Overview

The Financial Stability Report (FSR) is a half-yearly publication, with contributions from all financial sector regulators. It presents the collective assessment of the Sub Committee of the Financial Stability and Development Council on current and emerging risks to the stability of the Indian financial system.

Global Macrofinancial Risks

The global economy and the financial system are exhibiting resilience amidst heightened risks and uncertainties. While near-term prospects are improving, pitstops in the last mile of disinflation, high public debt, stretched asset valuations, economic fragmentation, geopolitical tensions, climate disasters and cyber threats present downside risks. Emerging market economies (EMEs) remain vulnerable to external shocks and spillovers.

Domestic Macrofinancial Risks

Strong macroeconomic fundamentals and a sound and stable financial system have supported the sustained expansion of the Indian economy. Moderating inflation, a strong external position and ongoing fiscal consolidation are anchoring business and consumer confidence. Domestic financial conditions are buttressed by healthy balance sheets across financial institutions, marked by strong capital buffers, improving asset quality, adequate provisioning and robust earnings.

Financial Institutions: Soundness and Resilience

Scheduled commercial banks (SCBs) have been boosted by rising profitability and declining non-performing assets. Return on assets (RoA) and return on equity (RoE) are close to decadal highs at 1.3 per cent and 13.8 per cent, respectively, while gross non-performing assets (GNPA) ratio and net non-performing assets (NNPA) ratios fell to multi-year lows of 2.8 per cent and 0.6 per cent, respectively. This has helped SCBs to maintain strong capital buffers: their capital to risk-weighted assets ratio (CRAR) and the common equity tier 1 (CET1) ratio at 16.8 per cent and 13.9 per cent, respectively, stood well above the regulatory minimum in March 2024. Macro stress test for credit risk, which should not be interpreted as forecasts and are based on scenarios and stringent conservative assessments under hypothetical shocks, demonstrate that SCBs have adequate capital buffers relative to the regulatory minimum even under adverse stress scenarios.

At the system level, the CRAR of urban co-operative banks (UCBs) inched up to 17.5 per cent in March 2024 while that of non-banking financial companies (NBFCs) declined marginally to 26.6 per cent, both remaining well in excess of the prescribed regulatory minimum. The consolidated solvency ratio of the insurance sector remains above the minimum threshold limit of 150 per cent. Stress tests on mutual funds and clearing corporations attest to the resilience of these segments of the financial sector. Network analysis indicates that the total outstanding bilateral exposures between financial institutions are expanding, with SCBs holding the largest share.

Regulatory Initiatives and Other Developments in the Financial Sector

Globally, regulatory efforts remain focused on promoting financial stability, consistent implementation of global standards and their refinement. Recent initiatives have been aimed at safeguarding the banking system from interconnectedness with the non-banking financial institutions, addressing risks associated with ongoing digitalisation of finance, improving climate-related risk assessments and strengthening resilience to cyber risks.

Domestic regulatory initiatives continue to work towards strengthening the safety and resilience of the financial system. Regulations are based on the principle of proportionality even as regulators harness the benefits of technology for strengthening customer service, improving governance and risk management at financial institutions and limiting procyclical activities while fostering efficiency.

Assessment of Systemic Risk

In the most recent systemic risk survey (SRS), carried out in May 2024, all major risk groups to domestic financial stability were categorised as 'medium'. Respondents expressed optimism about the soundness of the domestic financial system. Survey participants felt that risks from global spillovers have receded, with around one-third showing higher confidence in the Indian financial system. The main near-term risks identified by respondents were geopolitical risks, tightening of global financial conditions, and capital outflows.