Overview

The Financial Stability Report (FSR) is a half-yearly publication with contributions from all the financial sector regulators. The FSR reflects the collective assessment of the Sub Committee of the Financial Stability and Development Council on prevailing and emerging vulnerabilities to the Indian financial system.

Macrofinancial Risks

The stability of the global financial system is tested by high inflation, tight financial conditions and banking system fragilities. Simultaneously, geopolitical tensions and economic fragmentation are threatening macroeconomic stability. Bouts of volatility surge through financial markets amidst rapid shifts in investor sentiments. Emerging market economies (EMEs) could face significant spillover risks and asymmetric effects of macrofinancial instability.

Domestic Economy and Markets

The Indian economy presents a picture of resilience, supported by strong macroeconomic fundamentals. Sustained growth momentum, moderating inflation and anchoring of inflation expectations, a narrowing current account deficit (CAD) and rising foreign exchange reserves, ongoing fiscal consolidation and a robust financial system are setting the economy on a path of sustained growth.

Healthy balance sheets of banks and corporates are engendering a new credit and investment cycle. Strong revenue growth, higher profits and lower leverage are helping corporates to improve their bottom lines. Banks and non-bank financial intermediaries are posting strong earnings and robust credit growth with strengthening buffers. These improvements are brightening the prospects of the Indian economy, fortified by the rising pace of real economic activity, corporate resilience and sound and efficient financial intermediation.

Financial Institutions: Soundness and Resilience

Scheduled commercial banks (SCBs) bolstered their capital base, with the capital to risk-weighted assets ratio (CRAR) and the common equity tier 1 (CET1) capital ratio at historical highs of 17.1 per cent and 13.9 per cent, respectively, in March 2023 and have steadily enhanced their returns on assets (RoA) and returns on equity (RoE). SCBs' gross non-performing assets (GNPA) ratio continued its downtrend and fell to a 10-year low of 3.9 per cent in March 2023 and the net non-performing assets (NNPA) ratio declined to 1.0 per cent. The provisioning coverage ratio (PCR) rose to 74.0 per cent. Led by strong growth in net interest income and significant reduction in provisions, the profit after tax of SCBs registered a growth of 38.4 per cent in 2022-23.

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 16.5 per cent in March 2023 while that of NBFCs stood at 27.5 per cent. The 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. SCBs have the largest bilateral exposures in the Indian financial system, although their share declined in March 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

Regulatory efforts across the globe are focusing on improving financial system resilience amid interaction between higher interest rates and weak internal risk management practices in banks. Addressing liquidity and leverage vulnerabilities in non-bank financial intermediaries (NBFIs) remains a policy priority. Intensifying supervisory efforts to close data gaps, identify emerging risks and initiate strong and appropriate actions are gaining attention. Risks to the financial system from climate change, digital finance and cyberattacks are other key focus areas. Domestic regulatory priorities continue to focus on improving safety and soundness of financial institutions, increasing the financial system's resilience to shocks and promoting financial system efficiency to ensure financial stability and support sustainable economic growth.

Assessment of Systemic Risk

The latest Systemic Risk Survey of the Reserve Bank carried out in May 2023 showed that risk across most categories that contribute to domestic systemic risk have receded. Risk from global spillovers, however, remained in the 'high' risk category with more than half of the respondents expressing falling confidence in the stability of the global financial system. Tightening of global financial conditions, global growth slowdown and volatility in capital flows were cited as major risks. 94 per cent of the respondents expressed confidence in the Indian financial system with more than half of the respondents assessing improved domestic banking sector prospects over a one-year horizon.