Foreword

The whiff of optimism evident at the beginning of the year is morphing into a distinct recovery in the global economy, which appears sustainable supported by the tripod of consumption, investment and geographical spread. Yet, it is hard to miss the uneasy confluence of headwinds emanating from geopolitical risk triggering commodity price volatility, expectation of normalisation of US monetary policy, and emergence of a mercantilist approach to trade. Structurally, the declining labour share of GDP in advanced economies (AEs), the IT-enabled growth spawning a generation of "digital have-nots" and a declining working age population coupled with barriers to labour mobility, seem to be retarding potential growth.

Domestically, the economy appears to have rebounded after the initial hiccups associated with the rollout of nationwide goods and services tax (GST), coming on the back of demonetisation. While the ongoing deleveraging in the heavily indebted parts of the corporate sector and muted credit growth in the public sector banks pose a risk to growth, the decisive recapitalisation move by the Government could provide the much needed fillip to private investment going forward. If we keep our financial system, especially, the banking sector, in good shape, we can catch the tail winds of the external conditions. That would mean keeping the economy on even keel in terms of macroeconomic balance.

The overall risks to the banking sector arising from asset quality concerns continue to persist. The ongoing asset impairment in the banking sector and risks on this front have important regulatory implications, some of which are documented in this Report. In addition, this 16th issue of the Financial Stability Report (FSR) reviews the health of the financial system as a whole and focuses on some of the macroprudential issues that need to be addressed to strengthen financial stability.

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