Overview

The Financial Stability Report (FSR) is a half-yearly publication with contributions from all financial sector regulators. The FSR reflects 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.

Macrofinancial Risks

The global economy and the financial system, despite displaying resilience in the face of unprecedented monetary tightening and acute banking system stress, are facing difficult challenges. Multiple geopolitical conflicts, growing geo-economic fragmentation, elevated debt levels, and uncertainty about the global economic outlook are some of the key vulnerabilities that pose threat to financial stability. Emerging market economies (EMEs) remain vulnerable to global spillovers and volatile capital flows.

Domestic Economy and Markets

Amidst a challenging global macroeconomic environment, the Indian economy is exhibiting a quickening growth momentum, with resilience and macroeconomic and financial stability. Moderating inflation, improving external position, continuing fiscal consolidation and a strong and stable financial system with fortified balance sheets are hallmarks of this transformation in the post-pandemic period.

Bolstered by strong capital buffers and robust earnings, financial institutions are supporting durable credit growth. At the same time, higher profits and lower leverage are contributing to sound corporate financials. Proactive and prudent policy actions and availability of policy buffers are steering the economy on a rising growth trajectory with stability.

Financial Institutions: Soundness and Resilience

For scheduled commercial banks (SCBs), the capital to risk-weighted assets ratio (CRAR) and the common equity tier 1 (CET1) ratio stood at 16.8 per cent and 13.7 per cent, respectively, in September 2023. Their gross non-performing assets (GNPA) ratio and net non-performing assets (NNPA) ratio fell to multi-year lows of 3.2 per cent and 0.8 per cent, respectively, even as the provisioning coverage ratio (PCR) rose to 75.3 per cent. Healthy interest margins and lower impairments boosted profitability with return on assets (RoA) and return on equity (RoE) reaching decadal high of 1.2 per cent and 12.9 per cent, respectively.

Macro stress tests for credit risk showed that SCBs have sufficient capital buffers and even under adverse stress scenarios their capital ratios will remain above the regulatory minimum.

The CRAR of urban co-operative banks (UCBs) rose to 16.9 per cent in September 2023 while that of NBFCs stood at 27.6 per cent. The consolidated solvency ratio of the insurance sector remains above the minimum threshold limit of 150 per cent.

Network analysis indicates that the total outstanding bilateral exposures among constituents of the financial system continued to grow. As in the past, SCBs had the largest bilateral exposures in September 2023. A simulated contagion analysis shows that losses due to failure of five banks with the maximum capacity to cause contagion would not lead to failure of any additional bank.

Regulatory Initiatives and Other Developments in the Financial Sector

Global regulatory initiatives are refocusing on building up the resilience of the financial system.

These initiatives specifically aim to address fragilities in non-bank financial intermediaries and certain segments of financial markets, leveraged lending, cyber risks, crypto-assets and decentralised finance (DeFi). Management and mitigation of non-default losses (NDLs) by central counterparties (CCPs) is a focus area. Wider adoption of technology, along with new waves of innovations, also poses challenges for financial stability which may have to be addressed through appropriate regulatory/ supervisory measures.

Domestic regulatory initiatives, conditioned by the fast-changing macro-financial environment, are aimed at improving the robustness and resilience of the financial system. Regulatory measures focussed on stemming systemic risk, reducing regulatory arbitrage, expanding secure digitalisation, improving efficiency of the markets, ensuring customer protection and expanding access to finance. Regulators remain vigilant to the rapidly changing economic environment in order to ensure the efficiency and soundness of the financial system.

Assessment of Systemic Risk

A Systemic Risk Survey carried out in November 2023 showed that risk perceptions have either receded or remained unchanged across major categories of risk, except macroeconomic risks. Respondents cited tightening of global financial conditions and increase in commodity prices, particularly crude oil, as a key global risk. While a quarter of the respondents expressed that their confidence in the stability of the global financial system has declined over the last six months, over 95 per cent of them felt that the stability of the Indian financial system has either increased or remained unchanged. Moreover, underlining the resilience and strength of the Indian banking sector, about 80 per cent of the respondents assessed that the prospects of the Indian banking sector have either improved or remained unchanged over a one-year horizon.