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 stability of the Indian financial system.

Macrofinancial Risks

The outlook for the global economy is shrouded by considerable uncertainty on account of the war in Ukraine, elevated commodity prices, supply chain disruptions and darkening growth prospects. In tandem, front-loaded monetary policy normalisation in response to persistently high inflation is imparting high volatility to global financial markets. The evolving outlook is particularly challenging for emerging market economies (EMEs) that face rising indebtedness, currency depreciations, capital outflows and reserve losses, even as they grapple with the ravages of the pandemic. Stagflation risks are mounting for EMEs and advanced economies (AEs) alike as tightening financial conditions threaten to restrain the pace of growth with inflationary pressures.

Domestic Economy and Markets

In the Indian economy, high-frequency indicators point to a gradual but unevenly strengthening recovery in the first quarter of 2022-23, in spite of headwinds from the geopolitical situation, elevated commodity prices, especially of crude oil, and volatile financial conditions, as global spillovers endeavour to unsettle domestic financial markets with bouts of turbulence.

While corporate sales and profitability have risen, a durable commencement of the capex cycle remains elusive. Bank credit growth is picking up steadily, already clocking double digits. Banks have also bolstered capital and liquidity positions while asset quality has improved. Non-banking financial companies (NBFCs) remain well capitalised. Market risks are rising as spells of volatility are unleashed by foreign portfolio investment outflows and the sharp appreciation of the US dollar.

Financial Institutions: Soundness and Resilience

Scheduled commercial banks (SCBs) maintained robust capital positions, with the Capital to Risk Weighted Assets Ratio (CRAR) and Common Equity Tier 1 (CET-1) Ratio of SCBs as high as 16.7 per cent and 13.6 per cent, respectively, in March 2022, and improving returns on assets (RoA) and returns on equity (RoE). SCBs' gross non-performing assets (GNPA) ratio slipped to a six-year low of 5.9 per cent and net non-performing assets (NNPA) ratio fell to 1.7 per cent in March 2022. The provisioning coverage ratio (PCR) increased to 70.9 per cent in March 2022 from 67.6 per cent in March 2021.

Macro-stress tests for credit risk reveal that SCBs are well-capitalised and all banks would be able to comply with the minimum capital requirements even under adverse stress scenarios.

The CRAR of urban co-operative banks (UCBs) rose to 15.8 per cent in March 2022 while that of NBFCs stood at 26.9 per cent.

Network analysis indicates that the total outstanding bilateral exposures among constituents of the financial system continued to grow. The share of SCBs in bilateral exposure remain the largest, although, it is lower than pre-pandemic levels. A simulated contagion analysis shows that even though losses due to failure of five banks with the maximum capacity to cause contagion increased in March 2022 *vis-à-vis* their September 2021 position, this would not lead to failure of any additional bank.

Regulatory Initiatives and Other Developments in the Financial Sector

Regulators across the globe are focusing their attention on reprioritising regulatory initiatives even as they learn from the lessons gleaned during the pandemic. Strengthening the regulation of non-bank financial intermediation remains a priority. Developments in the crypto ecosystem and the broader role of technology in financial services are also receiving increased attention. Domestically, efforts continue to fortify the financial system against sudden shocks and to improve the credit environment to support the recovery while ensuring macroeconomic and financial stability.

Assessment of Systemic Risk

In the latest systemic risk survey (SRS) conducted by the Reserve Bank in May 2022, global spillovers and financial market volatility moved to the 'high' risk category. Global growth uncertainty, commodity price movements, geopolitical conditions and monetary tightening in AEs were perceived to be the major drivers of global risks. Macroeconomic, institutional and general risks were perceived as 'medium'. Nearly eighty per cent of the respondents judged that the prospects of the Indian banking sector are likely to improve or remain unchanged over a one-year horizon.