Foreword

The COVID-19 pandemic has changed the world, with a devastating impact on human and economic conditions. Governments, central banks and other public agencies across countries have responded unprecedentedly to mitigate its impact. A multi-speed recovery is struggling to gain traction, infusing hope, reinforced by positive news on vaccine development. Nonetheless, a second wave of infections and new mutations of the virus have spread heightened uncertainty, threatening to stall the fragile recovery.

India's banking system faced the pandemic with relatively sound capital and liquidity buffers built assiduously in the aftermath of the global financial crisis and buttressed by regulatory and prudential measures. Notwithstanding these efforts, the pandemic threatens to result in balance sheet impairments and capital shortfalls, especially as regulatory reliefs are rolled back. In addition, banks will be called to meet the funding requirements of the economy as it traces a revival from the pandemic. Consequently, maintaining the health of the banking sector remains a policy priority and preservation of the stability of the financial system is an overarching goal.

Congenial liquidity and financing conditions have shored up the financial parameters of banks, but it is recognised that the available accounting numbers obscure a true recognition of stress. It is in this context that banks must exploit the congenial financial conditions and the conducive policy environment to plan for capital augmentation and alterations in business models that address emerging challenges for future expansion, while strengthening the capacity to absorb shocks and supporting the revival of the economy.

In spite of rising public commitments for mitigating the impact of the pandemic, fiscal authorities are also witnessing revenue shortfalls. The resultant expansion in the market borrowing programme of the Government has imposed additional pressures on banks. The borrowing programme has been managed smoothly so far, with the lowest borrowing costs in 16 years and elongation of maturity. The corporate sector has also raised substantial funds from financial markets amidst easy financing conditions, which have been mainly used for deleveraging and building up precautionary buffers. As growth impulses take root, the private sector capex cycle should revive as existing capacities get utilised and new capacities are added. This will require the financial system to intermediate expanded growth requirements of Indian business. Meanwhile, the disconnect between certain segments of financial markets and the real economy has been accentuating in recent times, both globally and in India. Stretched valuations of financial assets pose risks to financial stability. Banks and financial intermediaries need to be cognisant of these risks and spillovers in an interconnected financial system.

Information technology platforms and digital payment systems have provided considerable support for business continuity and smooth functioning during the pandemic. More investment is required by all stakeholders for building robust IT platforms and technologies for operational purposes as well as for fortifying public confidence in digital banking, especially when the financial landscape is rapidly embracing new technologies. In fact, digital technologies have been identified as a bright spot in India's economic prospects.

We have been scarred by the COVID-19 pandemic and the task ahead is to restore economic growth and livelihood. Financial stability is a precondition for supporting this mission. This issue of Financial Stability Report should act as a springboard for further policy action. As we take up these challenges, we have to remain unwaveringly focussed on taking India to a new destiny.

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Governor

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