*For the Year April 1, 2021 to March 31, 2022 **

PART ONE: THE ECONOMY - REVIEW AND PROSPECTS

I ASSESSMENT AND PROSPECTS

I.1 The escalation of geopolitical tensions into war from late February 2022 has delivered a brutal blow to the world economy, battered as it has been through 2021 by multiple waves of the pandemic, supply chain and logistics disruptions, elevated inflation and bouts of financial market turbulence, triggered by diverging paths of monetary policy normalisation. The global macroeconomic outlook is overcast with the economic costs of the war and sanctions.

I.2 Emerging market and developing economies (EMDEs) are bearing the brunt of global spillovers, despite being bystanders. Capital outflows and sizeable currency depreciations have tightened external funding costs, pushed up debt levels and put their hesitant and incomplete recoveries in danger.

I.3 Turning to the domestic economy, the immediate impact of geopolitical aftershocks is on inflation, with close to three-fourth of the consumer price index at risk. The elevation in international prices of crude, metals, and fertilisers has translated into a terms of trade shock that has widened trade and current account deficits. High frequency indicators already point to some loss of momentum in the recovery that has been gaining traction from the second quarter of 2021-22, with 86.8 per cent of the adult population fully vaccinated and 3.5 per cent having received booster doses.[1] Furthermore, steadfast policy support put a floor underneath aggregate demand and economic activity. Fiscal policy focused on mitigating the hardships and loss of livelihood imposed by the pandemic, even as an impetus to growth was unleashed through reprioritising fiscal spending. Monetary policy remained accommodative and fostered congenial financial conditions for the recovery to take root, while being vigilant that inflation remains within the target going forward. Thus, the experience of 2021-22 has yielded valuable lessons that will illuminate the path of the Indian economy in the year ahead.

Lessons from the 2021-22 Experience

I.4 Over the first half of 2021, an uneven and divergent global recovery began to take shape with the ebbing of the “Delta” variant-driven infections[2]

* The accounting year for the Reserve Bank of India was changed to April-March (earlier July-June) from the financial year 2020-21 onwards. Where available, this chapter has been updated beyond March 2022.

1 The vaccination programme, which commenced on January 16, 2021 for health care workers and frontline workers as the first priority, progressed impressively, with around 96.4 per cent of the adult population (above 18 years of age, assuming around 95 crore people) inoculated with the first dose as on May 24, 2022, while 86.8 per cent received both the first and the second dose. So far, 5.9 crore people have been administered with the first dose in the 15-18 year age group and 3.3 crore in the age group of 12-14 years. As on May 24, 2022, around 3.2 crore people in the 60 plus age group and frontline workers have been inoculated with a precaution dose over and above two doses.

2 There were multiple peaks at the global level in terms of daily confirmed new cases. First peak was on January 7, 2021 (8.7 lakh cases), followed by another peak on April 23, 2021 (9.1 lakh cases), and yet another on August 13, 2021 (8.0 lakh cases). The highest per day spike was registered on January 19, 2022 with 40.9 lakh daily cases, led by the Omicron variant. As on May 24, 2022, the daily new cases were at 6.1 lakh. Total mortalities due to COVID-19 were around 63 lakh (52.7 crore confirmed infections) [Source: Ourworldindata.com].

and the gathering pace and scale of vaccination. In its April 2021 World Economic Outlook (WEO), the IMF estimated world GDP to grow by 6.0 per cent in 2021 and world trade by 8.4 per cent.[3] Emerging market and developing economies (EMDEs) were seen as lagging in view of limited space for maintaining policy stimulus and uneven access to vaccines.[4]

I.5 In the second half of 2021, the global recovery became hostage to the "Omicron" variant. This wave turned out to be short-lived and global trade recovered amidst supply and logistics bottlenecks to grow by 10.1 per cent over the year as a whole. Underpinning this upturn, global manufacturing accelerated to 9.4 per cent in 2021 from 4.2 per cent a year ago. The IMF's April 2022 WEO has placed global GDP growth for the year at 6.1 per cent, a shade higher than its projection made a year ago. This experience reflects the innate resilience that has built up in the global economy as it contended with the pandemic, the shortages, and supply chain disruptions that unravelled in its wake.

I.6 Globally, inflation broadened and acquired persistence during 2021 under the impact of repetitive shocks which severely constrained the supply response to the release of pent-up demand and pushed up costs and prices. It is estimated that supply chain pressures by themselves contributed 1.0 percentage points to global core inflation in 2021.[5] Emerging markets were hit hard by inflationary pressures, including from rising global commodity prices, shipping costs and shortages of key intermediates. Hence, they embarked upon withdrawal of policy support[6] and tightening of monetary policy ahead of advanced economies (AEs). As AEs joined them and systemically important central banks began signalling intent to normalise policy stances in response to surging inflation, emerging market economies (EMEs) had to brace up to tighter financial conditions as financial markets turned volatile in anticipation. The second half of 2021 saw many policy rate hikes globally.

I.7 Global equity markets remained bullish during 2021 as strong earnings expectations lifted sentiments in spite of sporadic bouts of volatility and brief sell-offs. Bond markets, on the other hand, turned bearish during the year, with treasuries delivering losses, but spreads between government and corporate bonds narrowed. Commodities markets sizzled as surging energy and food prices crossed multi-year highs. The US dollar rallied strongly, supported by an improving US economy as well as flights to safe haven and a hawkish pivot by the US Fed. Most EME currencies depreciated, barring a few.

I.8 In India, first the Delta-driven and then the Omicron-induced waves of the pandemic

[3] In October 2021, the IMF adjusted these forecasts to 5.9 per cent and 9.7 per cent, respectively. In April 2022, these forecasts were revised upwards to 6.1 per cent and 10.1 per cent, respectively.

[4] While 74.8 per cent of the population in high income economies are fully vaccinated and 49.7 per cent have received booster shots (May 23, 2022); only 12.8 per cent of the population in low-income countries got fully vaccinated (May 15, 2022).

[5] WEO, IMF, January 2022.

[6] Since January 2020, fiscal measures in response to COVID-19 pandemic (including additional spending, foregone revenues and liquidity support) amount to US$16.9 trillion or 16.4 per cent of world GDP. The large fiscal packages announced or approved by the European Union and the United States could add a cumulative US$ 4.6 trillion to global GDP between 2021 and 2026. Global government debt is expected to remain at record-high levels - close to, but below, 100 per cent of GDP - in 2021 and to decrease slightly through 2026 (Fiscal Monitor, October 2021, IMF).

unsettled the recovery in domestic economic activity. That the third wave turned out to be shorter-lived and less debilitating in terms of impact on economic activity than the first two waves attests to the efficacy of the nationwide vaccination drive and no less to learning and adaptation. The success in navigating two waves of the pandemic owes a lot to the coordinated efforts with central and state governments and third tiers of administration, running multiple awareness campaigns to quell vaccination hesitancy and the selfless, courageous and determined efforts of various stakeholders which imparted speed to the vaccination drive. In spite of the severity of the second wave, the loss of output in Q1:2021-22 was about one-third of what was suffered during Q1:2020-21 when measured from the level of GDP recorded in Q1:2019-20 (pre-pandemic). This resilience and the underlying strengthening of the impulses of growth were evident in the recommencement of the recovery from Q2:2021-22 onwards. In fact, the third wave[7] starting end-December 2021 was flattened in a month's time, with infections back to levels seen at the start of the pandemic. The National Statistical Office (NSO) has placed real GDP growth at 8.9 per cent in 2021-22, surpassing its pre-pandemic level (of 2019-20) by 1.8 per cent. Fiscal reprioritisation of expenditure towards infrastructure, robust crop production, ebullient export growth in the face of hostile international conditions, and congenial monetary and financial conditions engendered by the Reserve Bank underpinned this macroeconomic performance. Nevertheless, private final consumption expenditure (PFCE) and gross fixed capital formation (GFCF) remain work in progress, having barely exceeded their pre-pandemic levels.

I.9 From the supply side, agriculture exhibited pandemic-proofing and benefited from exemption from containment measures. Foodgrains production surged to new highs as did buffer stocks of rice and wheat. Various initiatives, including *Krishi Udan* 2.0, launch of 35 climate resilient and nutrient rich crop varieties, cluster-based Horticulture Cluster Development Programme and National Mission on Edible Oils - Oil Palm (NMEO-OP), boosted agricultural productivity. The distribution of free essential food items through the *Pradhan Mantri Garib Kalyan Anna Yojana* (PMGKAY) was extended in phases to ensure food security of poor households in both urban and rural areas, besides increase in the outlay of the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS).

I.10 In the industrial sector, manufacturing showed an uptick despite headwinds from persisting global supply bottlenecks and muted discretionary consumption and investment spending. Within services, the recovery was heterogeneous, with financial, real estate and professional services and public administration, defence and other services gaining traction, whereas construction and trade, hotels, transport, communication and services related to broadcasting remained sluggish, being largely contact-intensive in nature. Even though labour market conditions have started normalising along with the return of the migrant labour force, labour participation remains incomplete and reskilling assumes priority.

[7] India's first wave peak, in terms of daily confirmed new cases of COVID-19, occurred on September 16, 2020 with 97,894 infections. During the second wave, the daily spike reached the peak of 4.1 lakh infections on May 6, 2021. In the Omicron-led third wave, the peak was on January 20, 2022 with 3.5 lakh cases. Since then, the daily cases have fallen significantly and currently stand at 2,124 as on May 24, 2022. Total mortalities due to COVID-19 were 5.2 lakh (around 4.3 crore confirmed infections).

I.11 An important takeaway from the experience of 2021-22 is India's tryst with inflation. Supply shocks impacted food inflation intermittently, exacerbated by imported price pressures, especially from global edible oil prices. Crude oil prices pushed up core inflation later in the year. This experience also highlighted the important role of supply-side measures by the government in relieving price pressures in the case of edible oils and pulses, and in softening the pass-through of the sharp increase in global crude oil prices to domestic pump prices of petrol and diesel through timely reductions in excise duties and state-level value added taxes (VATs). Furthermore, the presence of considerable slack in the economy tempered the pass-through of input cost pressures into firms' selling prices. The resurgence in global commodity prices (prices of energy increased by 102.1 per cent; metals and minerals by 28.2 per cent; precious metals by 10.3 per cent; and agricultural commodities by 28.0 per cent year-on-year in March 2022) renewed supply chain pressures and heightened financial market volatility in Q4:2021-22, shifted the trajectory of inflation sharply to the upside. Overall, headline inflation averaged 5.5 per cent in 2021-22 as against 6.2 per cent a year ago. Headline inflation breached the upper tolerance band in Q4:2021-22 and rendered the conduct of monetary policy challenging.

I.12 The monetary policy committee (MPC) decided to look through the supply shocks and maintained *status quo* on the policy repo rate, persevering with an accommodative stance to revive and sustain growth on a durable basis while ensuring that inflation remains within the target going forward. Forward guidance gained prominence in 2021-22 as the MPC shifted away from explicit time-contingent to state-contingent guidance since the start of the year. In keeping with this guidance, congenial financial conditions were maintained for sustaining the recovery. Ample liquidity bolstered market sentiment. The Reserve Bank also continued with targeted measures to meet sectoral credit needs, including special refinance facilities for all-India financial institutions (AIFIs); a term liquidity facility to support COVID-related healthcare infrastructure and services; special long-term repo operations (SLTRO) for small finance banks (SFBs); and an on-tap liquidity window to mitigate the adverse impact of the pandemic on certain contact-intensive sectors.

I.13 In H2:2021-22, the Reserve Bank refrained from providing any additional liquidity and focused on management of the liquidity overhang by rebalancing absorption under the overnight fixed rate reverse repo window towards variable rate reverse repo (VRRRs) auctions of varying maturities. By end-March 2022, VRRR auctions absorbed 70 per cent of the overhang. These shifts were reflected in the effective reverse repo rate (ERRR)[8] moving closer to the policy repo rate and pulling up money market rates from pandemic lows. During the year, an amount of ₹2.2 lakh crore was also withdrawn from the system through restoration of cash reserve ratio (CRR) to pre-pandemic levels, repayment of targeted long term repo operations (TLTRO) and open market operations (OMO) sales. A collateral benefit of these liquidity operations and the external benchmark system was a significant improvement

[8] The weighted average of the fixed rate reverse repo rate and the VRRR auctions of varying maturities with the weights being the amounts absorbed under the respective windows.

in monetary transmission to the credit market during the year.

I.14 The gross fiscal deficit (GFD) for the central government declined by 2.5 percentage points of GDP in 2021-22 (revised estimates) in response to a calibrated withdrawal of pandemic related fiscal stimulus and robust tax and non-tax collections. Despite the consolidation, the net fiscal impulse remained positive with a focus on capital expenditure and welfare measures[9] to mitigate the second wave of the pandemic. Under the disinvestment programme, the privatisation of Air India was an important milestone. States' revenue and capital receipts posted strong recoveries and central tax devolution exceeded the Centre's budget estimates. Notably, the surge in states' capital expenditure improved the quality of spending. Key sub-national deficit indicators also showed improvement during the year.

I.15 In spite of formidable headwinds, India's merchandise exports touched a record of US$ 421.9 billion during 2021-22, with a volume expansion of 16.6 per cent over pre-pandemic level. Increasingly, hi-tech goods such as electronics provided the cutting edge to India's export performance, reflecting the strengthening of domestic manufacturing capabilities. Labour-intensive exports as well as agricultural items imparted vigour to the export drive. Furthermore, a diversified export portfolio in terms of products and destinations imparted resilience, reflecting conscious policy initiatives. A noteworthy feature of India's export performance in 2021-22 was the robust growth of services sector exports, with software exports scaling new highs on the back of strong revenues of major information technology (IT) exporters.

I.16 These distinctive features of the experience of 2021-22 endowed the Indian economy with external viability. Consequently, even though a massive increase in imports swung the current account from a surplus in the first quarter to deficits in subsequent quarters, the current account deficit remained modest at 1.2 per cent of GDP during April-December 2021-22. This was comfortably financed alongside a sizeable accretion to international reserves. Furthermore, low external debt turned out to be a mitigant against external sector risks.

I.17 The banking sector was cushioned against the disruptions caused by the pandemic by adequate liquidity support and various regulatory dispensations provided by the Reserve Bank. Banks bolstered their capital to augment risk absorbing capacity, aided by recapitalisation[10] by the government in case of public sector banks (PSBs) along with capital raising from the market and retention of profits by both PSBs and private sector banks. The gross non-performing assets (GNPA) ratio of all scheduled commercial banks (SCBs) moderated to its lowest level in six years, aided by due efforts towards recoveries and technical write-offs. Bank credit growth has begun to pick up to track nominal GDP growth and banks are regaining bottom lines.

[9] Central government announced a fiscal package amounting to ₹6.3 lakh crore during Q1:2021-22 (second wave), which included, *inter alia*, extension of the *Pradhan Mantri Garib Kalyan Anna Yojana*, measures to strengthen public health, extension of the *AatmaNirbhar Bharat Rozgar Yojana*, loan guarantee scheme for COVID-19 affected sectors, provision of broadband connectivity to villages and boost for project exports through the National Export Insurance Account.

[10] The Government has infused ₹2.9 lakh crore in the last five years in PSBs, including the recapitalisation of ₹4,600 crore in 2021-22.

I.18 The balance sheet of non-banking financial companies (NBFCs) expanded in 2021-22 (up to December 2021) but asset quality in the sector deteriorated. Nevertheless, capital cushions showed an improvement. Given the growing interconnectedness of NBFCs with other segments of the financial system, the Reserve Bank has issued guidelines on scale based regulations for NBFCs on October 22, 2021. The Reserve Bank has also issued guidelines on December 14, 2021 to extend the prompt corrective action (PCA) framework to NBFCs. The framework will be applicable to all non-government NBFCs in the middle, upper and top layers excluding primary dealers, housing finance companies and those NBFCs which are not accepting public funds. These measures will strengthen the financial health of the NBFCs.

I.19 Review of regulation of the microfinance sector also engaged the Reserve Bank's attention in 2021-22. Directions issued on March 14, 2022 were aimed at enhancing customer protection for microfinance borrowers and harmonising the regulation of microfinance loans provided by different regulated entities like commercial banks, NBFC-microfinance institutions (NBFC-MFIs) and other NBFCs. The Reserve Bank also directed these entities to put in place Board-approved policies for assessment of household income, limits on loan repayment obligations of a household as a percentage of household income, and pricing of microfinance loans. Details of major policy measures for banks and NBFCs announced by the Reserve Bank during the year are covered in Annex I and II of this Report.

I.20 A noteworthy development during the year was the establishment of a quantifiable metric to evaluate the efficacy of efforts towards financial inclusion. The Reserve Bank's Financial Inclusion Index (FI-Index)[11] draws on 97 indicators, reflecting ease of access, availability and usage of services, and quality of services. By end-March 2021, the value of the index reached 53.9 (43.4 at end-March 2017), indicating the road traversed so far and the miles to go.

I.21 On the technological front, the focus during the year was on leveraging technology to facilitate digital penetration, innovative payment options and consumer orientation towards a "less cash" dependent society. The Digital Payments Index (DPI), constructed to capture the extent of digitisation of payments across the country, indicated rising growth in adoption and deepening of the digital payments. The UPI system was leveraged to introduce UPI123Pay to facilitate digital enablement of over 40 crore feature phone users in the country. The operationalisation of the Payments Infrastructure Development Fund (PIDF) helped expand the digital payment acceptance footprint across the country, with over 85 lakh payment touch points deployed in 2021 alone. Round the clock availability of Centralised Payment Systems (CPS), introduction of additional settlement cycles, extension of cut-off timings for some segments operated by the Clearing Corporation of India Limited (CCIL) and operationalisation of the National Automated Clearing House (NACH) on all days helped reduce credit and settlement risks in the payment space.

I.22 In response to the expanding horizon of FinTech, the Reserve Bank set up a full-fledged FinTech Department effective January 4, 2022. The Reserve Bank Innovation Hub (RBIH) was

[11] The FI-Index will be published annually in July every year.

also set up during the year to build an ecosystem for development of prototypes, patents and proofs of concept while promoting cross-thinking spanning regulatory domains and national boundaries.

I.23 In order to build public confidence in the financial system and also to protect the interests of customers of regulated entities by making the alternate dispute redress mechanism simpler, more efficient and responsive, the Reserve Bank rolled out an Integrated Ombudsman Scheme, 2021 by adopting a 'One Nation One Ombudsman' approach in November 2021. The Reserve Bank set up a Centralised Receipt and Processing Centre (CRPC) for initial processing of physical and e-mail complaints. Furthermore, the Reserve Bank set up the first ever Contact Centre to provide information/assistance to complainants on its alternate grievance redress mechanism. The Internal Ombudsman mechanism was extended to eligible NBFCs.

I.24 In a landmark legislation in pursuance of the announcement made in the Union Budget 2021-22, the Deposit Insurance and Credit Guarantee Corporation (DICGC) Act 1961 was amended on August 13, 2021. The amendments, which came into force on September 1, 2021 empowered the DICGC to make payment to depositors up to the amount insured, in the case of banks with restrictions on withdrawal of deposits imposed by the Reserve Bank, within 90 days from the date of imposition of such directions. Such up-front payment to depositors is not observed in the cross-country experience. As of March 31, 2022, the DICGC sanctioned claims amounting to ₹3,457.4 crore to 2,64,142 depositors in respect of 22 urban co-operative banks placed under all-inclusive directions by the Reserve Bank.

Looking Ahead to 2022-23

I.25 The geopolitical conflict in Europe which started in February 2022 has imparted a strong shock that threatens to overwhelm the global economy and its constituents. Negative externalities are already rippling through financial and commodity markets, the international trade and financial systems, supply chains and the global geopolitical order. Surging food and fuel prices, in particular, and shortages of essential items are impacting the disadvantaged adversely. These forces are superimposed upon tightening financial conditions as countries across the world adopt more hawkish monetary policy stances in response to elevated and diffused inflationary pressures. As pointed out earlier, EMDEs are likely to bear the brunt of this vortex of factors: their fragile recoveries at risk, their populations enfeebled by high prices and supply bottlenecks, their currencies under downward pressures and exodus of capital, and their debt profiles rendered vulnerable. Scarring effects are larger for EMDEs due to human capital and investment losses which may keep economic activity and employment below pre-pandemic trends right up to 2023. The near-term outlook is fluid, rapidly evolving and extremely uncertain. It will likely have a bearing on longer-term prospects, including by exacerbating the scars of the pandemic, by deglobalisation, financial fragmentation and by setting back the initiatives towards climate change.

I.26 The global recovery is expected to suffer a significant loss of momentum in 2022. Risks are large and to the downside - war escalation; shortages; resurgence of the pandemic; slowdown in China; and climate stress overshooting the Paris agreement goals. In its April 2022 WEO, the IMF has marked down global growth for the year sharply to 3.6 per cent from 6.1 per cent in

2021. AEs may decelerate to 3.3 per cent from 5.2 per cent a year ago and EMDEs to 3.8 per cent from 6.8 per cent. Both groups are expected to experience inflation that is higher by 2.6 and 2.8 percentage points, respectively. The expansion of global trade volume is expected to halve from 10.1 per cent in 2021, mainly because of moderation in merchandise trade as services are expected to remain subdued, and slow even further in 2023.

I.27 The persistence of high inflation is forcing countervailing monetary policy action at a time when supporting the economic recovery should have been assigned priority. During 2022 so far (up to May 24, 2022), more than 40 central banks across AEs and EMEs have raised policy interest rates and/or scaled back liquidity. Policy trade-offs are becoming increasingly complex going forward and tail risks, including stagflation, loom large in several countries.

I.28 Nervous financial markets are already reflecting these strains. In the first quarter of 2022, major stock benchmarks suffered losses. Expectations of faster and larger than earlier anticipated monetary tightening contributed to a rally in the US dollar - with associated depreciation in emerging market currencies - and hardening of benchmark bonds yields. Yield spreads are compressing and even turning negative, with the yield curve inverting in segments. In fact, the first quarter of 2022 has already seen an episode of yield curve inversion in the US. With growing anticipation of sharp monetary tightening in the US, bond yields have hardened further along with strengthening of the US dollar in Q2:2022 so far. Equity indices in major economies have corrected further as uncertainties around geopolitical tensions, inflationary pressures emanating from continued volatility in commodity prices and fresh COVID-19 related restrictions in China have dampened investors' sentiments.

I.29 In response to the evolving challenges, the following policy priorities at the global level will condition the way forward: (a) calibrate monetary policy to fight inflation while safeguarding economic recovery; (b) prioritise fiscal support to the most vulnerable within the consolidation envelope; (c) tighten macroprudential policy in step with monetary policy; (d) focus on health and structural reforms (*viz.,* digitalisation, reskilling workers, reconfiguring supply chains, climate resilience, debt resolution, and trade cooperation), and (e) prevent economic fragmentation and support the poorest countries through coordinated actions of the international institutions. These priorities call for country specific as well as multilateral actions.

I.30 Amidst these adverse international developments, the Indian economy is relatively better placed to strengthen the recovery that is underway and improve macroeconomic prospects going forward. In recognition of the knock-on effects from geopolitical spillovers, the MPC revised downwards real GDP growth for 2022-23 to 7.2 per cent in its April resolution - a decline of 60 basis points from its pre-war projection, mainly due to higher oil prices weighing on private consumption and higher imports reducing net exports. Inflation was projected higher by 120 basis points at 5.7 per cent in April 2022. Monetary policy remains accommodative but focused on withdrawal of accommodation. Priority has been assigned to containing inflation within the target going forward, while supporting growth.

I.31 The prospects for agriculture and allied activities are brightening at this juncture on the prediction of a normal monsoon [at 99 per cent ±5 per cent of long period average (LPA)], with terms of trade gains anticipated from exports. The government has set the target for total foodgrains production at 328 million tonnes for 2022-23. The launch of nano-urea in liquid form augurs well for the upcoming *kharif* season. Raising farm productivity remains a key concern, however. It should be driven by agricultural research and development, next-generation technological advancements and an atmosphere of innovation and entrepreneurship for agri-tech start-ups to thrive.

I.32 Early indicators point to revival of economic activity across other sectors that needs to be assiduously nurtured in order to boost consumer and business confidence and private investment. Capacity utilisation in several industries is moving closer to normal levels, although rising input costs and persisting supply bottlenecks, as for instance in semiconductors for the automobile sector, may impede or delay a fuller recovery. With the lessons of the experience of 2021-22, contact-intensive sectors are expected to rebound over the year ahead, with positive implications for the workforce and for consumption demand. The thrust given to infrastructure and investment in the Union Budget 2022-23 will play a major role in shaping the post COVID-19 recovery. The *Pradhan Mantri Gati Shakti,* which brings together infrastructure plans under various ministries under a common digital platform, is expected to improve efficiency in execution and reduce logistic costs. Similarly, policy support for the digital economy, FinTech, and climate transition would enable India to participate and benefit from the fourth industrial revolution.

I.33 The inflation trajectory going forward is subject to considerable uncertainty and would primarily depend on the evolving geopolitical situation. Sharp movements in global commodity prices are having a significant bearing on food inflation dynamics in India. Though record foodgrains production and forecast of a normal south-west monsoon augurs well for food inflation, heightened uncertainty around global food prices arising from geopolitical risks might offset these positive domestic impulses, especially *via* elevated prices of wheat, edible oil, feed costs and key agriculture inputs like fertilisers. Moreover, volatility in the prices of international crude oil and key raw materials and intermediates, together with global supply chain disruptions, may push up input cost pressures. In particular, a scenario in which crude prices persist above US$ 100/barrel poses a major upside risk in terms of re-igniting second-round effects across manufacturing and services prices. Supply side policy interventions such as removing customs duty on import of raw cotton, prohibiting wheat exports, reducing road and infrastructure cess (RIC) on petrol by ₹8 per litre and diesel by ₹6 per litre, increasing exports duty on certain steel products, reducing imports duty on certain raw materials for steel and plastic manufacturing, restricting sugar exports, removing customs duty and agriculture infrastructure and development cess (AIDC) on import of 20 lakh tonnes of crude sunflower oil and crude soybean oil per financial year till March 31, 2024 and other measures as may be taken could, however, provide some offset. A faster resolution of the geopolitical conflict and no further severe COVID-19 waves could subdue and even reverse these pressures and help contain core inflation.

I.34 Against the background of the risks to the near-term inflation outlook rapidly materialising as reflected in the inflation print for March and the developments thereafter, the MPC held an off-cycle meeting on May 2 and 4, 2022. While noting that domestic economic activity is navigating the vortex of forces confronting the world with resilience on the strength of underlying fundamentals and buffers, the MPC expected inflation to rule at elevated levels, warranting resolute and calibrated steps to anchor inflation expectations and contain second round effects. Accordingly, the MPC decided to increase the policy repo rate by 40 basis points to 4.40 per cent. Concomitantly, the standing deposit facility (SDF) rate and the marginal standing facility (MSF) rate stood adjusted at 4.15 per cent and 4.65 per cent, respectively. Furthermore, in keeping with the stance of withdrawal of accommodation and in line with the earlier announcement of gradual withdrawal of liquidity over a multi-year time frame, the Reserve Bank decided to increase the cash reserve ratio (CRR) by 50 bps to 4.50 per cent, effective the fortnight beginning May 21, 2022, which would withdraw liquidity to the tune of ₹87,000 crore from the banking system. The Reserve Bank will continue to follow a nuanced and nimble footed approach to liquidity management while maintaining adequate liquidity in the system to meet the credit needs of the productive sectors of the economy. The introduction of the SDF in April 2022 as an uncollateralised facility at 25 basis points below the repo rate to provide a new floor for the liquidity adjustment facility (LAF), and two-way operations of absorbing liquidity through VRRR auctions of varying maturities and variable rate repo (VRR) auctions to meet transient liquidity shortages, will help to ensure this objective in a non-disruptive manner.

I.35 In 2022-23 (BE), the central government has sought to prioritise capital spending while maintaining fiscal prudence. A reduction in GFD-GDP ratio by 0.3 percentage points is envisaged in line with the target of achieving a GFD-GDP ratio below 4.5 per cent by 2025-26. Fiscal consolidation is sought to be achieved by reining in revenue spending even as capital expenditure is budgeted to increase to 2.9 per cent of GDP as against a decadal average of 1.8 per cent of GDP. The ratio of revenue expenditure to capital outlay is set to improve for the second consecutive year to 5.2 in 2022-23 (BE), distinctly lower than the average of 7.8 during 2010-11 to 2019-20. The strategy of building in of buffers at various levels and a realistic disinvestment target of ₹65,000 crore (close to the average realisation in the past 5 years) provides headroom to deal with future shocks. Transparency in accounting practices imparts credibility to the fiscal arithmetic. States' capex is expected to receive a strong push in 2022-23 on account of enhanced allocation under the 'Scheme for Financial Assistance to States for Capital Investment' from ₹15,000 crore in 2021-22 (RE) to ₹1 lakh crore in 2022-23 (BE).

I.36 If geopolitical tensions ease, ongoing global supply disruptions could dissipate and enable world trade to regain momentum. This could enhance India's growing agricultural exports. Efforts are also being made to boost India's defence exports. The recently announced Green Hydrogen/Green Ammonia Policy would secure India's energy security in an environmentally sustainable way and cut down dependence on fossil-based imports.

I.37 India's Comprehensive Economic Partnership Agreement (CEPA) with the United Arab Emirates (UAE) could boost prospects of trade with Africa and Asia. Furthermore, the signing of the India-Australia Economic Cooperation and Trade Agreement (ECTA) will open up preferential access to Australian markets for India. Trade agreements with various other nations/blocks like the UK, Canada, and Gulf Cooperation Council (GCC) are in the making and will likely galvanise India's export market diversification strategy. The Foreign Trade Policy (FTP) 2021-26 is expected to provide a medium-term path for achieving merchandise exports of US$ 1 trillion by 2030. States, on their part, are focusing on creating the enabling infrastructure, e-market strategies and export-oriented policies to complement the Government of India's initiatives such as 'One District One Product'. The PLI scheme for sectors such as electronics, pharmaceuticals, textiles, steel, and automotives are expected to enhance India's global value chain (GVC) participation and reduce import dependency in critical sectors. Furthermore, the rationalisation of customs duties aims to empower *AatmaNirbhar Bharat* goals through increasing value-added manufacturing, which will further strengthen India's GVC participation.

I.38 At the same time, longer-than-expected supply chain bottlenecks, elevated freight rates and the upsurge in global inflation amidst escalating geopolitical tensions pose significant risks. Although direct trade and finance exposures in the context of the ongoing conflict are limited, elevated crude oil prices can widen the current account deficit while foreign portfolio investors may remain risk averse towards EMEs, including India. Nevertheless, robust reserve buffers, a strong FDI pipeline and proactive policy measures towards supporting merchandise exports and participation in GVCs should help the economy withstand adverse global spillovers.

I.39 The banking sector has witnessed improved financial parameters despite the COVID-19 pandemic. There is, however, a need to be watchful of the credit behaviour of the restructured advances and possibility of increased slippages arising from sectors that were relatively more exposed to the pandemic. With the unwinding of support measures, some of the restructured accounts might face solvency concerns, with the impact on banks' balance sheets becoming clearer in the upcoming quarters. Prudence warrants proactive recognition of any non-viable accounts to activate timely resolution. Going forward, as the economy recovers and credit demand rises, banks will need to focus on supporting credit growth while being vigilant of the evolving risks. Care needs to be taken to ensure that fresh slippages are arrested, and banks' balance sheets are strengthened to avoid future build-up of stress.

I.40 The setting up of the National Asset Reconstruction Company Ltd. (NARCL) is a step forward for resolution of large value legacy stressed assets and is likely to serve as a time-efficient mechanism for reviving investor interest in primary and secondary markets for stressed assets. Going forward, continued commitment, professionalism and transparency in operation will help in making the exercise cost- and time-effective. The setting up of the National Bank for Financing Infrastructure and Development (NABFID) is expected to shift the burden of long-term financing away from banks. The NABFID can also play an active role in the development of bond and derivatives markets that are necessary for infrastructure financing.

I.41 NBFCs and urban cooperative banks (UCBs) will have to be mindful of frailties, wherever they exist, in their balance sheets and ensure robust asset-liability management, apart from improving the quality of their credit portfolios. Considering the significant share of funding absorbed by NBFCs at the system level, continued attention to their financial health is warranted from the viewpoint of financial stability. In order to further strengthen the regulatory and supervisory framework, several measures are expected to be put in place for banks and NBFCs during 2022-23, as covered in Chapter VI of this Report.

I.42 In the payments space, going forward, the focus would be on enhancing awareness about digital payments and extending the outreach of payment systems across India and beyond. Implementation of the geo-tagging framework will provide precise locations of existing payment touch points and facilitate implementation of targeted literacy programmes and intervention strategies. The possibility of linking India's payment systems to other jurisdictions, including the ongoing initiative of interlinking India's fast payment system - UPI - with similar systems in other jurisdictions, will enhance cross-border payment arrangements, including remittances.

I.43 The Reserve Bank is engaged in the introduction of a central bank digital currency (CBDC) in India. The design of CBDC needs to be in conformity with the stated objectives of monetary policy, financial stability and efficient operations of currency and payment systems. The Reserve Bank proposes to adopt a graded approach to introduction of CBDC, going step by step through stages of Proof of Concept[12], pilots and the launch.

I.44 In the FinTech space, the Reserve Bank will facilitate setting up of 75 Digital Banking Units in 75 districts of the country during 2022-23. It will also work towards ensuring execution of key projects of importance through the Reserve Bank Innovation Hub (RBIH) during the year while finalising its vision, mission and strategy documents and a policy framework for digital banking and FinTechs. Testing and evaluation of entities under the third and fourth cohorts of the Regulatory Sandbox on "MSME Lending" and "Prevention and Mitigation of Financial Frauds" as also the outcomes from the hackathon HARBINGER 2021 are expected to provide innovative solutions for the financial sector.

I.45 The Reserve Bank will continue its efforts towards improving the regulatory ecosystem for customer protection, upgrading and providing easy and quick access to the grievance redress mechanism, and also percolating customer awareness and financial education to the excluded sections of the population as also to remote areas of the country. Looking ahead, the implementation of the various milestones under the National Strategy for Financial Inclusion (NSFI) and the National Strategy for Financial Education (NSFE) would sustain the momentum of financial inclusion in the country.

I.46 To sum up, the year gone by brought many challenges, but a recovery is underway in spite of headwinds. The future path of growth will be conditioned by addressing supply-side bottlenecks, calibrating monetary policy to bring inflation within the target while supporting growth and targeted fiscal policy support to aggregate demand, especially by boosting capital spending. Undertaking structural reforms to improve India's medium term growth potential holds the key to secure sustained, balanced and inclusive growth, especially by helping workers adapt to the after-effects of the pandemic by reskilling and enabling them to adopt new technologies for raising productivity.

[12] It is an exercise in which work is focused on determining whether an idea can be turned into a reality or to verify, if the idea will function as envisioned.