Overview

Macro-Financial Risks

Global Economy and Markets

Global economic activity continues to face significant headwinds since the second-half of 2018 culminating in a lower global growth forecast of 3.3 per cent in 2019. Adverse geopolitical developments and trade tensions are gradually but predictably taking a toll on business and consumer confidence. In response, advanced economies' (AEs) central banks have eased their monetary policy stance. While asset prices and global capital flows initially recovered in response, the markets appear to be deeply conditioned by the implied 'Fed put' and any significant reassessment would require re-rating of a host of issues relating to emerging market and developing economies (EMDEs) with a risk of sharp adjustments.

Domestic Economy and Markets

Domestic economy hit a soft patch in the last quarter of 2018-19 as private consumption, the key driver of GDP, turned weak. This along with subdued new investment pipeline and a widening current account deficit have exerted pressure on the fiscal front. This has implications for the government's market borrowing programme and market interest rates. Reviving private investment demand remains a key challenge going forward while being vigilant about the spillover from global financial markets.

Financial Institutions: Soundness and Resilience

Credit growth of scheduled commercial banks (SCBs) picked up, with public sector banks (PSBs) registering near double digit growth. Capital adequacy of the SCBs improved after the recapitalisation of PSBs. With the bulk of the legacy non-performing assets (NPAs) already recognised in the banking books, the NPA cycle seems to have turned around. Provision coverage ratio (PCR) of all SCBs rose sharply to 60.6 per cent in March 2019 from 52.4 per cent in September 2018 and 48.3 per cent in March 2018, increasing the resilience of the banking sector.

Macro-stress tests for credit risk indicate that under the baseline scenario, SCBs' gross non-performing asset (GNPA) ratio may decline from 9.3 per cent in March 2019 to 9.0 per cent in March 2020.

Recent developments in the Non-banking financial companies (NBFC) sector have brought the sector under greater market discipline as the better performing companies continued to raise funds while those with ALM and/or asset quality concerns were subjected to higher borrowing costs.

Joint Solvency-Liquidity contagion losses to the banking system due to idiosyncratic failure of banks show that the losses as on March 2019 are significantly lower than in March 2018 (FSR June 2018) due to a better capitalised public sector banking system. Solvency contagion losses to the banking system due to idiosyncratic HFC/NBFC failure show that the failure of largest of these can cause losses comparable to those caused by the big banks, underscoring the need for greater surveillance over large HFCs/NBFCs.

Financial Sector: Regulation and Developments

Well over a decade after the global financial crisis, financial vulnerabilities continue to build although the financial system resilience has increased. Domestic financial markets saw some disruption emanating from the non-bank space and its growing importance in financial system

network. In order to finetune the supervisory mechanism for the banks, the Reserve Bank has recently reviewed the structure of supervision in the context of the growing diversity, complexities and interconnectedness within the Indian financial sector.

The Securities and Exchange Board of India (SEBI) has put in place broad guidelines for interoperable framework between Clearing Corporations. It has also concurrently overhauled the margin framework to make it more robust. The Insurance Regulatory and Development Authority of India (IRDAI) has constituted a committee to identify Systemically Important Insurers. The Insolvency and Bankruptcy Board of India (IBBI) is showing steady progress in resolution of stressed assets. National Pension System (NPS) and Atal Pension Yojana (APY) have both continued to progress towards healthy numbers in terms of total number of subscribers as well as assets under management (AUM).

Assessment of Systemic Risk

India's financial system remains stable despite some dislocation of late. The results of the latest systemic risk survey conducted by the Reserve Bank in April 2019 indicated that financial market risks continue to be perceived as a high-risk category affecting the system while global risks, risk perception on macroeconomic conditions and institutional risks are perceived as medium risks affecting the financial system.

Within global risks, the risk on account of global growth and commodity prices (including crude oil prices) were categorised as high risk. Within the macroeconomic risks group, risks on account of corporate sector vulnerabilities continue to be in the high-risk category.

Among the institutional risks, growth capital requirement of banks and cyber risk continued to be perceived as high-risk factors.