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RBI releases June 2016 Financial Stability Report

The Reserve Bank of India today released the Financial Stability Report (FSR) June 2016, a biannual publication and the thirteenth in the series.

The FSR reflects the overall assessment on the stability of India's financial system and its resilience to risks emanating from global and domestic factors. Besides, the Report also discusses issues relating to development and regulation of the financial sector. Beginning from June 2015 issue, a special thematic discussion is included in the FSRs brought out in June. Accordingly, this issue of FSR brings out a thematic discussion on 'An optimal configuration for the financial system – Banks versus Market' in the context of the progress towards making the Indian financial system more effective in supporting the economic growth.

Highlights of FSR- June 2016 are summarised below:

Overall assessment of systemic risks

- India's financial system remains stable, even though the banking sector is facing significant challenges. As global uncertainties and transiting geopolitical risks impact India, continuation of sound domestic policies and structural reforms remain the key for macroeconomic stability.

Global and domestic macro-financial risks

- The global recovery remains fragile amidst weak and uneven growth, a slowdown in world trade and prevailing uncertainties in financial and commodities markets. The unintended side effects of current ultra-easy monetary policies being pursued in many advanced economies - without any clear signs of an exit strategy, are becoming evident.
- Indian economy at this juncture stands out in terms of growth and investment potential. With the Government's commitment to continue on the path of fiscal discipline, the efforts on containing the revenue deficit and rationalising subsidies need to be reinforced, even as gross fixed capital formation needs a fillip.
- India's external sector indicators show a relatively stronger position. However, a faster growth in India's oil import in terms of volume in recent years makes it imperative to be alert to the risks of commodity cycle reversals.
- The prediction of a normal monsoon augurs well for agriculture sector growth in 2016-17, although the spatial and temporal distribution matter as much as the total quantum of rainfall. Given its large impact on broader political economy, the agriculture sector needs coherent policy measures to address sustained food price pressures and the overall rural distress.
- While stress in the corporate sector showed some signs of moderation in 2015-16, the risks of lower demand and weaker debt servicing capacity continue.

Financial Institutions: Performance and risks

- The business of scheduled commercial banks (SCBs) slowed significantly during 2015-16. The gross non-performing advances (GNPAs) ratio increased sharply to 7.6 per cent from 5.1 per cent between September 2015 and March 2016, largely reflecting reclassification of restructured standard advances as non-performing due to asset quality review (AQR).The restructured standard advances ratio declined but with a marginal increase in the overall stressed advances ratio from 11.3 per cent in September 2015 to 11.5 per cent in March 2016. The capital to risk-weighted assets ratio (CRAR) of SCBs showed some improvement across the bank-groups. However, the profitability of SCBs declined significantly and the public sector banks (PSBs) recorded losses during 2015-16.
- Asset quality of scheduled urban co-operative banks (SUCBs) as well as non-banking financial companies (NBFCs) improved. The performance of NBFC sector in general is relatively better than that of PSBs.
- From the perspective of the larger financial system, the flow of funds among various types of financial institutions assume importance. The asset management companies managing mutual funds (AMC-MFs) followed by insurance companies are the biggest fund providers in the system, while SCBs followed by NBFCs are the biggest receiver of funds.

Financial sector regulation

- Internationally, apart from the focus on the measures related to improving the capital and liquidity position of banks, the policies aimed at promoting public confidence and upholding the safety and soundness of the banking system with emphasis on issues of transparency and accountability assume a greater degree of significance.
- As Indian banks are currently focusing on cleaning their balance sheets in the wake of the AQR, various measures taken by the Government to address the issues related to distressed industrial sectors are expected to help the process and improve the credit growth. The regulatory steps taken by the Reserve Bank are aimed at improving banks' ability to deal with stressed assets. While the proposed 'Large Exposures' framework will help in mitigating the risk posed to the banking system on account of large aggregate lending to a single corporate entity, the recent guidelines on a 'Scheme for Sustainable Structuring of Stressed Assets (S4A)' will help in putting real assets back on track through another avenue for reworking the financial structure of entities facing genuine difficulties, while providing upside to the lenders when the borrower turns around.
- SEBI's framework providing an electronic book mechanism for issuance of debt securities on private placement basis is expected to result in improved efficiency, transparency in price discovery as well as reduction in cost and time taken for such issuances. With the regulatory impetus, the commodity derivatives market is poised to evolve with new products and new categories of participants leading to better liquidity and more efficient price discovery, further aided by recent initiative of Government in setting up the National Agriculture Market (NAM).
- There is a need to assess the resilience of reinsurance companies in the face of increasing concentration of contingent liabilities in a few reinsurance entities. The move towards adopting risk based supervision by the pension sector regulator is expected to ensure efficient allocation of supervisory resources.

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