Annexure 1

Systemic Risk Survey

In the 23rd round of the Systemic Risk Survey, risks from global spillovers and financial market volatility rose further and remained in the 'high' risk category. General risks were perceived to have increased though they continued to be in the 'medium' risk category. Macroeconomic uncertainty was assessed to have moderated but continued to remain in the 'medium' risk category. Going forward, respondents' perception of risk to financial stability included: (a) strengthening of US dollar and volatility in the exchange rate; (b) increase in crude oil prices; (c) global economic slowdown; (d) tightening of global monetary and liquidity conditions; (e) lower corporate growth on account of slowdown in consumption and weak external demand; (f) rise in current account deficit and capital outflows; (g) increased price pressures due to higher commodity prices; (h) decline in corporate margins due to an increase in cost of raw materials; (i) geo-political risks due to continued war in Ukraine. More than half of the respondents assessed that the prospects of the Indian banking sector over a one-year horizon have improved.

The 23rd round of the Reserve Bank's Systemic Risk Survey (SRS) was conducted in November 2022 to solicit perceptions of experts, including market participants and academicians, on major risks faced by the Indian financial system. In addition to its regular format, this round of the survey also captured (i) respondents' perception on risk to financial stability from external sector developments; and (ii) segments of the Indian financial system which are likely to be impacted by aggressive monetary policy tightening by advanced economies and (iii) respondents' views on the likelihood of global recession in 2023.

The feedback from 48 respondents is presented below.

- Risk perception from global spillovers and financial market volatility grew further and remained in the 'high' risk category. General risks were perceived to have increased though they continued to be in the 'medium' risk category. Institutional risks were perceived to have remained unchanged. Macroeconomic uncertainty, though remaining in the 'medium' risk category, was gauged to have moderated (Figure 1).

Figure 1: Systemic Risk Survey: Major Risk Groups

Major Risk Groups	May-22	Nov-22	Change in Risk Perception[1]
A. Global Risks	6.8	6.9	Increase
B. Macroeconomic Risks	5.6	5.4	Decline
C. Financial Market Risks	6.3	6.5	Increase
D. Institutional Risks	5.3	5.3	Unchanged
E. General Risks	4.8	5.2	Increase

Source: Systemic Risk Survey (May 2022 and November 2022)

Note:

Risk Category

Above 8-10	Above 6-8	Above 4-6	Above 2-4	0-2
Very high	**High**	**Medium**	**Low**	**Very low**

[1] The risk perception, as it emanates from the systemic risk survey conducted at different time periods (on a half-yearly basis in May and November), may shift 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 through average numeric values.

- Monetary tightening in advanced economies, geopolitical risks, global growth uncertainty and funding risk were perceived to be the major drivers of amplification in global risks (Figure 2).
- The rise in financial market risk emanated from tightening of financial conditions: foreign exchange pressure and liquidity tightening (Figure 2).
- Uptick in general risks primarily stemmed from cryptocurrencies, climate change and terrorism (Figure 2).
- Decline in risk perception on domestic growth and inflation, capital flows, fiscal deficit and sovereign credit rating resulted in moderation in overall macroeconomic risks, though risk perception remained elevated towards current account deficit (Figure 2).

Figure 2: Systemic Risk Survey: Risks Identified

Risk items		May-22	Nov-22	Change in Risk Perception
A. Global Risks	Global growth	7.0	7.6	Increase
	Sovereign risk / contagion	5.1	5.4	Increase
	Funding risk (External borrowings)	5.5	5.9	Increase
	Commodity price risk (including crude oil prices)	8.0	6.9	Decline
	Geopolitical risks	7.4	7.6	Increase
	Monetary tightening in advanced economies	7.7	7.9	Increase
B. Macroeconomic Risks	Domestic growth	6.0	5.7	Decline
	Domestic inflation	7.7	6.4	Decline
	Current account deficit	6.6	6.7	Increase
	Capital inflows/ outflows (Reversal of FIIs, Slowdown in FDI)	6.6	6.4	Decline
	Sovereign rating downgrade	4.4	4.3	Decline
	Fiscal deficit	6.0	5.5	Decline
	Corporate sector risk	5.1	5.2	Increase
	Pace of infrastructure development	4.5	4.7	Increase
	Real estate prices	4.7	4.9	Increase
	Household savings	5.5	5.4	Decline
	Political uncertainty/ governance /policy implementation	4.3	4.3	Unchanged
C. Financial Market Risks	Foreign exchange rate risk	6.3	6.6	Increase
	Equity price volatility	6.6	6.5	Decline
	Interest rate risk	6.7	6.5	Decline
	Liquidity risk	5.6	6.2	Increase
D. Institutional Risks	Regulatory risk	4.4	4.6	Increase
	Asset quality deterioration	5.5	5.4	Decline
	Additional capital requirements of banks	5.3	5.3	Unchanged
	Access to funding by banks	4.7	4.8	Increase
	Level of credit growth	5.4	4.9	Decline
	Cyber risk	6.0	6.5	Increase
	Operational risk	5.4	5.6	Increase
E. General Risks	Terrorism	3.9	4.2	Increase
	Climate related risks	5.7	5.9	Increase
	Social unrest (Increasing inequality)	5.2	5.2	Unchanged
	Cryptocurrency	4.4	5.5	Increase

Note:

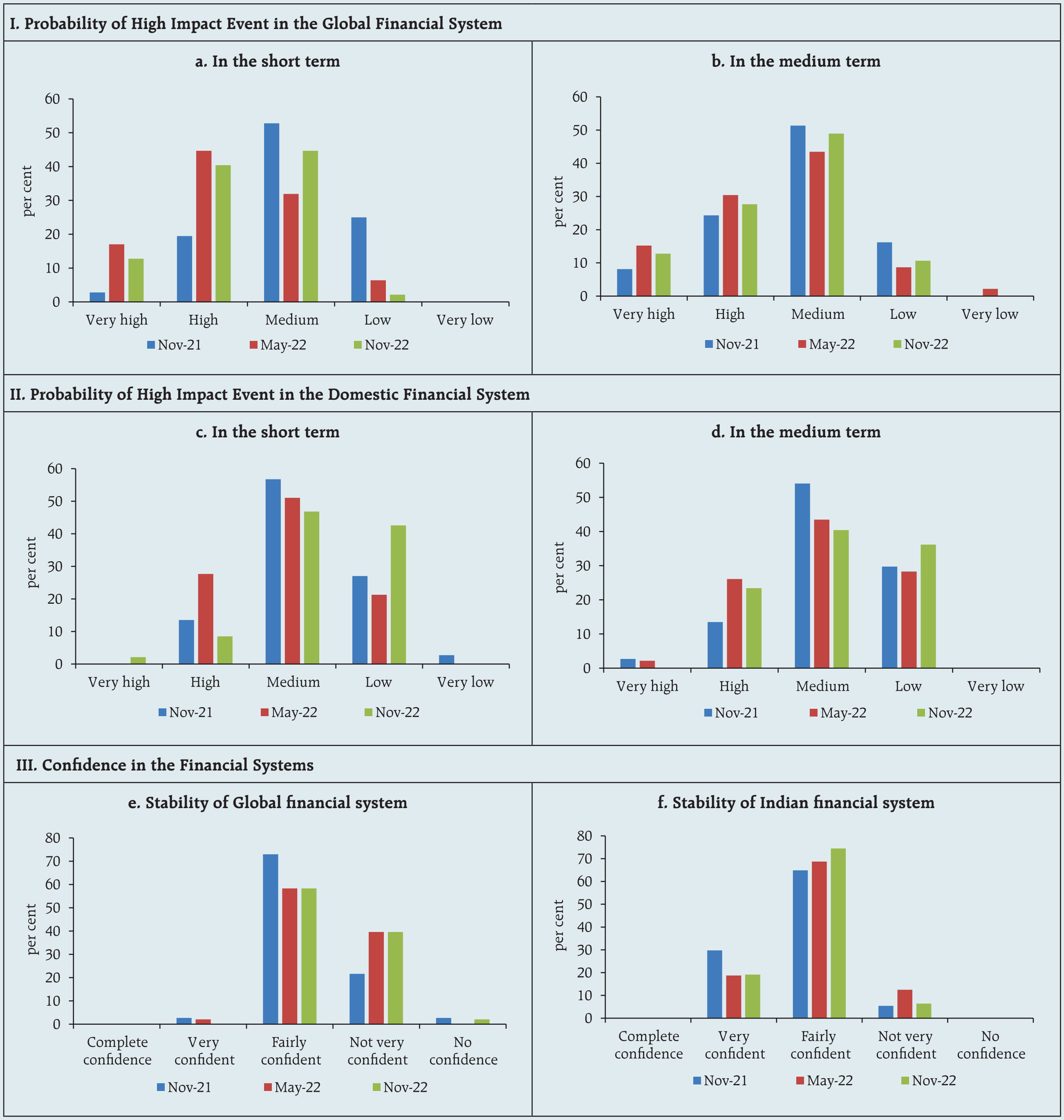
Risk Category

Above 8-10	Above 6-8	Above 4-6	Above 2-4	0-2
Very high	**High**	**Medium**	**Low**	**Very low**

- There is a 'medium' to 'high' probability of occurrence of a high impact event in the global financial system in the short run as well as medium term (Chart 1 a and b).
- There is a 'medium' to 'low' probability of occurrence of high impact event in the domestic financial system in both the short run and medium term (Chart 1 c and d).

Chart 1: Perception on Occurrence of High Impact Events in the Financial Systems

share of respondents (per cent)



- Confidence in the stability of the global financial system marginally declined during the last six months. In contrast, confidence in the Indian financial system further improved with 93.6 per cent of the respondents remaining fairly/ highly confident of the stability of the Indian financial system (Chart 1 e and f).
- 52.1 per cent of the respondents expected that the Indian economy will be impacted somewhat/to a limited extent from global spillovers (Chart 2).
- Despite global headwinds posing risks to domestic macro-financial conditions, the impact of external sector developments remained moderate as 53.2 per cent of the respondents perceived it of medium impact (Chart 3).
- More than three-fourths of the respondents perceived that the aggressive monetary policy tightening by advanced economies would adversely impact the exchange rate, capital flows, foreign exchange reserves and bond yields. Less than 40 per cent of respondents viewed that banks' profitability and external debt would be adversely impacted (Chart 4).

Chart 2: Expectation of Instability in Global Financial System affecting Indian Economy

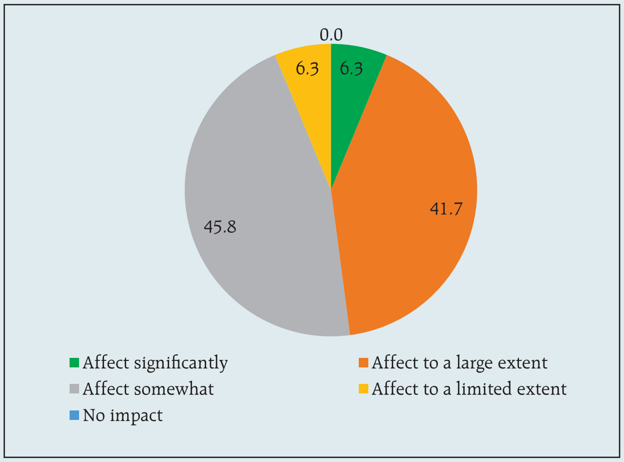


Chart 3: Risk to Financial Stability from External Sector Developments

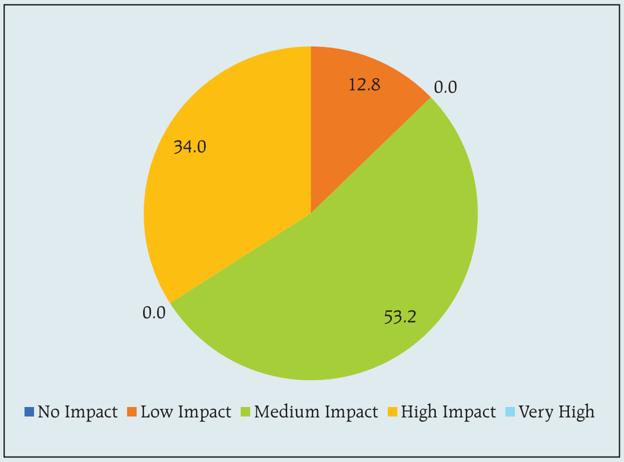
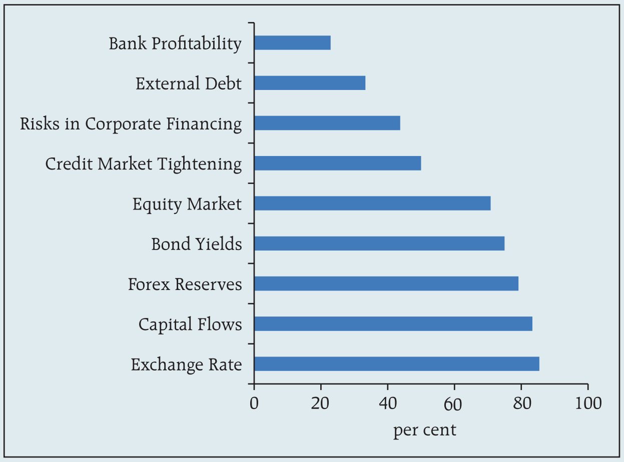


Chart 4: Impact of Aggressive Monetary Policy Tightening by Advanced Economies



- 57.8 per cent of the respondents assessed that the prospects of the Indian banking sector over a one-year horizon have improved and another 33.3 per cent of the respondents expected it to remain unchanged (Chart 5).
- Around 31 per cent of the respondents expected marginal improvement in banking sector asset quality over the next six months, and another 42.2 per cent expected it to remain unchanged attributable to factors such as economic recovery, pick up in credit growth, better underwriting standards of banks, improvement in credit profile of corporates, improved operating cashflows and credit guarantees to small enterprises (Chart 6 a).
- 66.7 per cent of the respondents expected marginal to considerable improvement in credit demand over the next six months on the back of recovery in economic activity, upturn in the investment cycle, strengthening of business sentiments, increased demand for working capital loans, higher public investment in infrastructure sector and export promoting production linked incentive (PLI) scheme by Government (Chart 6 b).

Chart 5: Prospects of Indian Banking Sector- Next One Year

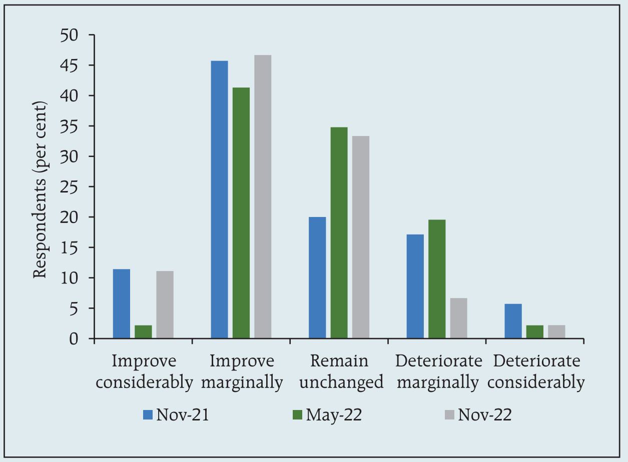
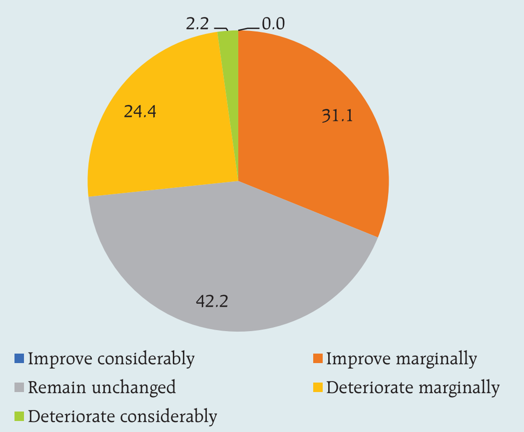
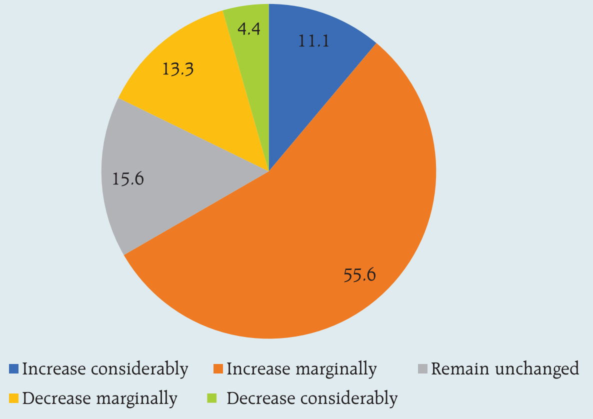


Chart 6: Indian Banking Sector – Outlook

a. Average credit quality: Likely change in next six months

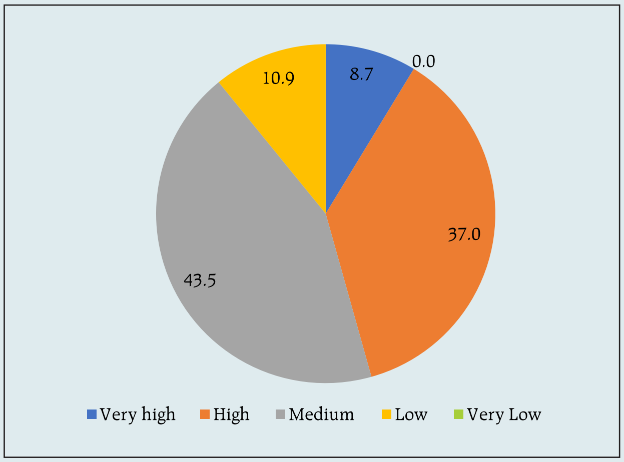


b. Demand for credit: Likely change in next six months



- Global economic outlook remains clouded as the number of downside risks remained high even though markets are pricing in moderate policy rate hikes in future. As per the survey responses, global economy is facing a threat of recession in 2023. More than 89 per cent of respondents expected medium to high and very high chances of global recession in 2023 (Chart 7).

Chart 7: Chances of Global Recession in 2023



Risks to Financial Stability

Going forward, respondents identified the following major risks to financial stability:

- Volatility in the exchange rate and strengthening of US dollar;
- Increase in crude oil prices;
- Global economic slowdown;
- Global monetary and liquidity tightening and interest rate risk;
- Lower corporate growth on account of slowdown in consumption and weak external demand;
- Rise in current account deficit and capital outflows;
- Increased price pressures due to higher commodity prices;
- Decline in corporate margins due to an increase in cost of raw materials;
- Geo-political risks due to continued war in Ukraine.