

Foreword

From a global financial stability perspective, 2015 has been an eventful year, with the stage set for policy divergence across the Atlantic. The recent Fed Fund rate hike and the developments in China call for a careful calibration of domestic policies to withstand global headwinds, even as managing 'volatile' volatility has become a big challenge for the guardians of financial stability across the world. The risks associated with weaker growth prospects in key advanced and emerging market economies combined with tighter financial market conditions and weak commodity prices could pose many challenges. While India appears to be relatively better placed compared to many of its emerging market peers, thanks to a combination of prudent policy measures and benign commodity prices, there are a few issues that we need to take note of as we prepare to take on the emerging risks.

First, corporate sector vulnerabilities and the impact of their weak balance sheets on the financial system need closer monitoring.

Second, cyber security will be a major challenge, being more of a strategic issue than a mere operational concern, requiring board level understanding of the threats and solutions therefor.

Third, despite domestic inflation coming down significantly, we should not lose sight of the fact that the climatic conditions have tended to be more erratic and unpredictable. This will have an impact on the volatility of inflation and perhaps its level.

Against this backdrop, this Report carries out both qualitative and quantitative analyses of the current strength and resilience of the Indian financial system thus indicating where the financial system is and how it needs to move, to achieve its goal of supporting the real sector more effectively.

Raghuram G.Rajan

Governor

December 23, 2015