Foreword

The global economic prospects, overshadowed by the possibility of a disruptive trade war, have noticeably softened although the risk of a recession in major economies appears modest at this point of time. The gyrations in global financial markets towards the end of 2018 point to their own shifting assessment of risks to global growth. Looking forward, a stricter enforcement of global trade and investment rules could potentially lead to market stability and win-win bargains in trade.

Domestically, while 2018-19:Q2 GDP growth number at 7.1 per cent was lower than market expectations, the uptick in Gross Fixed Capital Formation coupled with the recent decline in crude oil prices bodes well for a sustained growth, going forward.

After a prolonged period of stress, the banking sector appears to be on course to recovery as the load of impaired assets recedes; the first half-yearly decline in gross NPA ratio since September 2015 and improving Provision Coverage Ratio, being positive signals. Stress test results suggest further improvement in NPA ratio, though its current level remains still high for comfort. Notwithstanding the significant costs wrought by the enhanced recognition of asset impairment in Public Sector Banks (PSBs), it appears to have led to a greater discipline in credit assessment, higher sensitivity to market risk and better appreciation of operational risks.

The immense effort put in by the stakeholders so far is required to be buttressed with substantive reforms in governance and oversight regime, supported by recapitalisation of weak PSBs. Meanwhile, the Insolvency and Bankruptcy Code (IBC) has bridged an important institutional gap to strengthen the much-needed credit discipline. Some of the resolutions, however, are lagging behind the envisaged timelines. A time-bound resolution of impaired assets will go a long way in unclogging the credit pipeline thus improving the allocative efficiency in the economy.

The shift in credit intermediation from banks to non-banks has given the corporate sector a diverse choice of financing instruments. Such market-intermediated credit flows require robust supporting infrastructure in the form of appropriate valuation regime as also informative and responsive credit rating framework. Securities Exchange Board of India (SEBI) has recently taken significant initiatives in both these areas. Similarly, the recent developments in Non-Banking Financial Companies (NBFCs) have underscored the need for greater prudence in risk-taking. There is, in particular, a need for some rebalancing as excessive credit growth, especially if funded with short-term financing, either sectorally or overall, is not stability-enhancing. The framework for oversight of financial conglomerates also requires closer attention.

While the role of banks and non-banks in supporting the growth needs of an emerging economy like India is well recognised, emphasis should continue to be on diligent, prudent and sound risk management practices.

Some of these emerging developments, both global and domestic, and their attendant risks are documented in this 18th issue of the Financial Stability Report (FSR). The report also assesses the systemic resilience through stress tests and contagion analysis so as to look at the emerging vulnerabilities and help assess financial stability concerns.

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