

RBI releases Financial Stability Report- June 2019

The Reserve Bank of India has released the 19th issue of the Financial Stability Report (FSR). The FSR reflects the collective assessment of the Sub-Committee of the Financial Stability and Development Council (FSDC) on risks to financial stability, as also the resilience of the financial system.

Overall assessment of systemic risks: India's financial system remains stable in the backdrop of improving resilience of the banking sector, even though the emerging trends in global economic as also geopolitical environment pose challenges.

Global and domestic macro-financial risks

- Global economic activity continues to face significant headwinds since the second-half of 2018 culminating in a lower global growth forecast of 3.3 per cent in 2019. Adverse geopolitical developments and trade tensions are gradually but predictably taking a toll on business and consumer confidence.
- Advanced economies' (AEs) central banks have eased their monetary policy stance. While asset prices and global capital flows initially recovered in response, the markets appear to be deeply conditioned by the implied 'Fed put' and any significant reassessment would require re-rating of a host of issues relating to emerging market and developing economies (EMDEs) with a risk of sharp adjustments.
- Domestic economy hit a soft patch recently as private consumption, the key driver of GDP, turned weak. This along with subdued new investment pipeline and a widening current account deficit have exerted pressure on the fiscal front.

- Reviving private investment demand remains a key challenge going forward while being vigilant about the spillover from global financial markets.

Financial Institutions: Performance and risks

- Credit growth of scheduled commercial banks (SCBs) picked up, with public sector banks (PSBs) registering near double digit growth. Capital adequacy of the SCBs improved after the recapitalisation of PSBs.
- With the bulk of the legacy non-performing assets (NPAs) already recognised in the banking books, the non-performing asset (NPA) cycle seems to have turned around.
- Provision coverage ratio (PCR) of all SCBs rose sharply to 60.6 per cent in March 2019 from 52.4 per cent in September 2018 and 48.3 per cent in March 2018, increasing the resilience of the banking sector.
- Macro-stress tests for credit risk indicate that under the baseline scenario, SCBs' gross nonperforming asset (GNPA) ratio may decline from 9.3 per cent in March 2019 to 9.0 per cent in March 2020.
- Recent developments in the Non-banking financial companies (NBFC) sector have brought the sector under greater market discipline as the better performing companies continued to raise funds while those with ALM and/or asset quality concerns were subjected to higher borrowing costs.
- Analysis of the financial network structure reveals that joint Solvency-Liquidity contagion losses to the banking system due to idiosyncratic failure of banks are lower for March 2019 than in March 2018 (FSR June 2018) due to a better capitalised public-sector banking system. Solvency contagion losses to the banking system due to idiosyncratic HFC/NBFC failure show that the failure of largest of these can cause losses comparable to those caused by the big banks, underscoring the need for greater surveillance over large HFCs/NBFCs.

Financial sector: Regulation and developments

- In order to finetune the supervisory mechanism for the banks, the Reserve Bank has recently reviewed the structure of supervision in the context of the growing diversity, complexities and interconnectedness within the Indian financial sector.
- The revised prudential framework on stressed assets issued by the Reserve Bank on June 7, 2019 while extending the erstwhile stressed asset resolution framework, also builds in incentive for early adoption of a resolution plan (RP).
- To address counterparty concentration risk in the banking sector, the Reserve Bank introduced a revised large exposures framework (LEF) effective April 01, 2019.
- To further enhance the quality of disclosures made by Credit Rating Agencies (CRAs) and strengthen the rating framework, the Securities and Exchange Board of India (SEBI) has introduced Guidelines for Enhanced Disclosures by CRAs.
- To provide flexibility to pension funds to improve fund performance depending on market conditions, the Pension Fund Regulatory and Development Authority (PFRDA) amended the investment guidelines.
- The Insolvency and Bankruptcy Board of India (IBBI) is showing steady progress in the resolution of stressed assets.

Financial Stability Report –June 2019 released by RBI is enclosed for your kind reference.

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