Financial Stability Report

June 30, 2020

What is Financial Stability Report?

- The Financial Stability Reports are bi-annual reports published by the Reserve Bank of India(RBI).
- The report is the collective assessment of the Sub-Committee of the Financial Stability and Development Council (FSDC) on risks to financial stability.
- It reviews the nature, magnitude and implications of risks that may have a bearing on the macroeconomic environment, financial institutions, markets and infrastructure.

December 2019 Report Highlights

On India's Economic Growth:

- The Reserve Bank has said that the country's financial system remains stable despite slowing economic growth.
- The aggregate demand has slowed down in the second half of the current financial year ending March 2020 adding to an already slowing economic growth.
- The Global factors such as a delay in Brexit deal, trade tensions, impending recession, oil-market disruptions and geopolitical risks has caused uncertainties leading to a significant deceleration in growth.
- The reviving of the twin engines of India's economic growth namely private consumption and investment while being vigilant about developments in global financial markets remain a critical challenge for RBI.

On Banking Sector:

- The Bank's capital adequacy ratio has improved significantly after the recapitalisation of public sector banks(PSBs) by the government.

- The Insolvency and Bankruptcy Code (IBC) has tackled the issue of bad loans which had slowed down the performance and growth of private, public-sector banks and even non-banks.
- RBI has also taken several policy measures to improve the condition of the financial system such as (a) introducing a liquidity management regime for NBFCs (b)improving the banks' governance culture (c)resolution of stressed assets and (d)for the development of payment infrastructure.
- However, RBI expects the banks gross non-performing asset (GNPA) ratio to increase from 9.3% in September 2019 to 9.9% by September 2020.

This is primarily due to change in macroeconomic scenario, marginal

- increase in slippages and the denominator effect of declining credit growth.
- Further,the frauds reported by the banks touched an all time high of around Rs 1.13 lakhs in the FY19.The frauds reported between 2001-18 accounted to 90% of the frauds registered in 2019 alone.

June Report:

- The report assessed that India's financial system remains stable in the backdrop of improving resilience of the banking sector.However,the emerging trends in the global economy and geopolitical environment pose challenges.
- The report has said that the Gross non-performing assets in the banking system have declined for the second consecutive half year while credit growth is picking up.
- The credit has picked following capital infusion by the government in public sector banks. This has led to overall improvement in the capital adequacy ratio(CAR) of commercial banks but there was a marginal decline in

the CAR of private sector banks.

- Capital Adequacy Ratio (CAR) is the ratio of a bank’s capital in relation to its risk weighted assets and current liabilities. It is decided by central banks and bank regulators to prevent commercial banks from taking excess leverage and becoming insolvent in the process. The risk weighted assets take into account (a) credit risk (b)market risk and (c)operational risk.
- However, the report has called for greater surveillance on large entities in India’s Non-banking financial companies(NBFC) as their failure could lead to losses that are similar to those of big banks.
- NBFC have seen their source of funds suddenly dry up after a series of defaults by Infrastructure Leasing & Financial Services(ILFS) that has triggered a liquidity crisis.
- Further, the RBI has also said that it is reviewing its master direction on frauds and considering additional measures for timely recognition of frauds and enforcement action against violations.