Foreword

The global financial system has so far largely withstood the shocks from waves of the COVID-19 pandemic, even as the incidence and sheer scale of human misery and loss is unprecedented. Governments, central banks and financial regulators have mounted an extraordinary defence to mitigate the impact of the pandemic. By and large, these policy responses have contained the severity of the pandemic's toll on financial markets and institutions, and cushioned the shock to economic activity.

With vaccination drives and access being ramped up, globally a hesitant and uneven recovery is gaining ground under the protective cover of policy support. What has stood out as remarkable is the determination and the courage to fight the virus and its mutants and restore pre-pandemic normalcy.

In India, the second wave of the pandemic has taken a grievous toll. The recovery that had commenced in the second half of 2020-21 was dented in April-May 2021, but with the wave of infections abating as rapidly as it had set in, economic activity has started to look up in late May and early June. The stepped-up pace and scale of vaccination is catalysing the insulation of our communities from infections and gradually releasing the economy from regional and localised containment measures. Nonetheless, scarred as we are, there is no letting down of the guard against the rapidly mutating and transmissible virus.

With the scent of recovery, global financial markets are upbeat on reflation trade. Domestic financial markets are also boosted by the strengthening signs of the pandemic's abatement, the growing pace and breadth of the vaccination drive and renewed hopes of the economy clawing back lost ground as it unlocks. As this issue of the Financial Stability Report highlights, the dent on balance sheets and performance of financial institutions in India has been much less than what was projected earlier, although a clearer picture will emerge as the effects of regulatory reliefs fully work their way through. Yet, capital and liquidity buffers are reasonably resilient to withstand future shocks, as the stress tests presented in this report demonstrate.

It is important to note in this context that while the recovery is underway, new risks have emerged on the horizon and these include the still nascent and mending state of the upturn, vulnerable as it is to shocks and future waves of the pandemic; international commodity prices and inflationary pressures; global spillovers amid high uncertainty; and rising incidence of data breaches and cyber attacks. Accordingly, sustained policy support accompanied by further fortification of capital and liquidity buffers by financial entities remains vital.

Even as our financial system remains on the front foot and prepares to intermediate in meeting the resource needs of an economy on the move towards a brighter post-pandemic future, the priority is to maintain and preserve financial stability. In a situation in which economic activity has been disrupted by the pandemic, the financial system can take the lead in creating the conditions for the economy to recover and thrive. Stronger capital positions, good governance and efficiency in financial intermediation can be the touchstones of this endeavour so that financing needs of productive sectors of the economy are met while the integrity and soundness of banks and financial institutions are secured on an enduring basis.

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