Annexure 1

Systemic Risk Survey

In the 22nd round of Systemic Risk Survey, global spillovers and financial market volatility were assessed to have moved to the 'high' risk category. Macroeconomic uncertainty, though rising, remained a 'medium' risk. Going forward, respondents' perception of risks to financial stability included: (a) aggressive monetary policy tightening by advanced economies; (b) volatility in capital flows and exchange rates; (c) de-anchoring of inflation expectations; (d) faltering of economic recovery; (e) disruptions in global supply chains; (f) de-globalisation; and (g) climate change risk. A majority of the respondents judged that the prospects of the Indian banking sector over a one-year horizon have improved or remained unchanged.

The 22nd round of the Reserve Bank's systemic risk survey (SRS) was conducted in May 2022 to solicit perceptions of experts, including market participants, on major risks faced by the Indian financial system. In addition to its regular format, this round of the survey also captured (i) respondents' views on new risks, which can potentially have a large impact on the Indian financial system, going forward; and (ii) likely impact of the ongoing war in Ukraine on the Indian economy.

The feedback from 48 respondents is encapsulated below.

- Global spillovers and financial market volatility moved to the 'high' risk category. They also assessed that macroeconomic uncertainty, though rising, remained a 'medium' risk. On the other hand, institutional risks and general risks are gauged to have moderated during the preceding six months though they stayed in the 'medium' risk category (Figure 1).
- Global growth uncertainty, commodity price movements, geopolitical conditions and monetary tightening in AEs were perceived to be the major drivers of escalation in global risks (Figure 2).
- The rise in financial market risk was assessed to be emanating from tightening of financial conditions: foreign exchange pressure; interest rate and liquidity tightening; and elevated equity price volatility (Figure 2).

Figure 1: Systemic Risk Survey: Major Risk Groups

Major Risk Groups	Nov-21	May-22	Change in Risk Perception[1]
A. Global Risks	5.7	6.8	Increase
B. Macroeconomic Risks	5.2	5.6	Increase
C. Financial Market Risks	5.8	6.3	Increase
D. Institutional Risks	5.6	5.3	Decline
E. General Risks	5.2	4.8	Decline

Source: Systemic Risk Survey (November 2021 and May 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.

Figure 2: Systemic Risk Survey: Risks Identified

	Risk items	Nov-21	May-22	Change in Risk Perception
A. Global Risks	Global growth	5.6	7.0	Increase
	Sovereign risk/contagion	4.8	5.1	Increase
	Funding risk (External borrowings)	5.0	5.5	Increase
	Commodity price risk (including crude oil prices)	7.5	8.0	Increase
	Geopolitical risks#		7.4	
	Monetary tightening in advanced economies#		7.7	
B. Macro-economic Risks	Domestic growth	5.1	6.0	Increase
	Domestic inflation	6.6	7.7	Increase
	Current account deficit	5.1	6.6	Increase
	Capital inflows/outflows (Reversal of FIIs, Slowdown in FDI)	5.3	6.6	Increase
	Sovereign rating downgrade	4.3	4.4	
	Fiscal deficit	5.8	6.0	Increase
	Corporate sector risk	5.5	5.1	Decline
	Pace of infrastructure development	5.1	4.5	Decline
	Real estate prices	5.0	4.7	Decline
	Household savings	5.4	5.5	Increase
	Political uncertainty/governance/policy implementation	4.4	4.3	Decline
C. Financial Market Risks	Foreign exchange rate risk	5.5	6.3	Increase
	Equity price volatility	6.9	6.6	Decline
	Interest rate risk	5.9	6.7	Increase
	Liquidity risk	4.8	5.6	Increase
D. Institutional Risks	Regulatory risk	4.2	4.4	Increase
	Asset quality deterioration	6.1	5.5	Decline
	Additional capital requirements of banks	5.8	5.3	Decline
	Access to funding by banks	4.5	4.7	Increase
	Level of credit growth	6.2	5.4	Decline
	Cyber risk	6.6	6.0	Decline
	Operational risk	5.7	5.4	Decline
E. General Risks	Terrorism	4.5	3.9	Decline
	Climate related risks	5.6	5.7	Decline
	Social unrest (Increasing inequality)	5.5	5.2	Decline
	Cryptocurrency#		4.4	

Note:
Risk Category

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

#: New risk item introduced in 22nd round of RBI's Systemic Risk Survey conducted during May 2022.

- A bearish outlook on domestic economic growth, inflation, current account balance, capital flows and fiscal deficit has led to intensification of overall macroeconomic risks (Figure 2).
- 'High' to 'very high' probability of occurrence of a high impact event in the global financial system in the short run (Chart 1a).
- A high impact event in the domestic financial system was rated as 'medium' to 'high' for the same time horizon (Chart 1c).

- In the medium term, chances of a high impact event in the global financial system *vis-a-vis* the domestic financial system was rated as high (Chart 1b and 1d).
- Confidence in the stability of the financial system, both global and domestic, has diminished during the last six months, though 60 per cent and 88 per cent of respondents remained fairly/highly confident of the stability of global and Indian financial systems, respectively (chart 1e and 1f).

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

share of respondents (per cent)

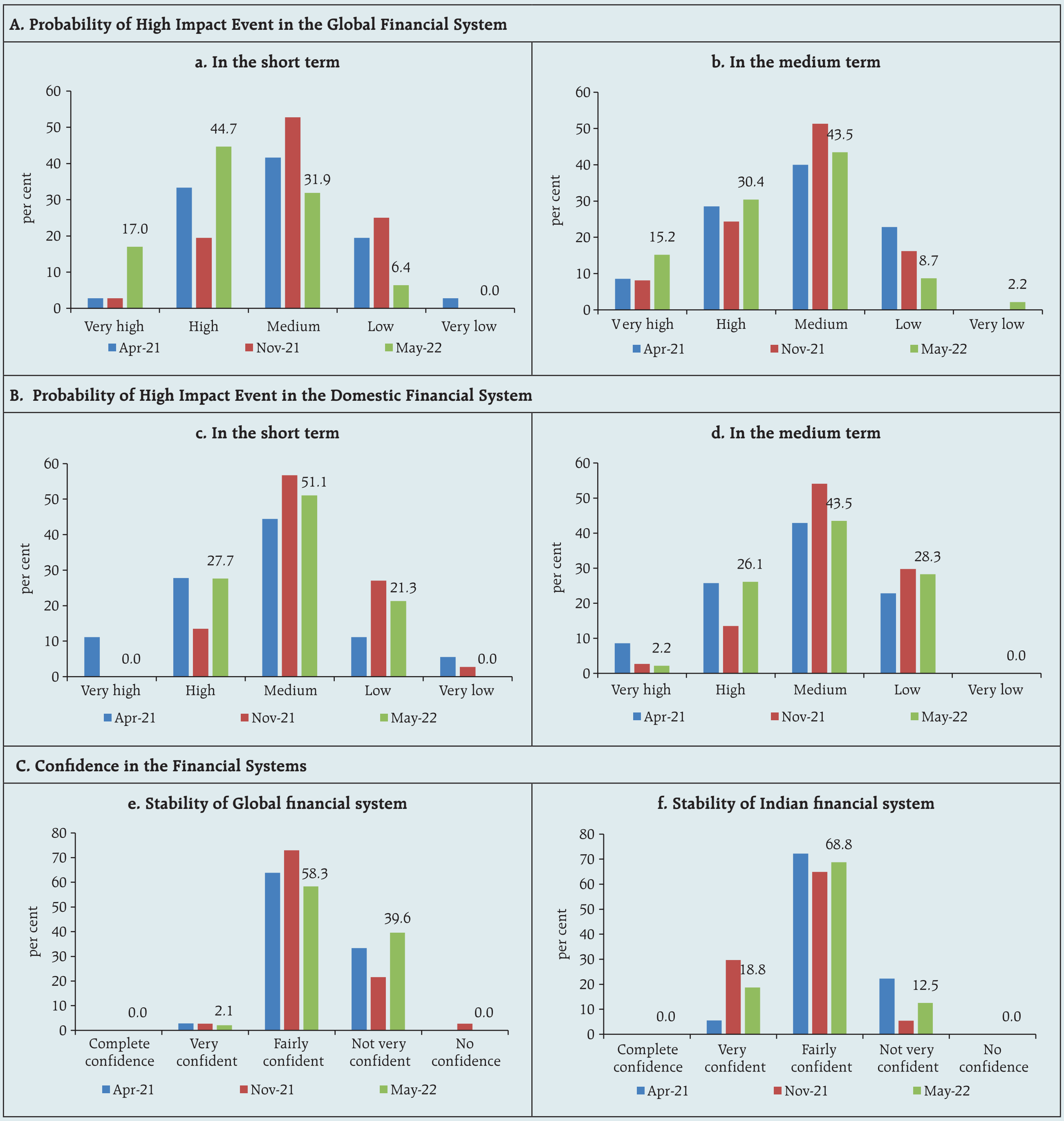


Chart 2: Expectation of Instability in Global Financial System affecting Indian Economy

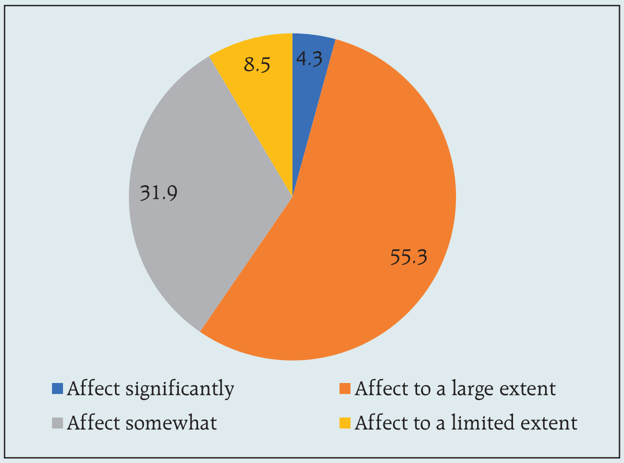
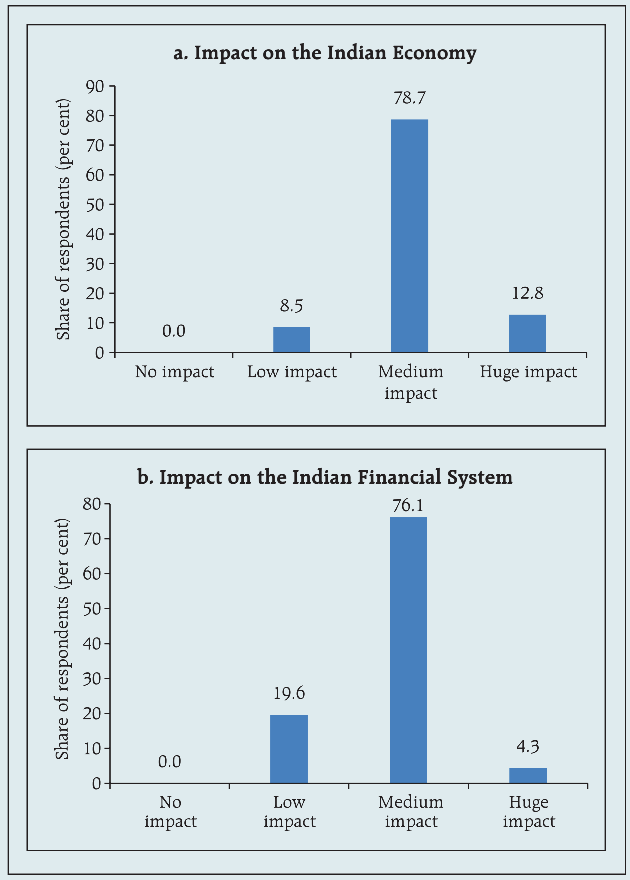


Chart 3: Impact of War in Ukraine



- Spillovers from the global financial system to the Indian economy could be large though 40.4 per cent of respondents expected the impact to be relatively limited (Chart 2).

Three-fourths of the respondents perceived that the war in Ukraine to have a medium impact on the Indian economy as a whole (Charts 3a and 3b). The majority felt that the impact of the war is likely to be more on edible oils, crude oil and gas, automobile sector, base metals, agricultural commodities and fertilisers.

Nearly 44 per cent of the panellists judged that the prospects of the Indian banking sector over a one-year horizon have improved and another 35 per cent expected it to remain unchanged (Chart 4).

Most of the panellists expected marginal to considerable improvement in credit demand over the next three months on the back of recovery in GDP growth, higher consumer spending, pick up in manufacturing sector activity, public investment in infrastructure and higher demand for working capital (Chart 5a). Around 38 per cent of the respondents expected marginal deterioration in asset quality of the banking sector over the next three months, attributable to factors such as COVID-19 induced regulatory forbearance, improved asset quality recognition, higher input costs, supply chain bottlenecks impacting profit margins of firms and tightening of monetary and liquidity conditions (Chart 5b).

Chart 4: Prospects of Indian Banking Sector- Next One Year

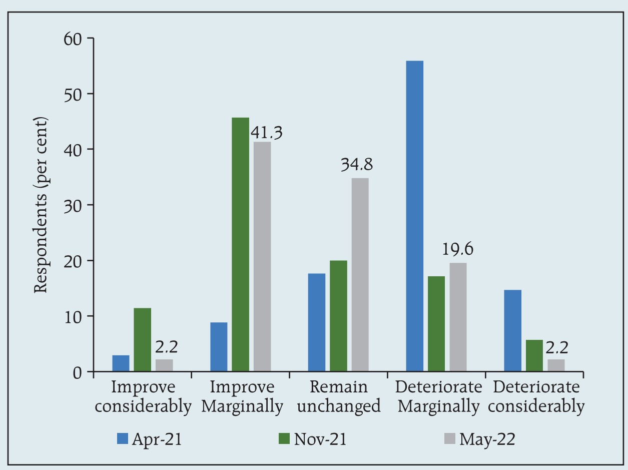
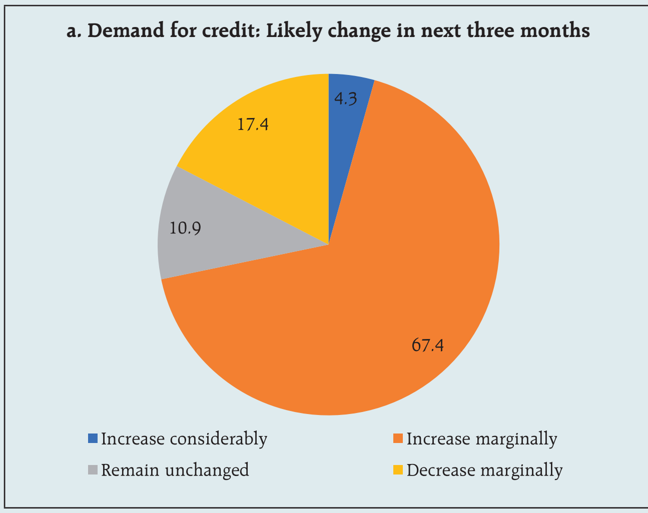
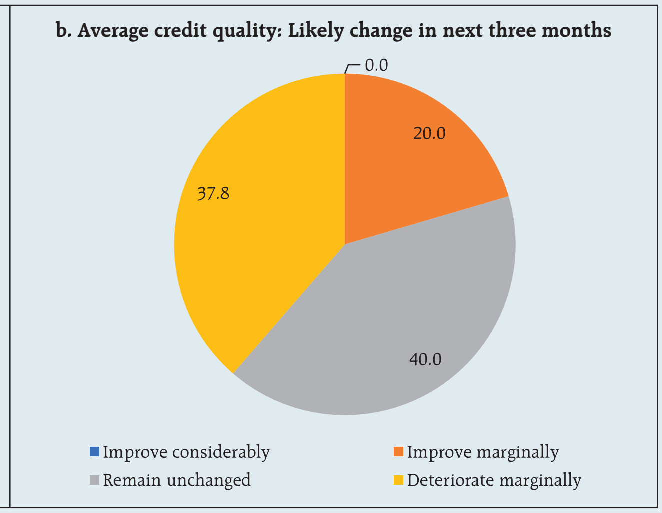


Chart 5: Indian Banking Sector – Outlook





Risks to Financial Stability

Going forward, respondents in the latest round of the SRS identified the following major risks to financial stability:

- Aggressive monetary policy tightening by AEs;
- Volatility in capital flows and exchange rates;
- De-anchoring of inflation expectations;
- Faltering of economic recovery;
- Disruptions in global supply chains;
- De-globalisation; and
- Climate change risk to the asset side exposure of financial sector.