustained, could improve the country's terms of trade, but the gain from this channel is not expected to offset the drag from the shutdown and loss of external demand.

The trajectory of inflation in the near-term is likely to be conditioned by the pace of reversal of the spike in vegetables prices, the dispersion of inflationary pressures across other food prices, the incidence of one-off cost-push effects on various elements of core inflation and especially, the evolution of the COVID-19 outbreak.

The adverse impact of COVID-19 on global supply chains and global economic activity may dent export performance going forward. The first month of FY2021 has been a washout with exports plunging by 61% in $ terms on a y-o-y basis and the pandemic does not bode well for future growth. However, reduction in oil prices can provide support to the import bill, thus helping in maintaining a sustainable Current Account Balance.

BANKING ENVIRONMENT

During the year, the aggregate deposits growth has remained in the range of 9% to 11%, before ending at 7.9% in FY20. The low growth is aided by last year's high base and COVID crisis. The credit offtake during 2019-20 was also muted with credit growth at 6.1% being less than half the growth of 13.3% in 2018-19, due to low momentum and unfavourable base effects. The seasonal decline in Q3 credit growth in 2019-20 was more pronounced than a year ago, while the offtake during Q4:2019-20 has been subdued as compared with the corresponding quarters of previous two years. The slowdown in credit growth was spread across all bank groups, especially private sector banks. Credit growth of public sector and foreign banks remained modest, even as there has been some uptick in credit by public sector banks in Q4. With credit offtake remaining muted and non-SLR investments declining, banks augmented their SLR portfolios. Banks held excess SLR of around 7.5% of net demand and time liabilities (NDTL) in FY2020 as compared with 6.3% of NDTL in FY2019.

While, the sector-wise credit data for March 2020, indicates that the incremental credit has increased only in Agri. & Allied sectors and all other sectors have shown a deceleration. Credit to Industry declined to 1.4%in FY2020 (6.9% in FY2019), services by 8.5% (17.8% in FY2019). While, personal loans declined marginally to 15.7% in FY2020 from 16.4% in FY2019, credit to MSE and NBFC has increased substantially, due to the enhanced support by Banks in the form of increase in working capital limits.

In FY2020, monetary policy transmission to banks' term deposit and lending interest rates has improved, with the improvement in transmission during H2:2019-20 to banks' deposit and lending interest rates reflecting the lagged impact of the previous rate cuts (110 bps during February–September 2019) as also the introduction of the external benchmark system from October 1, 2019 for the pricing of new floating rate loans to select sectors, viz., retail loans and loans to Micro and Small Enterprises (MSEs). Further, the data indicates that the public sector banks, while transmitting the repo rate cut, have tried to minimize the cut in term deposit rates to have minimal impact on the depositor. Meanwhile, for private sector banks & foreign banks the deposits rate cuts have been more aggressive than the MCLR cuts.

OUTLOOK

The last financial year was a mixed bag from the point of view of the Banks. The first half of the financial year saw good progress in resolution of the stress assets. The general budget was supportive of growth. However, in the backdrop of slowdown in private consumption, financial instability in Indian private banking and delays in resolution of NPAs in NBFC, the third quarter saw shift in the outlook.

With start of the fourth quarter, the outbreak of the COVID-19 in mainland China and its subsequent spread across globe, the outlook of global growth has markedly changed. The RBI preponed its scheduled monetary policy due in April to March and refrained from giving any growth forecast. RBI further instituted measure to ensure supply of liquidity to different sectors of the economy.

The impact of COVID-19 outbreak on economy and financial markets has been dramatic and severe. The commodities price deflated sharply with oil dropping over 70%. Equity markets also corrected sharply across emerging markets, including in India. Although forecast on GDP India's GDP growth differ widely, with deep negative to just positive growth in FY2021, demand inoperability due to lockdown measure has led to considerable loss of income in the poor sections of the society.

In this context, the future outlook for Bank's business needs a careful revision. The loss in output due to demand inoperability in sectors such as transport has cascading impact on other sectors. The elongation of the working capital cycle due to delay in realisation of sales have increased demand for working capital loans and the possibility of slippages. Loss in income may adversely impact the Bank's deposit mobilisation strategy in future.

However, the COVID-19 pandemic has also opened opportunities for the banks. Reordering of global supply chains presents unique opportunity to India to position itself as manufacturing hub to meet global demand. To the extent state governments are able to secure such relocation of businesses from China; banks will see opportunities to expand business. Rapid adoption of digital technology in response to the COVID-19 also augurs well from point of view of the banks as it may accelerate the adoption of digital offerings by the banks.

In a nutshell, the outlook on Bank's business and the economy will be conditional on time frame by which the virus is completely eliminated, and normalcy restored. The recently released fiscal stimulus package, its priorities and funding strategy will decide how banks will respond in the post-COVID scenario. Bank will also have to revisit its risk management framework, its internal models of risk assessment and capital planning and business procedures to better adapt to new operating environment.