Overview

The Financial Stability Report (FSR) is published biannually and includes contributions from all the financial sector regulators. Accordingly, it reflects the collective assessment of the Sub-Committee of the Financial Stability and Development Council (FSDC-SC) on risks to financial stability.

Macro-Financial Risks

With vaccination drives gathering momentum and policy support maintained, the global economy is gradually recovering from the ravages of the COVID-19 pandemic, though divergently and unevenly across countries. Capital flows have plotted a cautious return to emerging market economies (EMEs). Meanwhile, commodity prices have recorded a broad-based upswing in the recent period, portending inflationary implications as well as welfare losses for low income countries. Globally, government debt has scaled unprecedented levels, driven by a decline in government revenues and increased spending to safeguard economic and social welfare in the face of the pandemic. While banks have remained relatively unscathed by pandemic-induced disruptions, cushioned by regulatory, monetary and fiscal policies, they face prospects of a possible rise in non-performing loans, particularly in their small and medium enterprises (SME) and retail portfolios, especially as regulatory support starts getting wound down.

Domestic Economy and Markets

On the domestic front, the ferocity of the second wave has dented economic activity, though policy measures have ensured the smooth functioning of markets and financial institutions. Finances of the centre and states have been impacted by shortfalls and additional expenditure on health care and welfare measures. With a quantum jump in market borrowings, a significant share of public debt has been absorbed by banks; going forward, however, their absorptive capacity may be circumscribed by the likely expansion of bank credit in the wake of the recovery. Moreover, the sizable holdings of government securities required to be marked to market renders them sensitive to valuation changes.

For net commodity importers like India, the uptrend in the international prices of crude oil and other key commodities has emerged as a source of risk, fuelling inflation expectations and also translating into terms of trade losses. Within the domestic financial system, credit flow from banks and capital expenditure of corporates remain muted. While banks' exposures to better rated large borrowers are declining, there are incipient signs of stress in the micro, small and medium enterprises (MSMEs) and retail segments. The demand for consumer credit across banks and non-banking financial companies (NBFCs) has dampened, with some deterioration in the risk profile of retail borrowers becoming evident.

Financial Institutions: Soundness and Resilience

Bank credit growth has remained tepid, impacted by lockdowns and associated restrictions. On the other hand, deposit growth maintained its upward trajectory, with current account and savings account (CASA) deposits leading the way, reflecting continued preference for precautionary savings.

SCBs' return on assets (RoA) and return on equity (RoE) maintained a positive uptrend through 2020-21 and their capital to risk-weighted assets ratio (CRAR) improved by 130 bps year-on-year to reach 16 per cent in March 2021. The gross non-performing assets (GNPA) and net NPA (NNPA) ratios remained stable during the second half of 2020-21, amounting to 7.5 per cent and 2.4 per cent respectively in March 2021. On the other hand, special mention account (SMA) ratios deteriorated. The overall provisioning coverage ratio (PCR) increased from 66.2 per cent in March-2020 to 68.9 per cent in March 2021.

Macro-stress tests for credit risk show that SCBs' GNPA ratio may increase from 7.48 per cent in March 2021 to 9.80 per cent by March 2022 under the baseline scenario and to 11.22 per cent under a severe stress scenario. Stress tests also indicate that SCBs have sufficient capital, both at the aggregate and individual level, even in the severe stress scenario.

At the aggregate level, the CRAR of scheduled urban co-operative banks (SUCBs) improved to 9.5 per cent in March 2021. NBFCs recorded credit growth at 8.8 per cent during the year while their GNPA ratio declined marginally to 6.4 per cent.

Network analysis indicates that the total outstanding bilateral exposures among constituents of the financial system have been rising out of the sharp contraction in Q1:2020-21. SCBs continued to have the largest bilateral exposures in the Indian financial system at end-March 2021. In terms of inter-sectoral exposures, asset management companies/mutual funds (AMC-MFs), followed by insurance companies, remained the most dominant fund providers in the system, while NBFCs were the biggest receivers of funds, followed by housing finance companies (HFCs).

Regulatory Initiatives and Other Developments in the Financial Sector

As the global economy begins its recovery, regulatory attention has moved towards addressing the vulnerabilities in the prevailing market microstructures. In India, extraordinary measures taken by the Reserve Bank, other financial regulators and the government helped curtail the solvency risk of financial entities, stabilised the markets and provided the necessary impetus for economic revival, while maintaining financial stability. Alongside these actions, efforts to bolster the resilience of the financial system continue apace.

Assessment of Systemic Risk

In the latest systemic risk survey (SRS), all broad categories of risks to the financial system - global, macroeconomic, financial market, institutional and general - were perceived as 'medium' by the respondents. Within the above categories, commodity price risk, domestic growth and inflation, fiscal deficit, corporate vulnerabilities, equity price volatility, banks' asset quality and capital requirement, credit growth and cyber risk were rated as 'high'.