Overview

The Financial Stability Report (FSR) is a semi-annual publication. With inputs from all the financial sector regulators, it reflects the overall evaluation of the Sub Committee of the Financial Stability and Development Council on risks to the stability of the Indian financial system.

Macrofinancial Risks

The global economy is facing formidable headwinds with recessionary risks looming large. The interaction of multiple shocks has resulted in tightening of financial conditions and heightened volatility in financial markets. For emerging market economies (EMEs), the challenges are even harsher as they encounter global spillovers, debt fragility, currency volatility and capital outflows.

Domestic Economy and Markets

The Indian economy is confronting strong global headwinds. Yet, sound macroeconomic fundamentals and healthy financial and non-financial sector balance sheets are providing strength and resilience and engendering financial system stability. Inflation, though elevated, is retreating in response to front-loaded monetary policy actions and supply side interventions.

In the financial sector, buoyant demand for bank credit and early signs of a revival in investment cycle are benefiting from improved asset quality, a return to profitability and resilient capital and liquidity buffers. These strengths are helping the financial system weather external spillovers, tightening global financial conditions and high volatility in financial markets.

Financial Institutions: Soundness and Resilience

Capital positions of scheduled commercial banks (SCBs) remained strong in September 2022. The Capital to Risk Weighted Assets Ratio (CRAR) and Common Equity Tier 1 (CET1) ratio of SCBs stood at 16.0 per cent and 13.0 per cent, respectively. Their gross non-performing assets (GNPA) ratio have been steadily trending down to a seven-year low of 5.0 per cent in September 2022, while net non-performing assets (NNPA) have dropped to ten-year low of 1.3 per cent of total assets. The provisioning coverage ratio (PCR) has been increasing steadily since March 2021 to 71.5 per cent. The profit after tax of SCBs registered a growth of 40.7 per cent in H1:2022-23, led by strong growth in net interest income and a reduction in provisions.

Macro-stress tests for credit risk reveal that SCBs are well-capitalised and all banks would be able to comply with the minimum capital requirements even under adverse stress scenarios.

The CRAR of urban co-operative banks (UCBs) rose to 16.1 per cent in September 2022 while that of NBFCs stood at 27.4 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 are stable. SCBs continued to have the largest bilateral exposures in the Indian financial system, which reached pre-pandemic levels in September 2022. 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

Globally, the focus of prudential regulation is on protecting the financial system from spillover effects of synchronised monetary tightening by central banks amidst a highly uncertain economic environment. Enhancing the resilience of non-bank financial intermediaries (NBFIs) and assessing climate-related financial risks are among the key priorities. On the domestic front, the emphasis remains on improving the resilience of the financial system and fostering a conducive credit environment that supports a sustainable economic recovery and preserves financial stability.

Assessment of Systemic Risk

The Reserve Bank's latest Systemic Risk Survey (SRS) showed that global spillovers, financial market and general risks have increased, while macroeconomic risks have moderated. No change is perceived in institutional risks. Monetary tightening in advanced economies, tightening of financial conditions, geopolitical risks, global growth uncertainty and growing risks from private cryptocurrencies and climate change are cited as the major contributors to rise in global, financial market and general risks. The majority of the respondents saw further improvement in credit prospects for the Indian economy and remained confident about the stability of the Indian banking sector. Nearly ninety per cent of the respondents assessed that the prospects of the Indian banking sector are likely to improve or remain unchanged over a one-year horizon.