Annex 1

Systemic Risk Survey

The twentieth round of the systemic risk survey (SRS) was conducted during April-May 2021[1] to capture the perceptions of experts, including market participants, on the major risks faced by the Indian financial system. In this round, in addition to the usual coverage, views of the panellists were also solicited on the short-term and long-term impacts of the second wave of the COVID-19 pandemic. The survey results, based on feedback from 36 respondents, are encapsulated below.

Outlook on Major Risk categories

2. The participants perceived all broad categories of risks to the financial system - global, macroeconomic, financial market, institutional and general - as 'medium' in magnitude (Figure 1). Their opinion about institutional risk which had been categorised as 'high' in the previous two survey rounds, moderated in the latest round. Within the major categories, however, certain components were rated as 'high' risk viz., commodity price risk, domestic growth and inflation, fiscal deficit, corporate vulnerabilities, equity price volatility, banks' assets quality and capital requirement, credit growth and cyber risk (Figure 2). Commodity price risk was assessed to have been amplified as compared to the previous round, while risks relating to global growth and pace of infrastructure development were seen as having waned.

Figure 1: Major risk groups identified in the Systemic Risk Survey

Major Risk Groups	Apr-21	Oct-20[2]	Change in Risk Perception*
A. Global Risks			Decline
B. Macroeconomic Risks			**Increase**
C. Financial Market Risks			**Increase**
D. Institutional Risks			Decline
E. General Risks			Decline

Source: RBI's Systemic Risk Survey (October 2020 & April 2021).

Note:
Risk Category

Very high	**High**	**Medium**	**Low**	**Very low**

* The risk perception, as it emanates from the systemic risk survey conducted at different time points (on a half-yearly basis in April and October), may shift (increase/decrease) from one risk category to the other, which is reflected by the change in colour. However, within the same risk category (that is, boxes with the same colour), the risk perception may also increase/decrease or remain the same, the shift being indicated accordingly.

[1] Responses for the survey launched in April 2021 round were received during April-May 2021.
[2] Responses for the October 2020 round of SRS were received during October-November 2020.

Figure 2: Various risks identified in Systemic Risk Survey

Risk items		Apr - 21	Oct - 20	Change in Risk Perception*
A. Global Risks	Global growth			Decline
	Sovereign risk / contagion			Decline
	Funding risk (External borrowings)			**Increase**
	Commodity price risk			**Increase**
	Other global risks			**Increase**
B. Macro-economic Risks	Domestic growth			Decline
	Domestic inflation			**Increase**
	Current account deficit			**Increase**
	Capital inflows/ outflows (Reversal of FIIs, Slowdown in FDI)			**Increase**
	Sovereign rating downgrade			**Increase**
	Fiscal deficit			Decline
	Corporate sector risk			Decline
	Pace of infrastructure development			Decline
	Real estate prices			Decline
	Household savings			**Increase**
	Political uncertainty/ governance /policy implementation			**Increase**
	Other macroeconomic risks			**Increase**
C. Financial Market Risks	Foreign exchange rate risk			**Increase**
	Equity price volatility			**Increase**
	Interest rate risk			**Increase**
	Liquidity risk			Decline
	Other financial market risks			**Increase**
D. Institutional Risks	Regulatory risk			Decline
	Asset quality deterioration			Decline
	Additional capital requirements of banks			Decline
	Access to funding by banks			Decline
	Level of credit growth			Decline
	Cyber risk			Decline
	Operational risk			Decline
	Other institutional risks			**Increase**
E. General Risks	Terrorism			Decline
	Climate related risks			Decline
	Social unrest (Increasing inequality)			**Increase**
	Other general risks			**Increase**

Note:
Risk Category

Very high	**High**	**Medium**	**Low**	**Very low**

* The risk perception, as it emanates from the systemic risk survey conducted at different time points (on a half-yearly basis in April and October), may shift (increase/decrease) from one risk category to the other, which is reflected by the change in colour. However, within the same risk category (that is, boxes with the same colour), the risk perception may also increase/decrease or remain the same, the shift being indicated accordingly.

Outlook on the Financial System

3. Majority of the respondents envisaged marginal deterioration in the prospects of the Indian banking sector over the next one year: this was a significant worsening of sentiments from the previous survey round (Chart 1).

4. Most of the respondents expected a 'medium' probability of occurrence of a high impact event in the financial system, in India as well as globally, in the short-term (up to one year) and medium term (one to three years) (Chart 2). The uncertainty regarding the short-term assessment of the domestic financial system reduced *vis-à-vis* the previous survey round (Chart 2c).

Chart 1: Prospects of Indian banking sector in the next one year

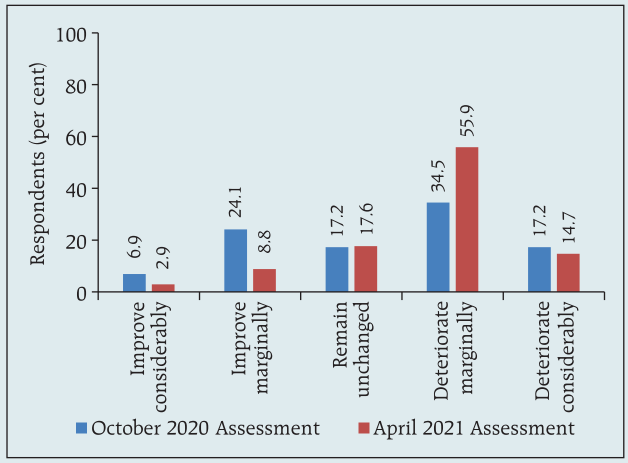
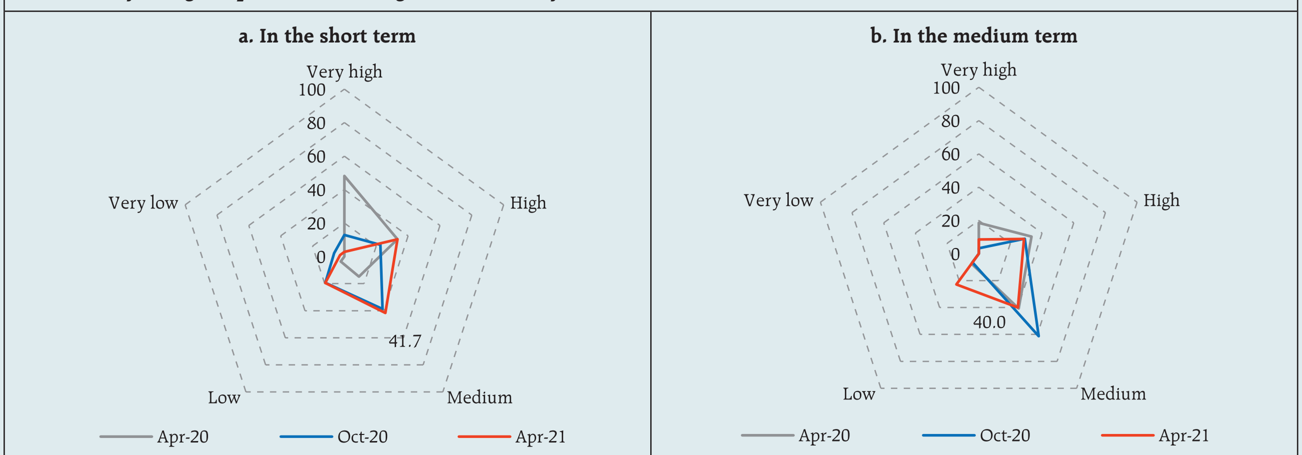


Chart 2: Perception on occurrence of high impact events and confidence in the financial systems *(Contd.)*

share of respondents (per cent)

A. Probability of high impact event in the global financial system



B. Probability of high impact event in the domestic financial system

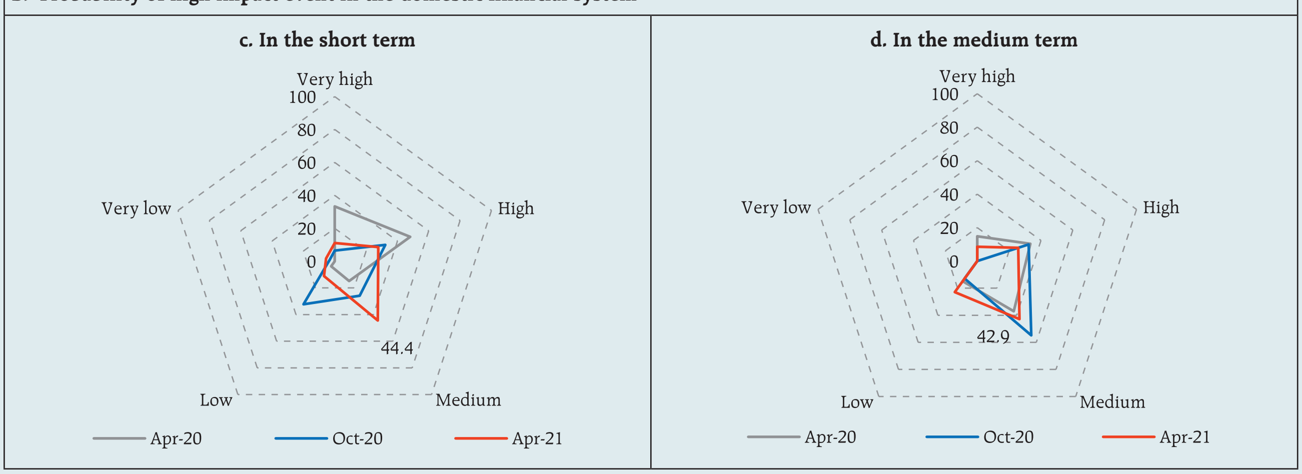
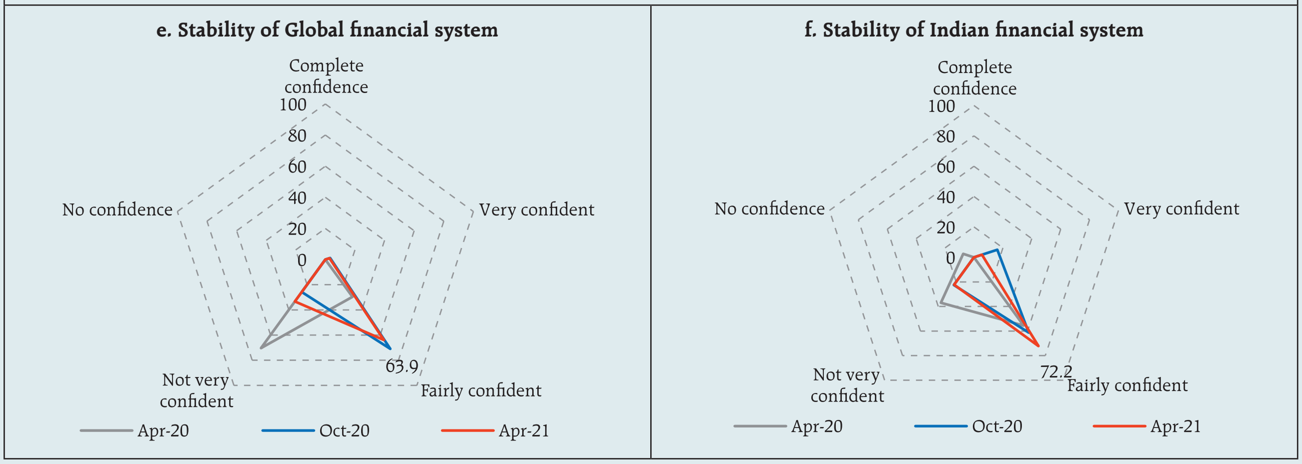


Chart 2: Perception on occurrence of high impact events and confidence in the financial systems *(Concld.)*

share of respondents (per cent)

C. Confidence in the financial systems



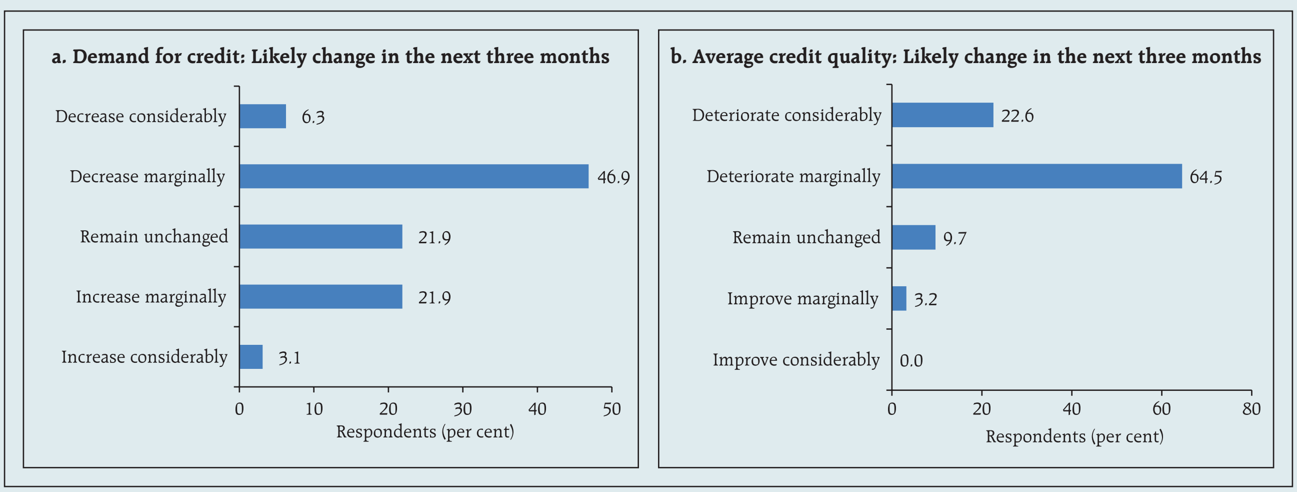
5. The survey panellists had lower confidence about stability of both global and Indian financial system, as compared to the previous round. The share of respondents who were 'fairly confident' about the stability of the global and the Indian financial system stood at 63.9 per cent and 72.2 per cent, respectively (Charts 2 e and f).

6. Majority of the respondents anticipated marginal fall in credit demand and deterioration in average credit quality over the next three months due to uncertainty caused by second wave of COVID-19 pandemic involving localised lockdowns in different parts of the country and postponement of discretionary spending (Chart 3). Stress in MSME and contact intensive sectors was expected to exacerbate further.

Post-pandemic Recovery

7. As regards short-term effects of the second wave of the pandemic, respondents were unequivocal that employment, productivity and wages will decline; while prices, debt-to-GDP ratio and size

Chart 3: Indian Banking Sector – Outlook



of the Reserve Bank of India's balance sheet will increase. More than half of the respondents expected capital stock to fall. The share of NBFCs in financial intermediation may remain close to its present level over the next one year and is expected to improve in the subsequent period (Chart 4).

Chart 4: Impact of the second wave (April 2021) *(Contd.)*

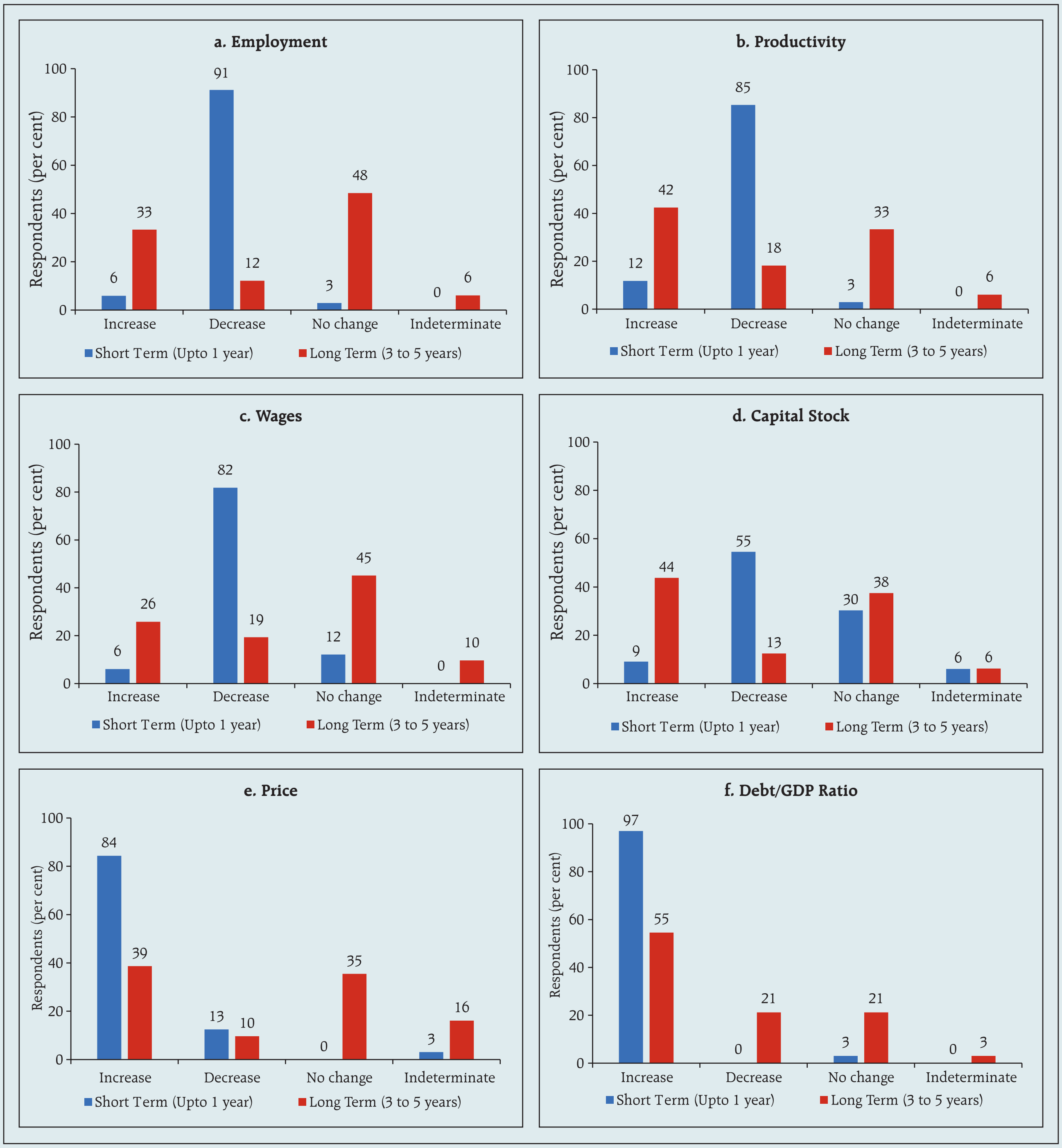
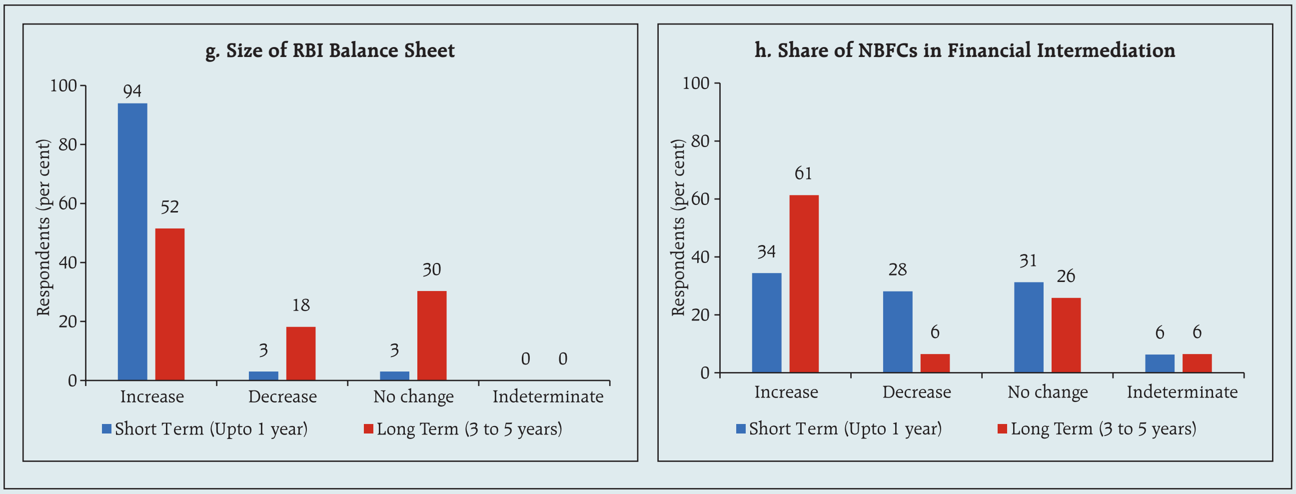


Chart 4: Impact of the second wave (April 2021) *(Concld.)*

Respondents (per cent)



8. On the long-run (3 to 5 years) impact, a majority of the respondents was of the view that debt-to-GDP ratio, size of the Reserve Bank of India's balance sheet and involvement of NBFCs would grow (Chart 4).

9. The survey respondents identified tourism and hospitality, construction and real estate, aviation, retail and entertainment as the major sectors adversely affected by the second wave of the COVID-19 pandemic (Table 1). Pandemic related lockdowns, requirement of social distancing, risk aversion and curb in discretionary spending have worsened the already bleak economic prospects assessed in the previous round. Many respondents hinged their expectations of economic recovery on the pace and extent of the vaccination drive.

Table 1: Sectors adversely affected by COVID-19 and their future prospects

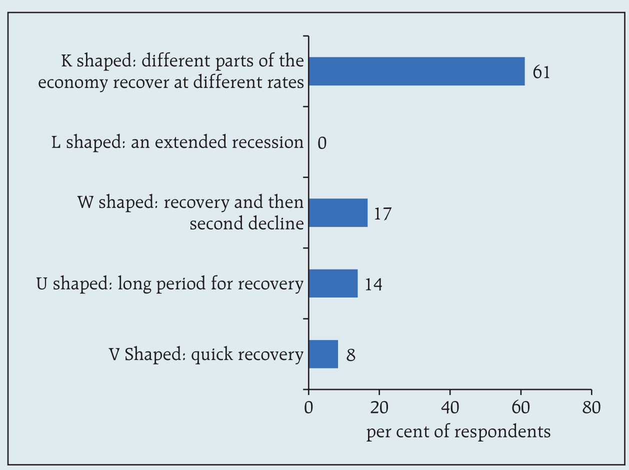
(per cent of respondents)

Sector	Prospects of recovery in the next six months			
	Good	Moderate	No change	Bleak
Tourism and Hospitality		27.6 (29.0)	17.2 (16.1)	55.2 (54.8)
Construction and Real Estate	0.0 (5.0)	27.8 (30.0)	27.8 (35.0)	44.4 (30.0)
Aviation	0.0 (5.3)	33.3 (36.8)	11.1 (10.5)	55.6 (47.4)
Retail		62.5 (66.7)	0.0 (16.7)	37.5 (16.7)
Entertainment*		28.6	28.6	42.9

Note: Figures in brackets represent per cent of respondents in the previous survey round.
* Not adjudged as one of the most affected sectors in the previous survey round.

10. Over 60 per cent of the respondents anticipated K-shaped recovery post the second wave, *i.e.*, different parts of the economy recover at different rates (Chart 5). About 17 per cent of the responses indicated a quick recovery followed by a second decline (W-shaped) and another 14 per

Chart 5: Possible shape of Economic Recovery



cent of the respondents projected a long period for recovery (U-shaped).

Risks to Financial Stability

11. The survey panellists cited the following major factors as posing risks to financial stability (global and domestic), going forward:

- highly accommodative monetary policies and large fiscal stimuli adding to concerns around market-based indicators of inflation expectations, unsettling bond markets globally;
- disparity in recovery between countries resulting in increasing inequality in emerging markets and developing economies;
- increase in global commodity prices leading to higher volatility in the markets; supply chain disruptions leading to inflationary pressures;
- muted consumer demand due to the pandemic related uncertainty;
- overleveraged balance sheets;
- pandemic related restrictions imposed in major states which contribute significantly to India's GDP, GST collection and thereby, Central Government's finances; and
- prolonged restrictions on movement and supply chain disruptions on business and credit-offtake as well as asset quality of financial institutions, particularly retail exposure.