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भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

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RBI releases Financial Stability Report
(Including Trend and Progress of Banking in India 2013-14) December 2014

The Reserve Bank of India today released the Financial Stability Report (Including Trend and Progress of Banking in India 2013-14) December 2014. The Statistical Tables Relating to Banks in India (STRBI) have also been released simultaneously with this Report.

The highlights of the latest Report are as follows:

Macro-financial risks

The current weak global growth outlook may prolong easy monetary policy stance in most advanced economies (AEs). Consequently, low risk premia may lead to accumulation of vulnerabilities, and sudden and sharp overshooting in markets cannot be ruled out. As of now, financial risk taking has not translated into commensurate economic risk taking. Against the backdrop of low interest rates in AEs, portfolio flows to emerging market and developing economies have been robust, increasing the risk of reversals on possible adverse growth or financial market shocks, thus necessitating greater alertness. On the domestic front, macroeconomic vulnerabilities have abated significantly in recent months on the back of improvement in growth outlook, fall in inflation, recovery in the external sector and political stability. However, growth in the banking business and activity in primary capital markets remain subdued due to moderate investment intentions. Sustaining the turnaround in business sentiment remains contingent on outcomes on the ground.

Financial institutions: Developments and stability

The growth of the Indian banking sector moderated further during 2013-14. Profitability declined on account of higher provisioning on banks' delinquent loans and lacklustre credit growth. The financial health of urban and rural co-operatives indicated divergent trends in terms of key indicators. While urban co-operative banks exhibited improved performance, the performance of primary agriculture credit societies and long term rural credit co-operatives remained a matter of concern with a further increase in their losses coupled with a deterioration in asset quality. While the asset size of the non-banking financial companies (non deposit taking-systemically important) showed an expansion, asset quality deteriorated further during the period of review. The banking stability indicator suggests that overall risks to the banking sector remained unchanged during the first half of 2014-15. In individual dimensions, though the liquidity position improved in the system, concerns remain on account of deterioration in asset quality along with weakened soundness. The profitability dimension of the indicator showed an improvement but it remained sluggish. The stress tests suggest that the asset quality of banks may improve in the near future under expected positive developments in the macroeconomic conditions and banks may also be able to meet expected losses with their existing levels of provisions. However, the asset quality of scheduled commercial banks may worsen from the current level if the macroeconomic conditions deteriorate drastically, and banks are likely to fall short in terms of having sufficient provisions to meet expected losses under adverse macroeconomic risk scenarios. Analysis of the interconnectedness indicates that the size of the interbank market in relation to total banking sector assets has been on a steady decline. However, contagion analysis with top five most connected banks reveals that the banking system could potentially lose significant portion of its total Tier-I capital under the joint solvency-liquidity condition in the event of a particular bank triggering a contagion.

Financial sector regulation and infrastructure

While the capital to risk weighted assets ratio (CRAR) of the scheduled commercial banks at 12.8 per cent as of September 2014 is satisfactory, going forward, the banking sector, particularly the public sector banks would require substantial capital to meet regulatory requirements with respect to additional capital buffers. With the increased regulatory focus on segregating the cases of wilful defaults and ensuring the equity participation of promoter(s) in the losses leading to defaults, there is a need for greater transparency in the process of carrying out a net economic value impact assessment of large Corporate Debt Restructuring (CDR) cases. Another aspect that impinges upon the banks' asset quality is corporate leverage and its impact on banks' balance sheets, particularly 'double leveraging' through holding company structures and the pledging of shares by promoters. Indian stock markets have seen a rapid growth in recent months. While the retail investor base still remains comparatively low, India's stock markets have been attracting substantial amounts of foreign investments, increasing the risk of reversal. The Securities and Exchange Board of India has introduced an additional safety net in the form of core settlement guarantee fund to mitigate risks from possible default in settlement of trades and to strengthen risk management framework in the domestic capital markets. With a view to improving participation of actual users / hedgers and the quality of price discovery in the market, the Forward Markets Commission has revised position limits which are linked to estimated production and imports of the underlying commodities. To deal with issues relating to unauthorised deposit acceptance and financial frauds, the State Level Coordination Committee (SLCC) mechanism has been strengthened under the initiative of the Financial Stability and Development Council (FSDC).

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