Chapter I
Assessment and Outlook

Growth has rebounded strongly in the Indian economy while financial conditions remained stable since the publication of the first Financial Stability Report (FSR) in March 2010. Notwithstanding intermittent volatility, especially in equity and foreign exchange markets, driven primarily by exogenous developments, the financial sector remained stress-free. This is also displayed by the Financial Stress Indicator for India, which was introduced in the first FSR. Financial institutions remained healthy, credit offtake has picked up, as has profitability, especially in the first half of 2010-11. The Banking Stability Index points to a healthy improvement in the stability of the banking sector over the past few years. This is corroborated by the results of a range of stress tests undertaken by the Reserve Bank. A number of regulatory measures were announced with a view to tightening the prudential infrastructure, plugging gaps in regulation and ensuring that regulatory and supervisory set up reflected international best practices.

Some soft spots are, however, discernible. The current account deficit is widening while capital flows continue to be dominated by volatile components. External sector ratios have deteriorated, fiscal conditions are still under pressure and inflationary pressures persist. Liquidity conditions tightened beyond the Reserve Bank's comfort level though some policy measures have recently been taken to alleviate the stress. Some issues in the financial market microstructure will need to be addressed. Asset quality of banks and their ALM position continue to warrant monitoring. Regulatory gaps in the non-banking financial sector will need to be plugged. A robust macroprudential framework for the identification of systemic risks will need to be set up. Convergence with the emergent international reforms agenda presents challenges and will require careful calibration.

The tail risks to financial stability are largely exogenous given increasing correlation between global growth and that of EMEs, including India. The finance channel has assumed greater importance increasing the pace and degree of contagion from disturbances abroad. Similarly, business cycle synchronisation of the Indian economy with most of the advanced economies and other EMEs has increased. With both financial and real sector still under stress in advanced economies, the country will have to guard against vulnerabilities arising from risks to global growth and financial stability.

The Global environment

Global economic recovery remains uncertain

1.1 Global economic recovery continues to be uneven and uncertain with downside risks remaining significant. With fiscal stimulus slowly being phased out in advanced economies, private consumption and investment, both of which remain weak in these economies, need to take up the slack seamlessly.

A prolonged low interest rate regime in advanced countries has the potential to increase systemic leverage

1.2 Policy rates in advanced economies are low and are likely to remain so for a protracted period. A prolonged low interest rate regime reduces the opportunity cost of capital and potentially increases forbearances in credit markets and encourages higher systemic leverage. It also creates a yield-seeking environment wherein the investors get into 'crowded trades', including investments in emerging market assets. In times of stress, unwinding of such trades can cause a disorderly correction in asset prices.

Capital flows beyond absorption capacity could create imbalances

1.3 In contrast to advanced economies, in many emerging markets including India, both consumption and investment are fuelling demand and contributing to strong growth. As output nears potential in these economies, monetary accommodation is being withdrawn and policy rates raised to near-neutral levels. The two-track global recovery and divergent course of monetary policy actions have created push and pull factors for large capital inflows into EMEs. Such capital flows have the potential to create imbalances in

domestic financial markets, especially if they exceed the country's absorption capacity. They also leave the country vulnerable to sudden reversals that destabilise the domestic financial markets and the broad economy.

Structural factors behind global imbalances need addressing

1.4 Current account deficits continue to persist in the advanced economies, particularly the United States, though they are expected to narrow down somewhat in 2011. Some of these economies have also been recording high fiscal deficits before and after the crisis. To prevent reemergence of global imbalances, rebalancing from public to private demand in advanced economies and from external to domestic demand in key emerging economies is imperative.

Tensions over currency valuations could escalate

1.5 Easy monetary policy, especially in the US, has led to a weaker US dollar. Several economies in advanced and emerging markets, have reportedly stepped up intervention in the foreign exchange market in a bid to arrest the appreciation of their respective currencies. This has raised the risks of tensions over currency valuations, especially among countries enjoying large current account surpluses with the US.

Fiscal profligacy can disrupt sovereign debt markets and threaten financial stability

1.6 Turbulence in sovereign debt markets in May 2010 and again in recent months has strongly underscored the importance of credible medium-term fiscal consolidation plans for ensuring financial stability. Unfolding market developments clearly demonstrate the strong potential of problems in one country spilling over to other similarly vulnerable nations and to the global economy in general. In particular, the crisis highlighted the limitations imposed by a unified currency (the Euro) in conducting monetary policy tailored to the specific needs of individual jurisdictions leaving the burden of adjustments to fiscal policy. Significant amounts of sovereign debt, especially in European countries, are maturing in the next few years and any renewed turbulence could severely impair the fragile global recovery.

Global banking system is more resilient but funding risks remain

1.7 Since the outset of the financial crisis, financial institutions globally have worked their way through large losses, strengthened capital and liquidity buffers and have lowered leverage. The improvements have, however, yet to fully normalise conditions in bank funding markets. Weaker banks remain dependent on support from central banks and governments. Banks face a major refinancing challenge given the 'wall of redemptions' in the next few years. Strains could emerge as they compete with sovereigns in bond markets. Funding problems could also arise for specific institutions, prompted by renewed stress in sovereign debt markets or downside surprises to economic activity. The problems could quickly become more widespread given the complex linkages of institutions and markets within and across borders.

1.8 A more recent threat has emerged from alleged irregularities in mortgage documents in the US housing markets. If documentation problems prove to be pervasive and, more importantly, throw into doubt the ownership of not only foreclosed properties but also pooled mortgages, the consequences could be severe.

Domestic outlook and assessment

Growth buoyant, but downside risks remain

1.9 Buoyed by strong domestic demand, GDP growth rates have rebounded after some moderation in the aftermath of the global financial crisis. Going forward, the growth momentum is expected to be sustained by increased corporate capital expenditure, infrastructure investments and strong consumption demand. Downside risks remain, especially if global recovery falters, given the greater integration of the domestic economy with the global economy. Persistent accommodative policy in the advanced nations leading to a weak US dollar could impact exports.The key domestic challenges include the widening gap between savings and investment rates and the constraints placed by the availability of infrastructure.

Inflation in India has some structural basis

1.10 Inflation, particularly food inflation, in India continues to rule at elevated levels reflecting in part the structural demand-supply mismatches resulting from, *inter alia*, rising incomes and changing consumption patterns. Non-food manufacturing inflation remains above trend though some moderation has been a welcome development. The recent upswing in food and commodity prices at the global level is also a concern for domestic inflation, going forward. Monetary policy has been tightened. This, along with

the stressed liquidity conditions, has caused short term rates to harden. The increased frequency of policy reviews should help manage expectations and reduce uncertainties.

Stressed liquidity conditions warrant caution

1.11 Liquidity conditions remain tight. The liquidity stress arose initially due to payouts to the Government in respect of telecom auctions. Strains continued to prevail on account of rising large government cash balances, accentuated by rising currency in circulation and faster growth of advances compared to deposits. While the tight liquidity conditions have aided the transmission of monetary policy, excessive deficits induce unpredictability in both availability and cost of funds, making it difficult for the banking system to sustain credit delivery. Several measures have recently been taken (announcement of OMO purchases of government securities of ₹48,000 crore and a permanent reduction in SLR to 24 per cent) to alleviate the tight liquidity conditions. The liquidity situation will require watchful management in the coming months.

Sovereign debt and fiscal deficit, though under control, still remain a concern

1.12 On the fiscal front, though high fiscal deficit is perceptibly worrisome, it has not been considered a major source of vulnerability due to strong growth rates and the fact that India predominantly funds its deficit through domestic sources. The Government has, in the Union Budget for 2010-11, announced a road map for a return to fiscal consolidation and measures for fuel price liberalisation and proposed tax reforms are expected to aid this process. Going forward, fiscal consolidation will necessitate focusing on the 'quality of adjustment', which involves substantial expenditure compression under-pinned by revenue-led correction while ensuring that capital outlay to aid medium-term growth prospects is not affected.

Management of capital flows poses challenges

1.13 Accelerated capital flows to the economy have helped finance the widening current account deficit. However, a potentially worrying feature of capital flows to India has been the dominance of portfolio flows and debt flows as compared to the more stable investment flows on gross basis. Such flows require watchful management as they are prone to sudden stops and reversals.

External debt ratios of the country require careful management

1.14 Increasing international liabilities have resulted in a worsening net international investment position of the country with the ratio of short term external debt to foreign exchange reserves and of total external debt to foreign exchange reserves having risen to their highest level since the foreign exchange crisis during the early 1990s.

Developments in the housing sector have prompted tightening of prudential norms

1.15 House prices have risen sharply in some pockets and the sector remains susceptible to asset price booms. Alluring housing loan schemes offered to the banking system clientele could also be aiding demand in the sector. Against this backdrop, the Reserve Bank has tightened the prudential norms for housing credit.

Household and corporate balance sheets are healthy

1.16 Household and corporate leverage remained low especially relative to norms in the advanced economies. The Industrial Outlook survey also points to an improvement in business sentiments. A few concerns arise in respect of banks' exposures to some industry segments/firms which are highly leveraged. Overall, there was an improvement in the quality of the retail portfolio of banks which points to a possible improvement in the health of households though the level of retail NPAs remains high.

Financial Markets

1.17 Domestic financial markets remained stress-free but susceptible to large external shocks. Looking ahead, the Financial Stress Indicator (FSI) anticipates that conditions are likely to remain orderly over the next three months. However, a few market microstructure issues need attention.

Efficacy of the LAF corridor needs to be improved

1.18 Recourse to liquidity under LAF is dependent upon availability of government securities in excess of mandatory Statutory Liquidity Ratio (SLR) holdings. Since the distribution of excess SLR holdings is not uniform across banks, those short on funds and excess SLR securities have to depend upon other banks to access funds from the Reserve Bank. At times, such indirect access is constrained by availability of limits -

interbank as well as regulatory (lending and borrowing as a proportion of capital funds) limits and banks' own contingency liquidity assessments. In view of such market microstructure issues, the call money rates often breach the LAF corridor when liquidity conditions are beyond the "comfort zone". The Reserve Bank has constituted a Working Group to examine the gamut of issues related to the operating procedures of monetary policy.

Need for a well-developed term structure in money markets

1.19 The money markets in India, including interbank markets, are well regulated. The inter-bank market is largely collateralised but restricted to the overnight tenor. Term money market has not developed on account of the unique circumstances and structure of the financial system. Banks, though, have been raising term funding through Certificate of Deposits (CDs) and bulk deposits. Compared to the term money market, volumes in the CD market are high and growing. However, dependence of banks on such wholesale funding for credit creation is not excessive. If the CD market gets more standardised and there is greater transparency in secondary market trades in CDs, it may promote development of a credible term structure /benchmark.

Deeper and more liquid bond markets desirable

1.20 Bond markets in India and elsewhere in EMEs are characterised by lack of incentives to trade actively. A supply-heavy market on account of large government borrowings is a key factor behind the lack of active trading interest. Moreover, banks and insurance companies are statutorily required to maintain a relatively high proportion of their liabilities in approved securities, mainly government bonds. For financial stability reasons, regulations allow banks in India to hold the entire mandated proportion under the Held-till-Maturity (HTM) category which also reduces the tradeable portion of securities portfolio held by banks.

Increased integration of foreign exchange markets

1.21 The exchange rate of the Indian rupee displayed two-way movement consistent with the Reserve Bank's policy of maintaining orderly conditions in the market rather than targeting any level of the exchange rate. The Reserve Bank's exchange rate policy is designed so as not to intervene in foreign exchange markets if capital flows are "driven by changing economic fundamentals". Increased correlation across markets and faster and easier "pass through" of global disturbances to the domestic markets have led to higher volatilities in the domestic foreign exchange market relative to past years. At the same time, the real sector's ability to hedge the concomitant risks have been enhanced through liberalisation and introduction of hedging products, though the costs of hedging could increase with increased volatility.

Growth of the offshore market

1.22 A recent survey conducted by the BIS points to the rising share of the Rupee offshore non-deliverable market. A large offshore market which interacts with the domestic market raises some systemic concerns since flows arising abroad out of transactions that are not permissible onshore find resonance in the domestic foreign exchange market. Moreover, transactions in these markets are non-transparent and outside the regulatory ambit. A large offshore market, therefore, constrains the systemic regulator's actions for maintaining orderly conditions in the domestic market.

Concentration in few segments

1.23 Some segments of the interest rate market exhibit significant concentration. Market activity in the interest rate swap and, to a lesser extent, in the government bond market is dominated by a small number of banks. While such concentration is not uncommon even in advanced countries, in India, trading is concentrated mostly in banks with smaller balance sheets. As a consequence, the risk taking ability of the system is low and the market remains prone to bouts of illiquidity. Higher participation by 'larger' banks (in terms of balance sheet size) is desirable for market liquidity and vibrancy.

Market development – an ongoing process

1.24 As the economy matures, new and more complex products will need to be introduced in a calibrated manner. In recent times, interest rate futures, STRIPS, currency futures and repo in corporate bonds have been introduced while work is underway for introducing some others like credit default swaps and futures on shorter dated securities. Measures that are being considered to enhance the depth and liquidity of corporate bond markets in India include proposals to remove withholding tax on FII investment, relaxation of rating and net worth criteria for the insurance sector and

relaxation of stamp duties. Introduction of each new product would need to be of value to the real economy and concomitant with the introduction of prudent guidelines, a robust market infrastructure and a systemic monitoring framework for these new markets.

Financial Institutions

Financial sector remained resilient but vigilance on asset quality and liquidity is needed

1.25 The financial sector in India remained resilient. The Banking Stability Index points to a healthy improvement in the stability of the banking sector over the past few years, though the dimensional risk associated with the liquidity of scheduled commercial banks (SCBs) has increased. Capital adequacy ratios of SCBs were well above the regulatory requirements – both from a micro and a systemic perspective. Credit offtake improved with rebound in economic growth. Credit acceleration was evidenced across segments. However, it was particularly marked in case of infrastructure advances and retail credit. Increase in advances in both these segments has to be viewed with caution. A growing portfolio of infrastructure finance could aggravate asset liability mismatches despite the presence of mitigants, while in the retail sector, high levels of NPAs persist. Liquidity conditions could be impacted as the incremental credit deposit ratio accelerated in recent quarters with credit growth outpacing deposit growth.

Asset quality needs to be monitored

1.26 Asset quality continued to pose some concerns as the growth in NPAs outstripped growth in advances leading to a deterioration of gross NPA ratios. These ratios deteriorated despite increased write offs and one time settlements. Doubtful and loss assets comprised over 50 per cent of the stock of NPAs indicating the preponderance of sticky advances.

1.27 Recently, some concerns had arisen in respect of real estate firms allegedly involved in the loan syndication bribery case and the fallout of investigations in regard to issuance of 2G telecom licenses on bank exposures to telecom companies. Detailed enquiries have been undertaken though preliminary findings do not point to widespread irregularities or systemic concerns. However, there could be a potential impact on the flow of credit to these sectors as banks adopt a more cautious approach to lending to these segments of the economy.

Provision coverage ratio met in aggregate, some laggards

1.28 The Reserve Bank, as a countercyclical requirement, had announced that all scheduled commercial banks would be required to maintain a provision coverage ratio of 70 per cent by September 2010. The banking sector, in the aggregate, has met the regulatory requirement though the coverage ratio was yet to be met by the public sector banks, as a whole.

Infrastructure loans could heighten ALM risks though there are mitigants

1.29 From a longer term perspective, the maturity profile of the deposits, advances and investments of banks indicates concentration of shorter term deposits as against deployment of credit in the medium to long term tenure implying presence of inherent structural mismatches in their balance sheets. These trends are primarily driven by the growing share of infrastructural lending in total advances of banks. There are, however, mitigants in the form of high share of low cost CASA deposits and interest rate reset clause stipulated by banks. Further, several initiatives taken recently viz., introduction of repos in corporate bonds, facilitating take out financing, proposed infrastructure debt funds, enhancement in the limit for FII investment in government securities and corporate bonds and the proposed introduction of single name CDSs are expected to improve the flow of finance to the infrastructure sector reducing the pressure on banks to take on increasing quantities of long term credit exposure to this sector.

Off balance sheet (OBS) exposures of foreign banks warrants monitoring

1.30 The OBS exposures of foreign banks increased, warranting careful monitoring, especially as foreign banks account for the bulk of OBS exposures of SCBs. The credit equivalent of these exposures, however, remained low.

A robust co-operative banking sector is critical for financial inclusion

1.31 The co-operative sector remains critical for greater financial inclusion in the country. Multifaceted

efforts at reorganisation of the sector (for example through mergers and amalgamations), recapitalisation, intensive supervision, etc. have led to some improvement in the performance and financial soundness parameters of this segment though some concerns on this front remain. While the segment is not systemically important in terms of size, past instances have amply demonstrated the significant impact any failure in the segment can have on market sentiments about the financial sector with downstream impact on its smooth functioning.

Regulatory environment

The proposed capital rules – some challenges but the banking system not likely to be unduly stretched

1.32 The Basel III proposals reflect the lessons from the crisis and are expected to be "quite game changing". In particular, for emerging economies like India, the implementation comes at a time when the credit demand will remain strong given, *inter alia*, the compulsions of robust growth, the investment needs of infrastructure and the demand ushered in by increasing financial inclusion. However, the comfortable capital adequacy position of the banks in India vis-à-vis Basel II norms means that the Basel III requirements, once fully calibrated, are not likely to be very much higher than the current position. Nevertheless, there could be shortfalls, at the level of individual banks, which would necessitate raising additional capital. The extended implementation schedule for the requirements is expected to ease the transition. Additional capital requirements by public sector banks, if any, could also necessitate recapitalisation by the Government with resultant impact on the total internal debt.

Leverage and liquidity norms not binding constraints but pose some challenges

1.33 The Basel III requirements in respect of leverage and liquidity are also not expected to unduly stretch banks in India. However, constraints in the availability of accurate and timely data and absence of historical episodes of significant liquidity stress in the Indian context means that formulating and predicting liquidity stress scenarios with reasonable accuracy and consistency, as is required under the proposed rules, is going to be difficult.

Identifying objective alternatives to CRAs presents difficulties while the regulatory framework needs to be strengthened

1.34 In India, the Reserve Bank has been emphasising that banks should carry out their own assessment and not rely on ratings exclusively. There are, however, several issues with reducing such reliance. In particular, the reliance of banks on external ratings for arriving at their capital requirements using the Standardised Approach under Basel II is likely to continue in many jurisdictions, including India. CRAs in India are regulated by SEBI. SEBI's jurisdiction over the CRAs, however, only extends to their activities in securities market. It is thus imperative that the accreditation process of rating agencies in respect of activities coming under other regulators and the rating methodology employed for such activities is looked into by the regulator concerned. In respect of banks, the Reserve Bank does accredit CRAs as External Credit Assessment Institutions based on a rigorous evaluation.

Critical accounting standards are currently moving targets and convergence may pose difficulties

1.35 Phased road maps for convergence with the International Financial Reporting Standards (IFRSs) for corporates and banks in India has been announced. The convergence programme could be a major challenge in view of, *inter alia*, the rigorous requirements for skill upgradation and changes in IT systems. This was observed in the previous FSR and needs re-iteration. Also, IFRS 9 relating to Financial Instruments, which is very crucial for banks, is still evolving and the final standard is unlikely to be available before the middle of 2011. The Reserve Bank has constituted a Working Group to address the implementation issues and facilitate formulation of operational guidelines for the convergence.

The supervisory structure for financial conglomerates (FC) will have to draw on international policy developments

1.36 The current supervisory structure for FCs which encompasses a two-pronged approach of off-site surveillance and periodic interface with the conglomerates has proved quite robust in assessing the risks faced by these institutions. Going forward, international regulatory requirements may not immediately mandate separate prudential

requirements for the large Indian firms, as none of them are likely to be considered systemically important globally. Regardless, policies for FCs will need to be strengthened drawing on international policy developments on SIFIs. The legal and operational framework for orderly resolution of institutions, more so for complex financial institutions, will need to be strengthened. A Working Group is examining the feasibility of a holding company model for FCs having banks as well as non-banks.

Nature of incorporation of foreign banks needs careful consideration

1.37 Issues with respect to the operating structure i.e. branch versus wholly owned subsidiary, of foreign banks in India will need careful consideration. From the financial stability angle, the subsidiary model is the preferred approach as it provides effective regulatory control, ring fencing of capital and clearer resolution in case of bankruptcy.

NBFCs vis-a-vis banks – a few avenues for regulatory arbitrage remain

1.38 Internationally, tightening of the regulatory regime for the banking sector has raised the possibility of increased regulatory arbitrage vis-à-vis the non-banking financial sectors. In India, too, this remains an area where vigilance will need to be continuously exercised in view of the strong cross-linkages between the various segments of the financial sector. This is particularly so in the current environment when NBFCs (especially systemically important non-deposit taking NBFCs) are expanding rapidly and both interconnectedness and product competition across types of institutions are intensifying. Several initiatives have been taken to tighten the regulatory framework for NBFCs which include, *inter alia,* imposition of prudential norms as applicable to banks to the non-banking sector.

Entity regulation could leave regulatory gaps which need to be addressed

1.39 Multiple regulators for non-banking financial entities in the country and an entity based approach to regulation gives rise to possible regulatory gaps – functional activities remaining unregulated, gaps in regulation permitting surrogate raising of public funds, leveraged activities by entities like merchant banks, portfolio managers and brokerages not being subject to prudential regulation. These will need to be urgently addressed.

Microfinance institutions (MFIs) – recent concerns warrant closer examination

1.40 In the wake of the legislation by the Government of Andhra Pradesh and the serious concerns in the methods of operations of MFIs, particularly the large for-profit companies, bank loans to these entities which is a significant source of funding, is likely to be impacted. Fresh disbursements have come to a standstill while the recovery rate of the NBFC-MFIs has come down sharply. The impact of non-recovery of MFI loans spilling over to other states and to other channels, including bank lending through Self Help Groups, cannot be ruled out. Given the total outstandings of banks, it is not yet a systemic issue as far as bank balance sheets are concerned. However, the recent developments are bound to impact the MFI-model in a significant way. The Malegam Committee is looking into all the issues and is expected to come out with its recommendations shortly.

Network connectivity important for ascertaining systemic vulnerabilities

1.41 Interconnectedness between various segments of the financial markets and among financial market participants has emerged as an important element of macroprudential supervision. Closer supervision of institutions which are highly interconnected in payment and settlement systems or through inter-bank liabilities is warranted. A systemic regulator would require sophisticated network tools to rigorously study the complex nature of functioning of interconnected financial systems.

Strengthening the institutional mechanism for financial stability

1.42 Post crisis, the Union Budget 2010 has announced the establishment of a high-level Financial Stability and Development Council (FSDC) with a view to strengthen and institutionalise the mechanism for maintaining financial stability. The FSDC is taking shape and the Reserve Bank's role in it would expectedly be critical. The Union Budget also proposed the setting up of a separate Financial Sector Legislative Reforms Commission to rewrite and clean up the financial sector laws to bring them in line with the requirements of the sector. Any revision to legislations

in the banking and financial sector will, however, need to be driven by clear policy direction for the sector.

Financial Market Infrastructure

Financial Market Infrastructure remained robust

1.43 Payment and settlement systems in the country functioned without disruptions. The degree of concentration of payment activities in a few participants requires careful monitoring. Some critical payment and settlement systems remain outside the purview of the Payment and Settlement System Act, 2007.

Systemic risk bearing capacity of CCPs has become critical

1.44 Settlement through Central counterparties (CCPs) has been the preferred mode of settlement for large value interbank transactions in India, wherever feasible. The Clearing Corporation of India (CCIL) acts as a CCP in a wide range of markets, products and participants and the spillover effects of defaults/ disturbances in any one market/product are likely to be commensurately greater. From a stability perspective, a multi-product CCP such as CCIL essentially becomes, and will need to be treated as, an entity which is systemically important.

OTC derivative markets in India have developed within a regulated space; a few issues need to be addressed

1.45 Setting up of a resilient OTC derivatives market infrastructure has been a widely shared key priority for policy makers internationally. In India, the OTC derivatives markets developed within a regulated framework. But some concerns remain. The participation structure in many derivative markets remains skewed with volumes concentrated in a few participants. Volumes in some derivatives markets remain relatively low making it challenging to mandate guaranteed clearing for such products. A further area for regulatory initiative in the Indian markets would be greater standardisation of OTC products and introduction of central clearing arrangements for a greater number of such products. However, given the vanilla nature of products permitted in the country, standardisation of existing products may not be very difficult.

Deposit insurance system in India– robust but some issues remain

1.46 Several issues and key challenges continue to be faced by the deposit insurance system in India. Ensuring the adequacy of the deposit insurance fund remains critical for ensuring the efficiency of the system. The Reserve Ratio for Deposit Insurance and Credit Guarantee Corporation (DICGC) at end-March 2010 was relatively low at 0.85 per cent, though there is no clear international benchmark in this regard. The coverage ratio of deposit insurance in the country remains one of the lowest in terms of per capita income. The need for increasing the cover requires to be examined carefully.

1.47 A robust delivery system to reduce the time taken by DICGC to effect payments on claims well within the stipulated time presents a huge challenge given the geographic spread of the country and the unsatisfactory quality of data in respect of particulars of depositors. The process necessitates improvements to systems of record keeping - the Corporation has already initiated early steps in this direction; and accountability of liquidators to ensure timely flow of information to the Corporation.

Stress testing

Stress Tests reflect muted macro-financial risks in the short run

1.48 Stress testing on the credit, market and liquidity risks faced by banks in India indicates a reasonable degree of resilience of the banking sector. Some deterioration in the capital position of banks is evidenced only in case of a very sharp increase from the current NPA levels. Interest rate risks displayed an increasing trend while some banks continued to face liquidity constraints under stringent stress scenarios. Both aspects warrant monitoring.

1.49 The banking sector also displays resilience in response to stressed domestic macroeconomic variables though the impact of strong headwinds arising from any sharp deterioration in the global economic situation needs to be monitored.