Annex 1

Systemic Risk Survey

A systemic risk survey (SRS), the eighteenth in the series, was conducted during April-May 2020 to capture the perceptions of experts, including market participants, on the major risks faced by the financial system. According to the survey results, all major risk groups *viz.*, global risks, risk perception on macroeconomic conditions, financial market risks and institutional positions were perceived as 'high' risks affecting the financial system (Figure 1).

Within global risks, global growth was categorised as a 'very high' risk. Within the macroeconomic risks group, domestic growth and the fiscal deficit were perceived to be in the 'very high' risk category, while risks on account of reversal of FIIs/slowdown in FDI, corporate sector vulnerabilities, collapsing real estate prices and household savings were perceived to be in the 'high risk' category. Among the institutional risks, the risks on account of asset quality deterioration and level of credit growth were perceived as 'high risk' factors. Cyber risk appeared in the 'high risk' category for the first time since the inception of the survey (Figure 2).

Participants opined that the effects of COVID-19 are likely to remain for 3-5 years and may impact the quality of credit in the books of banks, the general risk taking ability of entrepreneurs, investments in capital markets and real estate, and the saving pattern of households. All these could have an impact on domestic financial stability.

Figure 1: Major risk groups identified in systemic risk survey (April 2020)*

Major Risk Groups	Oct-19	Changes	Apr-20
A. Global Risks		⇧	
B. Macro-economic Risks		⇧	
C. Financial Market Risks		⇧	
D. Institutional Risks		⇧	
E. General Risks		⇧	

Source: RBI systemic risk survey (October 2019 & April 2020).

Note:
Risk Category

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

Change in risk since last survey		
⇧	⇔	⇩
Increased	Same	Decreased

*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 by arrows . The shift in risk perception pertains to the comparative analysis of two consecutive surveys.

Figure 2: Various risks identified in systemic risk survey (April 2020)*

Risk Groups	Risk Items	Oct-19	Changes	Apr-20
A. Global Risks	Global growth		⇧	
	Sovereign risk / contagion		⇧	
	Funding risk (External borrowings)		⇧	
	Commodity price risk (including crude oil prices)		⇧	
	Other global risks		⇧	
B. Macro-economic Risks	Domestic growth		⇧	
	Domestic inflation		⇧	
	Current account deficit		⇩	
	Capital inflows/ outflows (Reversal of FIIs, Slowdown in FDI)		⇧	
	Sovereign rating downgrade		⇧	
	Fiscal deficit		⇧	
	Corporate sector risk		⇧	
	Pace of infrastructure development		⇧	
	Real estate prices		⇧	
	Household savings		⇧	
	Political uncertainty/ governance /policy implementation		⇧	
	Other macroeconomic risks		⇩	
C. Financial Market Risks	Foreign exchange rate risk		⇧	
	Equity price volatility		⇧	
	Interest rate risk		⇧	
	Liquidity risk		⇧	
	Other financial market risks		⇧	
D. Institutional Risks	Regulatory risk		⇧	
	Asset quality deterioration		⇧	
	Additional capital requirements of banks		⇧	
	Access to funding by banks		⇧	
	Level of credit growth		⇧	
	Cyber risk		⇧	
	Operational risk		⇧	
	Other institutional risks		⇩	
E. General Risks	Terrorism		⇔	
	Climate related risks		⇩	
	Social unrest (Increasing inequality)		⇧	
	Other general risks		⇩	

Source: RBI systemic risk survey (October 2019 and April 2020).

Note:

Risk Category

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

Change in risk since last survey		
⇧	⇔	⇩
Increased	Same	Decreased

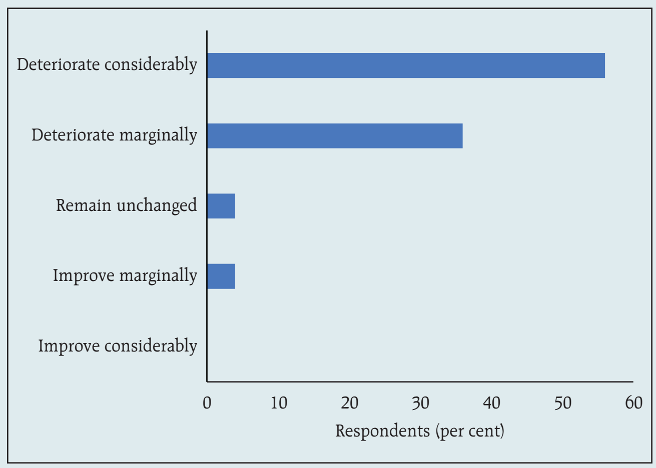
*The risk perception, as it emanates from the systemic risk survey conducted at different time points (on a half yearly basis in April and October), may shift (increase/decrease) from one risk category to the other, which is reflected by the change in colour. However, within the same risk category (that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

The MSME sector is affected because of lack of cash flows. Low demand, lack of manpower, stuck working capital and lack of capital may lead to further stress on employment. Real estate prices and cash flows on commercial real estate can undergo a major structural correction due to change in working patterns, which will lead to further pressure on real estate developers and lending. Potential margin compression in corporate bonds was seen as increasing leverage, leading to negative impact on credit metrics and consequent rating downgrade that can result in difficulties for refinancing of loans and raising capital.

In the financial sector, the existing stock of non-performing assets in the banking system and bankers' risk aversion remain big worries and impediments to economic growth. Despite measures taken by the Reserve Bank, transmission of liquidity and rate actions is still slow. Coupled with continued risk aversion, the flow of credit to the productive sectors (including NBFC & HFC) remains a challenge, Given that financial services are an integral and important constituent of the credit market, many participants opined that support from RBI would be important in the current environment.

About 56 per cent of the respondents opined that the prospects of Indian banking sector are going to deteriorate considerably in the next one year, as earnings of the banking industry may be negatively impacted due to slow recovery post lockdown, lower net interest margins, elevated asset quality concerns and a possible increase in provisioning requirements. About 36 per cent of the respondents felt that the prospects are going to deteriorate only marginally (Chart 1).

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



Source: RBI systemic risk survey (April 2020).

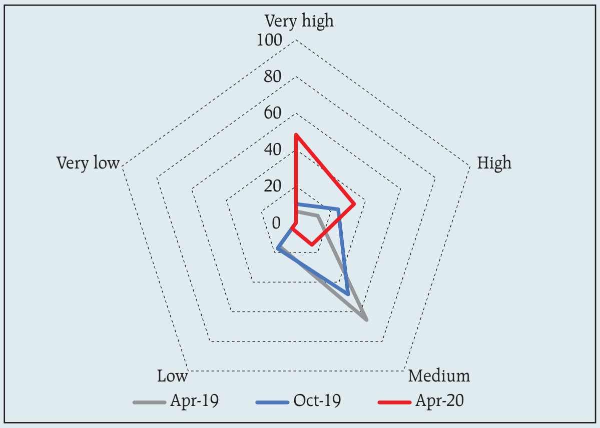
Majority of the participants in the current round of the survey expect a very-high probability of occurrence of a high impact event in the global financial system in the short term (upto 1 year). In the medium term (1 to 3 years) majority of the participants in the current round of the survey assign a 'medium' probability to the occurrence of a high impact event in the global financial system. In the Indian financial system, the participants opined that there is a high probability of occurrence of a high impact event in the short-term but the probability of such an occurrence in the medium term (1 to 3 years) is medium. About 70 per cent of the respondents were not very confident in the stability of the global financial system (Chart 2).

Chart 2: Perception on occurrence of high impact events and confidence in the financial systems

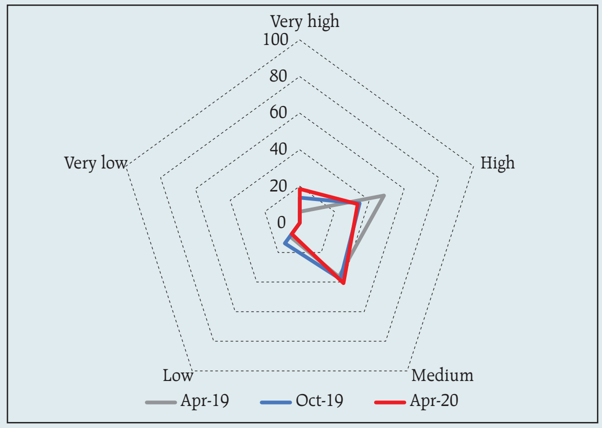
Respondents (per cent)

Probability of high impact event in the global financial system

a. In the short term

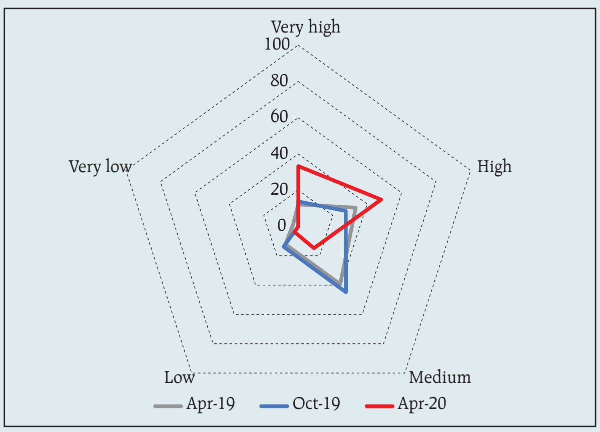


b. In the medium term

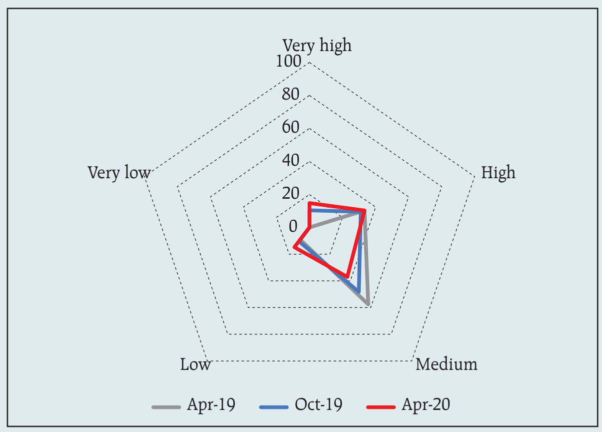


Probability of high impact event in the domestic financial system

c. In the short term

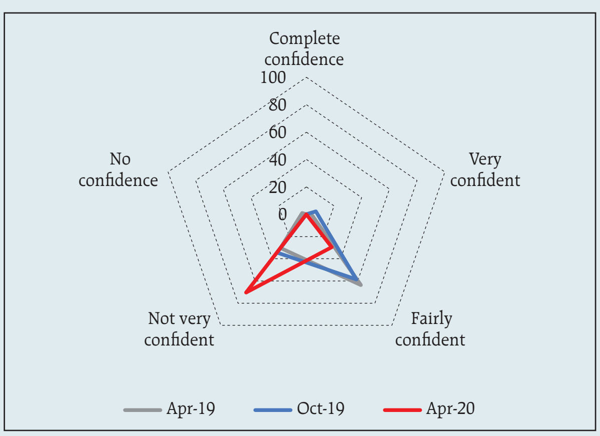


d. In the medium term

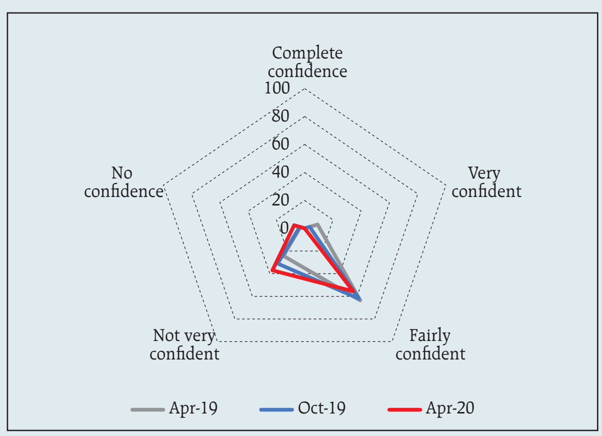


Confidence in the financial systems

e. Stability of the global financial system



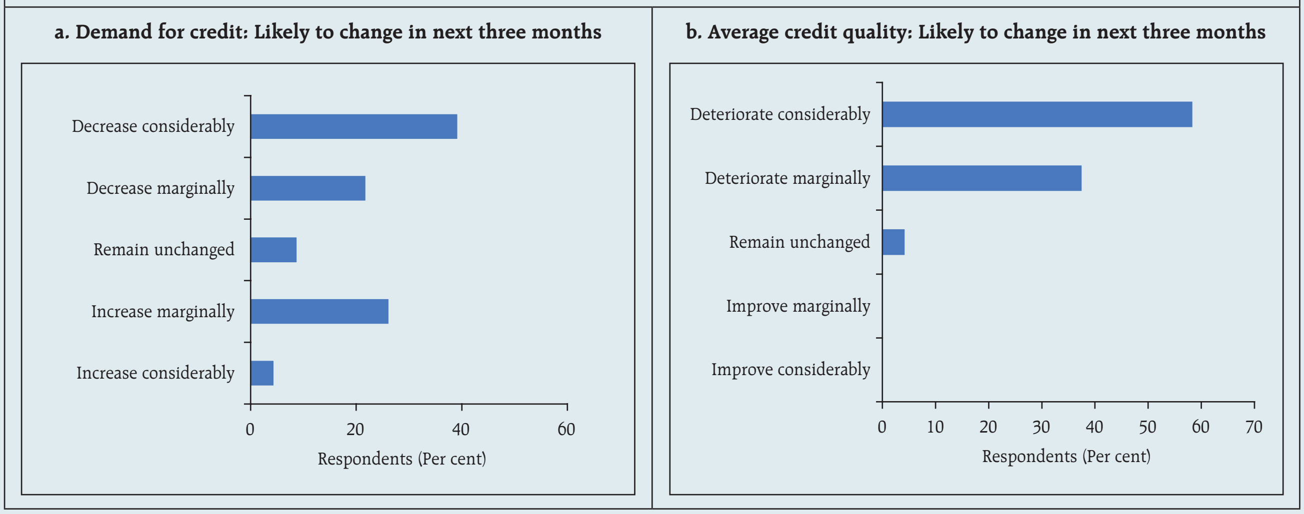
f. Stability of the Indian financial system



Source: RBI systemic risk surveys (April 2019, October 2019 and April 2020).

Majority of the respondents were of the view that the demand for credit in the next three months would decrease considerably. Average credit quality is also expected to deteriorate considerably in the next three months (Chart 3).

Chart 3: Outlook on credit demand and its quality (April 2020)



Source: RBI systemic risk survey (April 2020).

COVID-19 pandemic: Effects and economic recovery

Respondents opined that while most sectors face sizeable and immediate revenue losses, the adverse impact is seen in sectors where consumption spending is discretionary in nature. The survey results point to 5 sectors which are adversely affected by the COVID-19 pandemic (Table 1). Within the tourism sector, about 90 per cent of the respondents mention that the prospects of recovery within the sector in the next 6 months appear bleak. The aviation sector appears to be a close second, with about 85 per cent of the respondents categorising the future prospects as bleak.

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

(per cent of respondents)

Sector	Prospects of recovery in the next 6 months			
	Good	Moderate	No change	Bleak
Tourism and Hospitality		5	5	90
Construction and Real Estate		37.5	12.5	50
Aviation		7.7	7.7	84.6
Automobiles		50		50
Micro Small & Medium Enterprises		40		60

Source: RBI systemic risk survey (April 2020).

Participants were asked to rank the major financial stability concerns arising out of COVID-19 going forward (Table 2). Supply chain disruptions and decreasing consumer spending/confidence were the top two concerns of the participants, followed by worries about a global recession and the financial impact of liquidity/capital on operations.

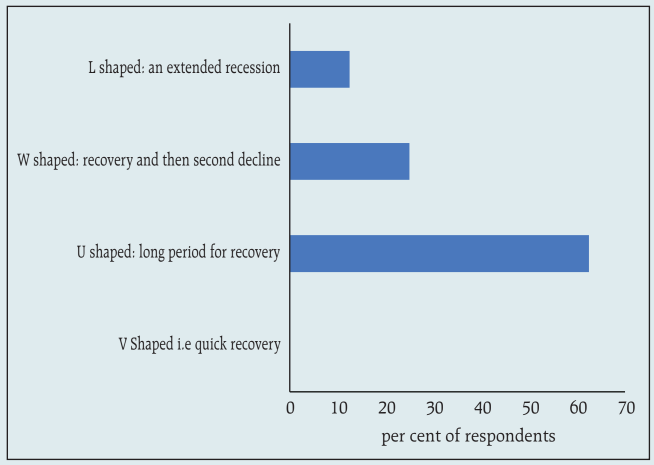
Table 2: Sectors adversely affected by COVID-19 and their future prospects

Concern	Rank
Supply chain disruptions	1
Decreasing consumer confidence/spending	2
Global recession	3
Financial impact on operations and/or liquidity and capital	4
Workforce reduction/Employee stress	5
Impact on tax and trade issues	6
Lower productivity	7
Lack of information for decision making	8

Source: RBI systemic risk survey (April 2020).

About 63 per cent of the respondents predicted that the economic recovery post COVID-19 is likely to be U-shaped i.e., immediate fall followed by a longer period to recover (Chart 4).

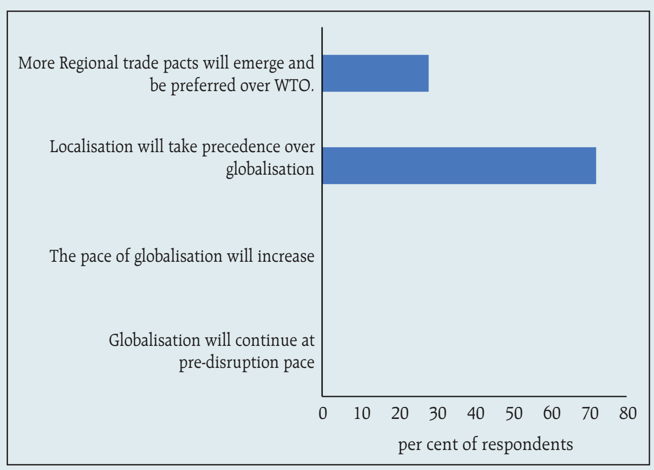
Chart 4: Possible shape of economic recovery (April 2020)



Source: RBI systemic risk survey (April 2020)

72 per cent of the respondents opined that in trade terms going forward, localisation will take precedence over globalisation and more regional trade pacts would emerge and be preferred (remaining 25 per cent) (Chart 5).

Chart 5: Impact on globalisation/global trade (April 2020)



Source: RBI systemic risk survey (April 2020)