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Summary of Financial Stability Report

June 2024 (29th)

Contents

1 - What is RBI's FSR Report?

The FSR which is published biannually reflects the collective assessment of the Sub-Committee of the Financial Stability and Development Council (FSDC - headed by the Governor of RBI) on risks to financial stability and the resilience of the financial system. The Report also discusses issues relating to development and regulation of the financial sector.

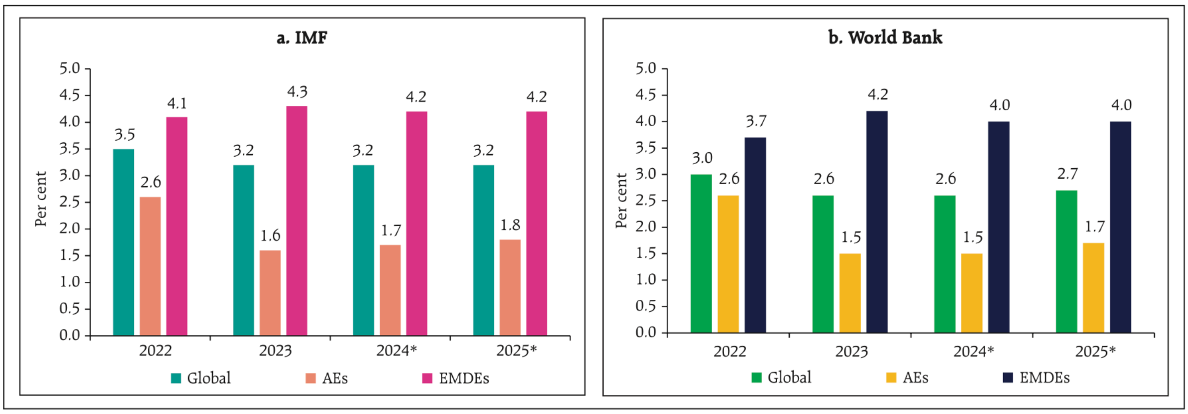
2 – Summary of the FSR

2.1 Macro financial Risks

Global Economy – Macro-financial Development and Outlook

- ❖ The global financial system has demonstrated remarkable resilience despite challenges such as slow progress in disinflation, high public debt, and geopolitical tensions.
- ❖ The IMF projects global growth to remain steady at 3.2% in 2024, while the World Bank forecasts a lower growth rate of 2.6%.
- ❖ Although progress in disinflation has been slow, economic fragmentation and realignment of supply chains continue. Market expectations have aligned with policy guidance, stabilizing financial conditions and reducing the risks of a hard landing.

Chart 1.1: Global Growth Forecast



Note: * Forecasts.
Sources: IMF & World Bank.

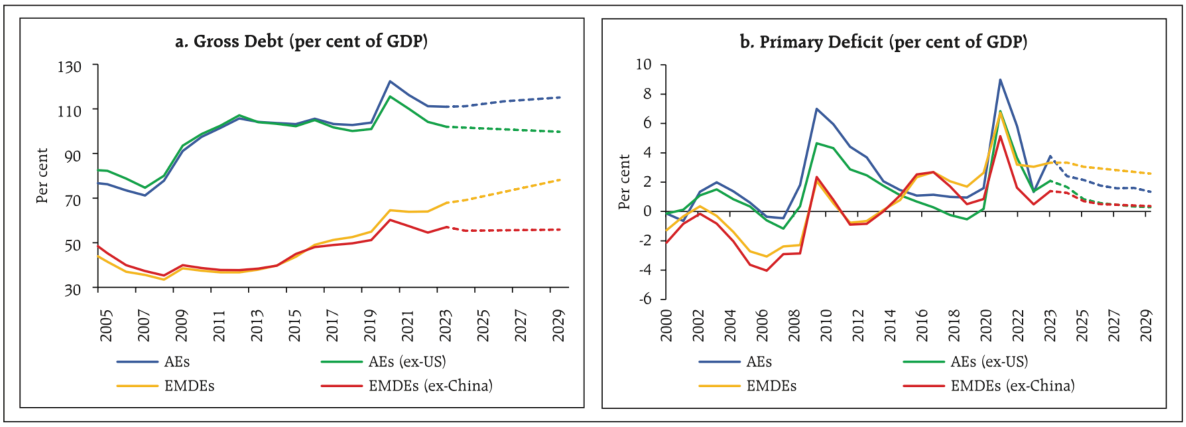
- ❖ However, public debt remains a significant concern, with global debt increasing to 93.2% of GDP by the end of 2023.

Global Micro financial Risks

Elevated Public Debt

- Global public debt has risen to 93.2% of GDP by the end of 2023, driven by expansionary fiscal policies during the pandemic and the slow rollback of supportive measures.
- This increase is led by the U.S. and China, contributing to a total global debt of 239.9% of GDP, amounting to US$ 251.4 trillion.
- Public debt stands at US$ 97.7 trillion, while private debt is at US$ 153.7 trillion.
- The narrowing interest rate-growth rate differential threatens debt sustainability, with global fiscal deficits averaging 5.5% of GDP in 2023, up by 1.6 percentage points from the previous year.
- High debt levels and elevated interest rates pose significant risks to economic stability, particularly in low-income and low-rated countries.

Chart 1.11: Global Public Debt

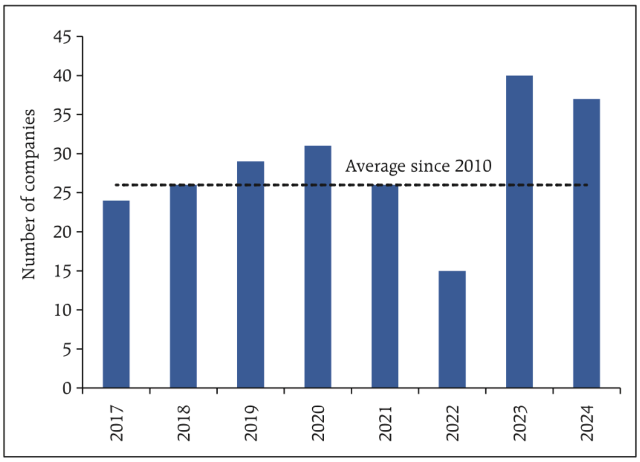


Note: Dotted lines represent forecasts.
Source: IMF.

Stretched Asset Valuations

- Financial markets have remained buoyant, with equity markets rallying and bond yields increasing. However, the narrowing of corporate bond spreads coincides with rising episodes of corporate defaults. High correlations among equities, bonds, credit, and commodity indices indicate increased market risks.
- Despite strong earnings, the elevated valuations of riskier assets pose potential financial stability concerns.

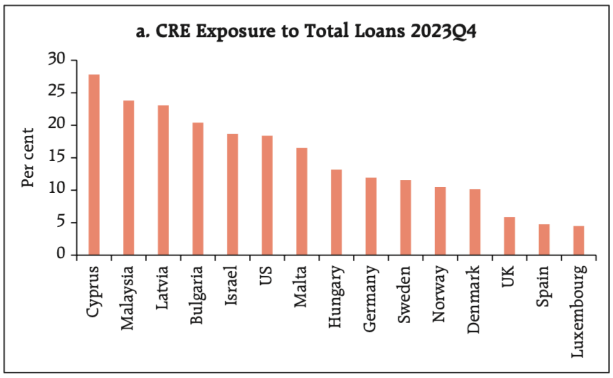
Chart 1.15 Corporate Defaults (January-March)



Source: S&P Global Ratings Credit Research & Insights

Stress in the Commercial Real Estate Sector

- The commercial real estate (CRE) sector faces significant risks due to heightened exposures and interlinkages with banks and non-banking financial intermediaries (NBFIs).
- Strains in the CRE sector pose potential financial stability implications, as seen in increased default rates and valuation pressures.



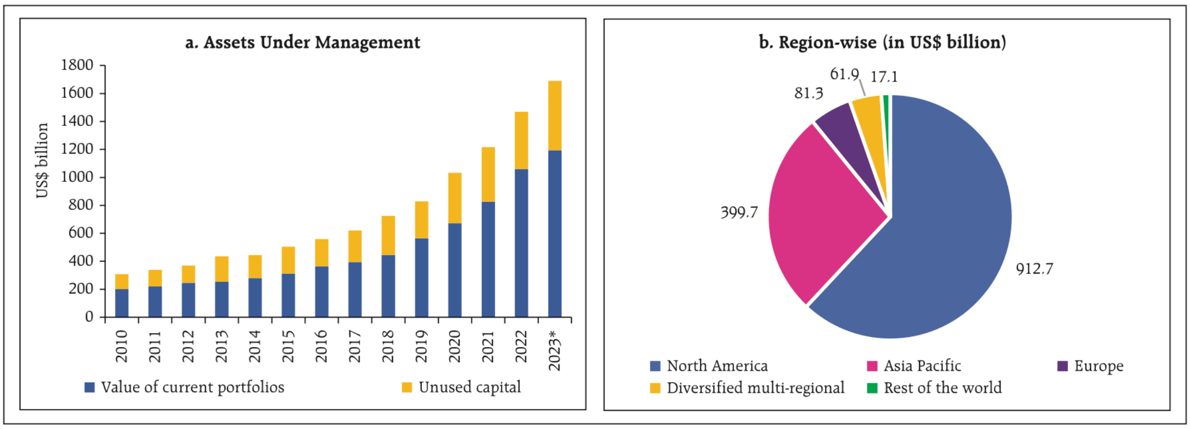
Geopolitical Risks

- Prolonged geopolitical tensions continue to pose risks to global economic stability, affecting logistics, supply chains, and commodity prices. These tensions impact the global disinflation process and overall economic outlook. Events such as trade restrictions and geopolitical conflicts have significant spillover effects on the financial system.

Risks stemming from Private Credit

- The private credit market is under scrutiny due to high levels of leverage and potential defaults, raising concerns about financial stability. The increasing size and complexity of private credit markets necessitate robust risk management and regulatory oversight to mitigate systemic risks.

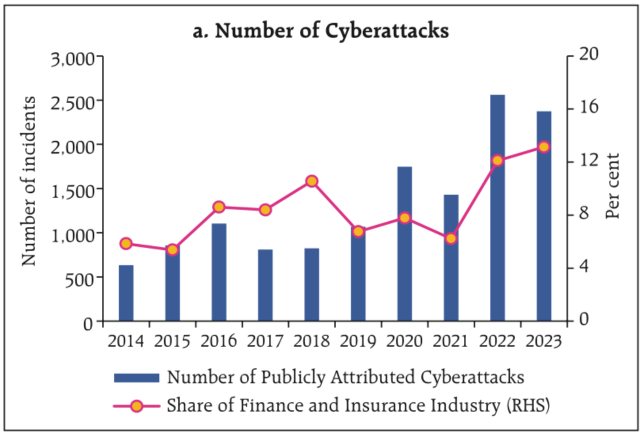
Chart 1.23 Size of Private Credit Market



Note: *Data upto June 2023.
Sources: Bloomberg News and Preqin.

Cyber Risk

- ❖ The rising prevalence of cyber threats necessitates robust frameworks to ensure financial system resilience.
- ❖ Cyber risk awareness is increasing, with measures being implemented to safeguard against potential disruptions and enhance cyber security across financial institutions.

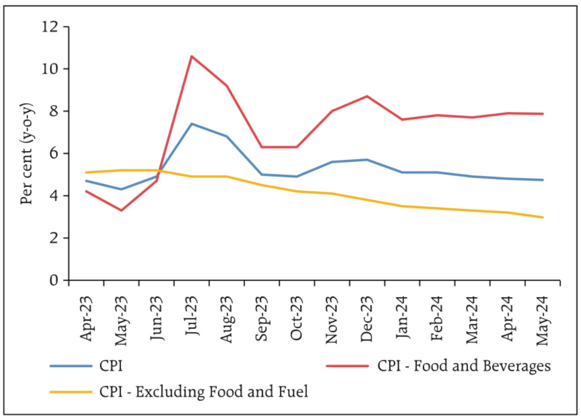


Domestic Micro financial Risks

Domestic Growth and Inflation

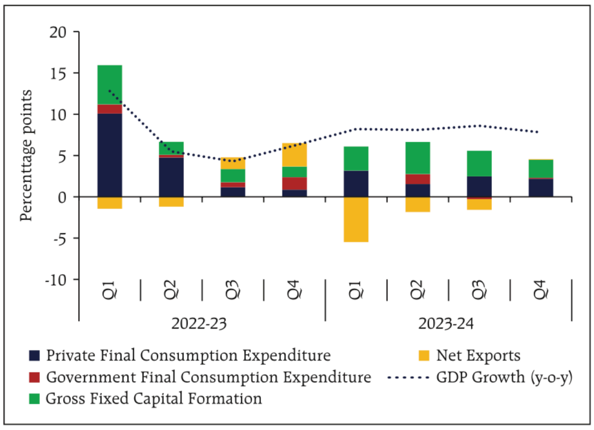
- ❖ India's economy is expanding steadily, with real GDP growth on a rising trajectory supported by strong macroeconomic fundamentals. India's contribution to global growth is significant at 18.5% in 2023-24.
- ❖ The country is experiencing moderating inflation, albeit at an uneven pace, with fiscal consolidation efforts bolstering business and consumer confidence.
- ❖ Real GDP growth is projected to continue its upward trend, driven by robust economic activities and a stable financial environment.

Chart 1.27: Consumer Price Inflation



Sources: National Statistics Office and RBI staff calculations.

Chart 1.26: Contribution to GDP Growth



Sources: NSO and RBI staff estimates.

External Sector

- ❖ India's external sector shows strength with a stable foreign exchange market, growing service exports, and a narrowing trade deficit. The balance of payments position is improving, supported by resilient foreign exchange reserves and increasing private transfers. The exchange rate remains stable, with reduced volatility in the foreign exchange market, reflecting the country's robust external sector fundamentals.

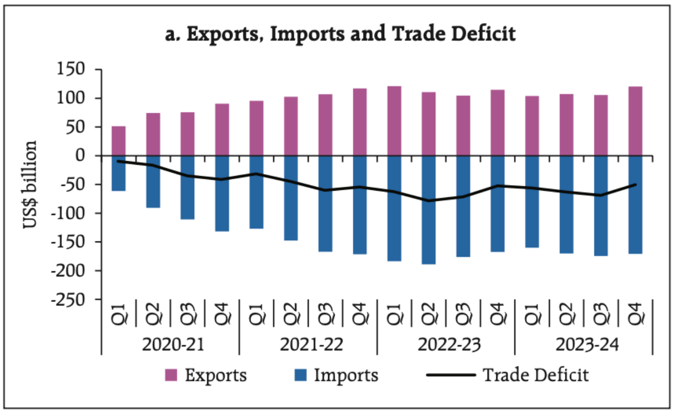
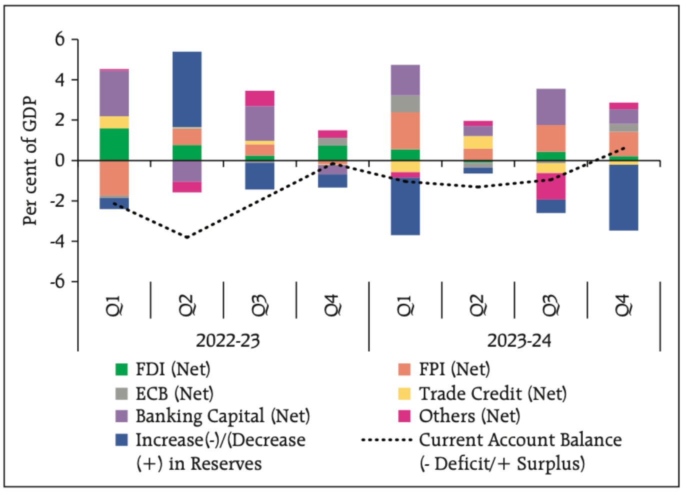


Chart 1.30: Balance of Payments



Note: 'Others' includes external assistance, rupee debt service, other capital and errors and omissions.
Source: RBI.

Table 1.1: Capital Flows

(US$ billion)

Component	Financial year so far			Financial Year	
	Period	2024-25	2023-24	2023-24	2022-23
FDI (net)	April	4.0	2.8	9.8	28.0
FPI (net)	April-June	-3.9	9.0	44.6	-4.8
ECB (net)	April	-0.1	1.9	3.8	-4.1
Non-resident Deposits (net)	April	1.1	-0.2	14.7	9.0

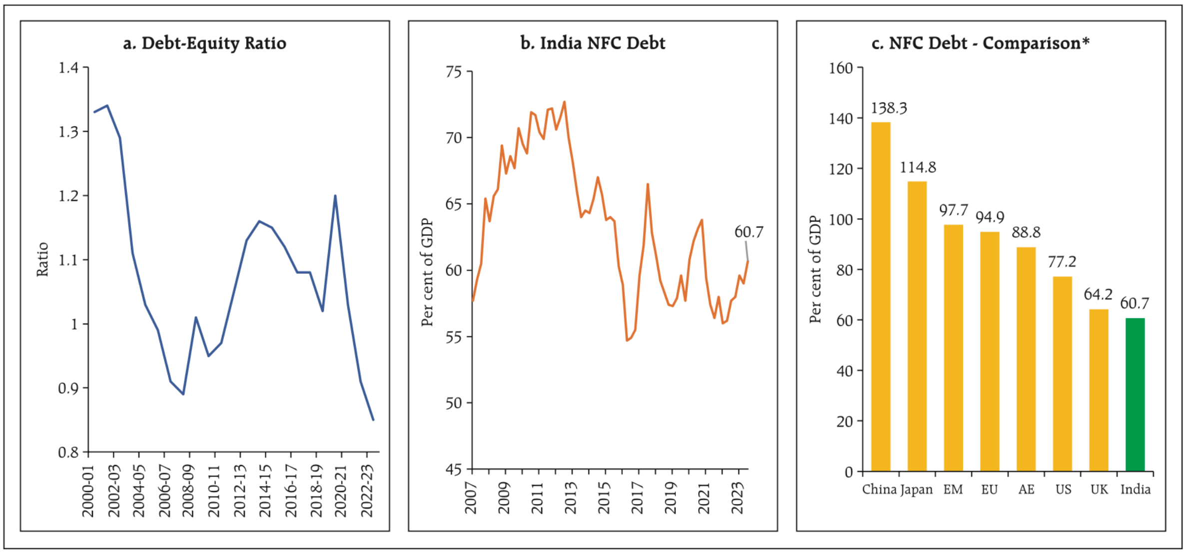
Note: Data on FPI for financial year so far (June 12, 2024) and corresponding previous year period have been sourced from NSDL, whereas data for full year is based on BoP.
Sources: RBI and NSDL.

Corporate Sector

- The corporate sector shows improved asset quality, with favorable debt-equity ratios and lower default risks. Enhanced credit ratings and financial health support overall economic stability.

❖ The corporate sector's nominal sales growth and operating profit margins indicate strong performance, contributing to reduced financial vulnerabilities.

Chart 1.34: Non-Financial Corporates – Debt-Equity and Debt-to-GDP Ratios



Note: * Data as on December 2023.
Sources: CMIE and BIS.

Government Finance

❖ Continued fiscal consolidation efforts are evident, with improvements in key fiscal performance indicators such as the fiscal deficit and government debt levels.

❖ Both central and state governments are managing their finances prudently, with fiscal measures aimed at ensuring long-term sustainability and stability.

❖ The government's focus on reducing the fiscal deficit and managing public debt contributes to overall economic resilience.

Table 1.5: Central Government Finances - Key Deficit Indicators

(per cent of GDP)

Item	2020-21	2021-22	2022-23	2023-24 (PA)	2024-25 (BE)
Revenue Deficit	7.3	4.4	4.0	2.6	2.0
Gross Fiscal Deficit	9.2	6.7	6.4	5.6	5.1
Primary Deficit	5.7	3.3	3.0	2.0	1.5

Note: PA: Provisional Accounts; BE: Budget Estimate.
Sources: Union Budget Documents and CGA.

Table 1.6: State Government Finances: Key Deficit Indicators

(per cent of GSDP)

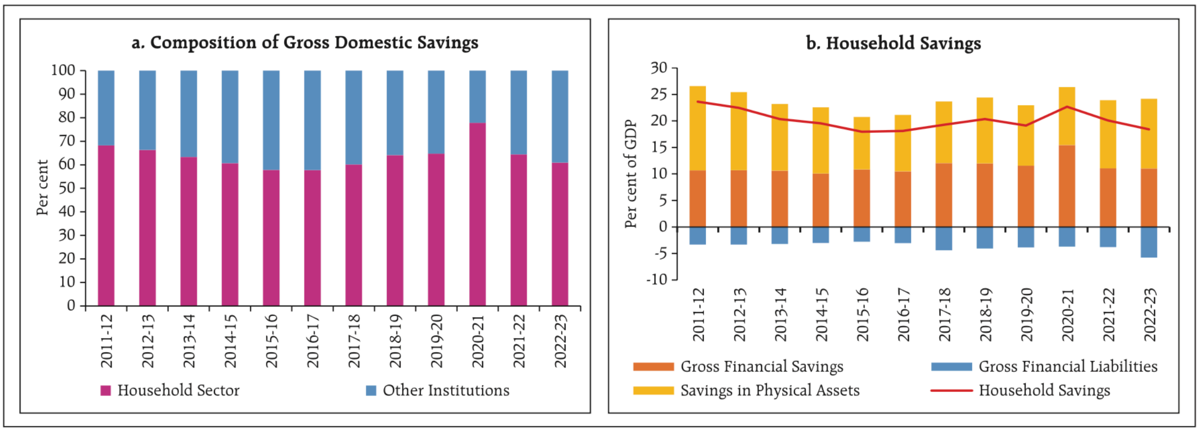
Item	2022-23	2023-24(PA)	2024-25 (BE)
Revenue Deficit	0.2	0.2	0.2
Gross Fiscal Deficit	2.7	3.0	3.0
Primary Deficit	1.0	1.4	1.3

Note: (1) Data for 2022-23 and 2023-24 (PA) pertain to 31 States/ UTs and for 2024-25 (BE) pertain to 27 States/UTs. Data for 2023-24 (PA) and 2024-25 (BE) is taken as a per cent of GSDP.
(2) PA: Provisional Accounts; BE: Budget Estimate.
Source: Budget documents of the States; and Comptroller and Auditor General of India.

Household Finance

- Household finance remains stable, with manageable debt levels and increasing savings. Borrowings from financial institutions are stable, and there is a growing trend in financial savings, supported by diversification into various instruments.
- Household financial savings and borrowings reflect a balanced approach to managing finances, contributing to the overall stability of the financial system.

Chart 1.43: Gross Savings and Household Savings



Source: National Statistical Office, MoSPI.

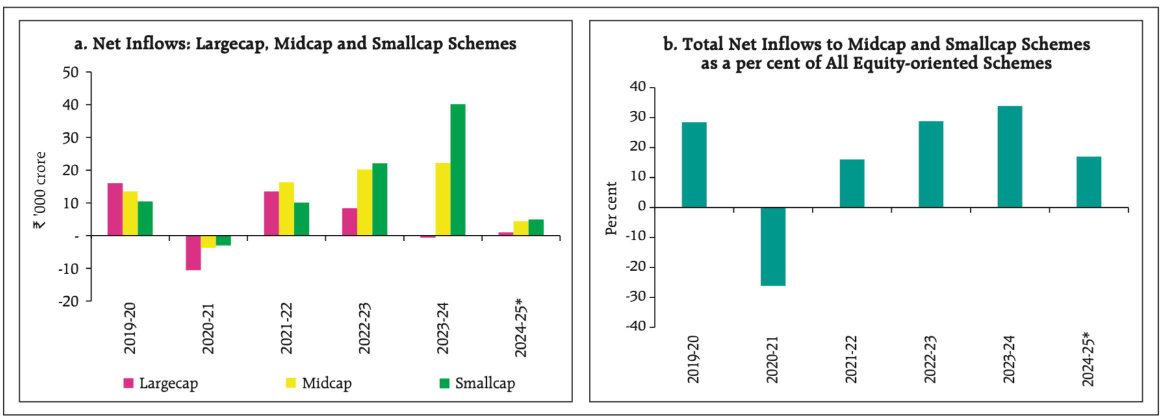
Money and Capital Markets

- The domestic financial system is well-buffered, with strong capital and liquidity ratios, declining levels of asset impairment, and rising profitability.
- Financial markets are stable, with robust credit growth supported by healthy balance sheets across financial institutions.
- Money market rates, system liquidity, and mutual fund investments indicate a well-functioning and resilient financial market environment.

Mutual Funds

- The mutual funds sector is resilient, with growing assets under management (AUM) and increasing investor participation.

Chart 1.58: Annual Trends in Net Inflows to Different Schemes of Mutual Funds



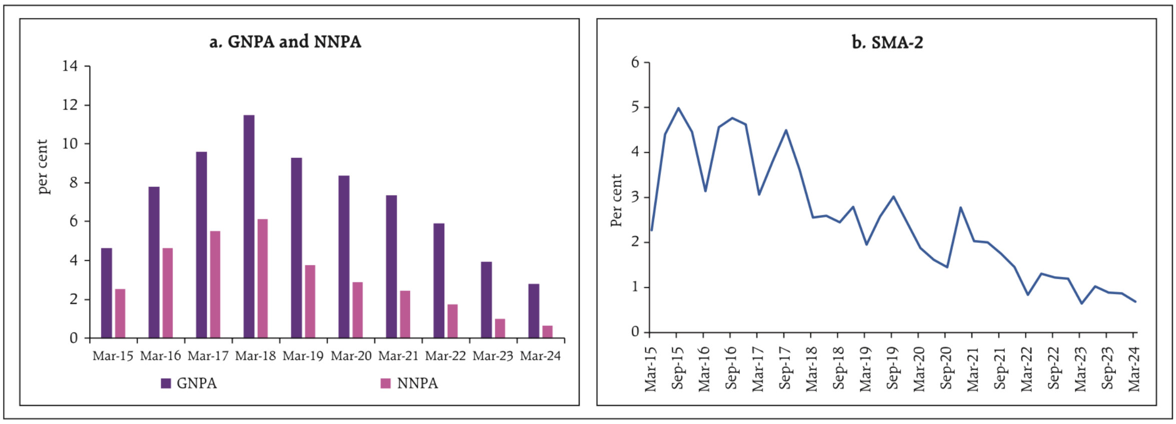
Note: * For April-May 2024.
Source: SEBI.

- ❖ The sector's stability is supported by diversified investments across asset classes, ensuring robust performance and investor confidence.
- ❖ Trends in net inflows, systematic investment plans (SIPs), and mutual fund schemes highlight the sector's growth and resilience.

Banking Stability Indicator and Financial System Stress Indicator

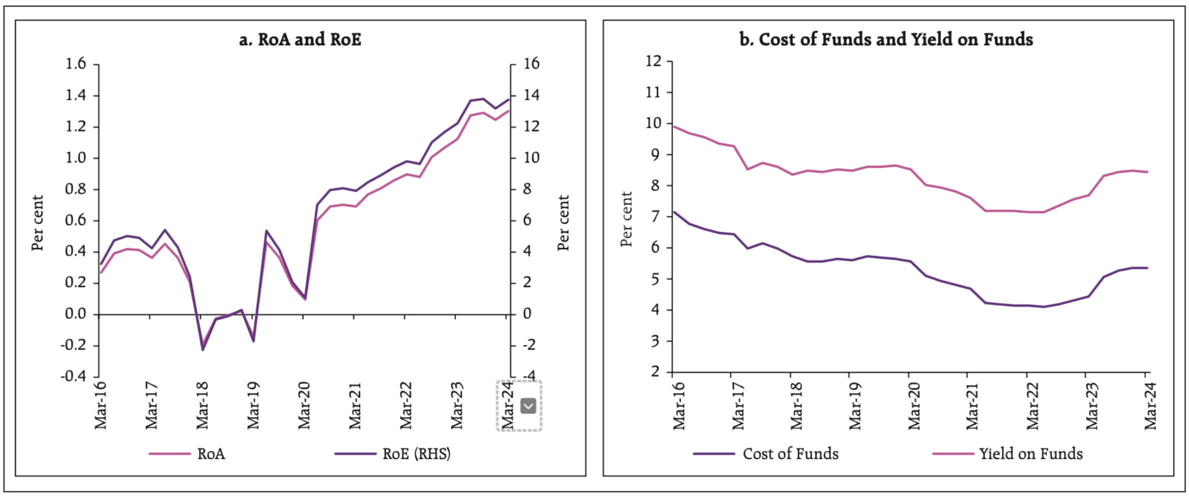
- ❖ The banking system is robust, with multi-year low non-performing asset (NPA) ratios, higher provisioning, and strong capital positions.
- ❖ The GNPA ratio is at 2.8%, and the NNPA ratio at 0.6%. Banks maintain strong capital buffers, with the CRAR at 16.8% and the CET1 ratio at 13.9%, well above regulatory minimums.
- ❖ Profitability indicators are at decadal highs, with RoA at 1.3% and RoE at 13.8%. The Financial System Stress Indicator highlights stable conditions but remains vigilant against emerging risks.

Chart 1.65: Asset Quality Indicators



Source: RBI supervisory returns.

Chart 1.66: Banking System Profitability and Market Valuation Indicators



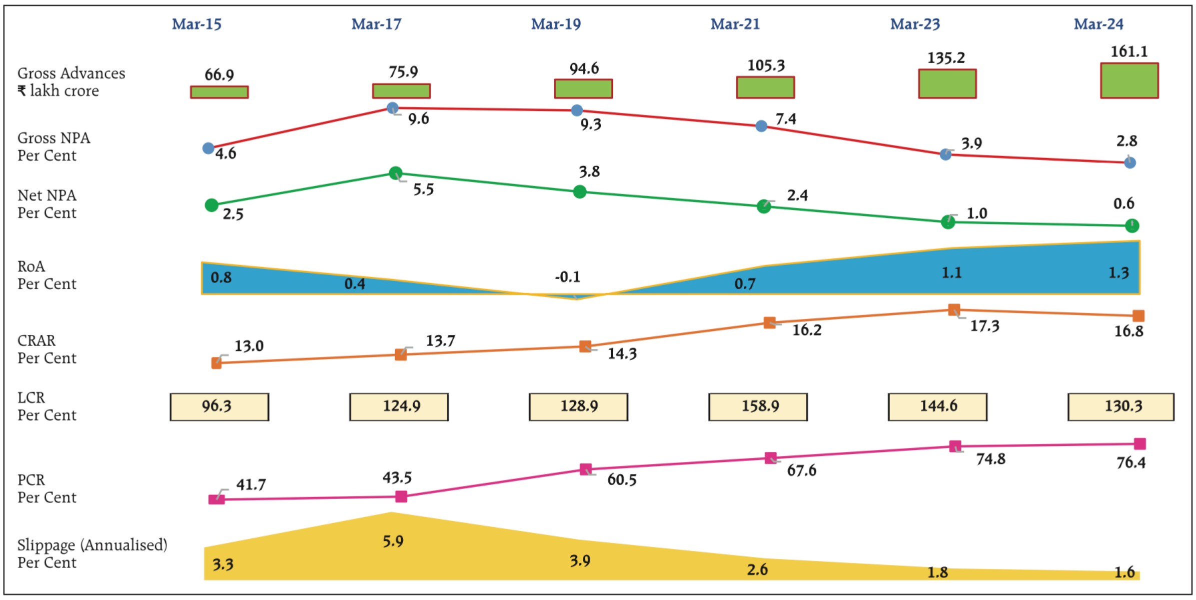
Sources: RBI supervisory returns and NSE.

Scheduled Commercial Banks (SCBs)

1. Asset Quality

- Scheduled commercial banks (SCBs) have shown significant improvements in asset quality, with the GNPA ratio decreasing to 2.8% and the NNPA ratio dropping to 0.6%. Increased provisioning coverage and strong capital positions further strengthen financial stability.
- The sectoral asset quality improvements across various sectors contribute to overall financial health.

Chart 1.6: Banking Sector Soundness Indicators

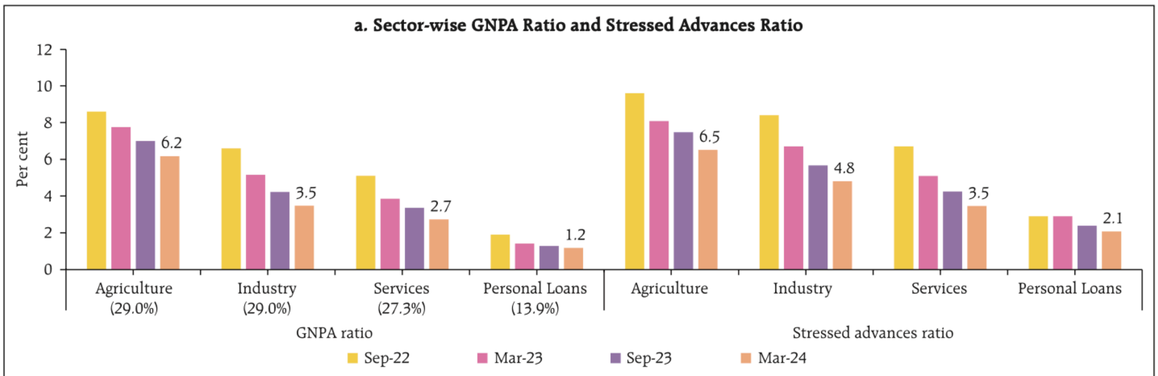


Note: As on June 14, 2024.
Source: RBI supervisory returns and staff calculations.

2. Sectoral Asset Quality

- Improvements are seen across various sectors, supported by strong provisioning and capital positions. Enhanced credit quality of large borrowers reduces systemic risk, contributing to the stability of the financial system.

Chart 2.3: Sectoral Asset Quality Indicators

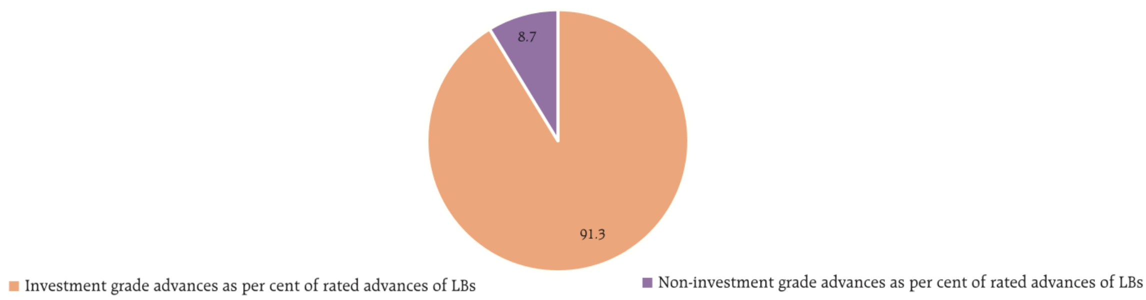


Note: Numbers given in parentheses are percentage shares of the respective sector's GNPA in total GNPA as of March-24.

3. Credit Quality of Large Borrowers

- ❖ Credit quality has improved, reducing systemic risks. Enhanced monitoring and management practices contribute to better financial health. Large borrowers' credit profiles show improvements, indicating reduced default risks and stronger financial stability.

g. External Rating Profile of Large Borrowers – March 2024

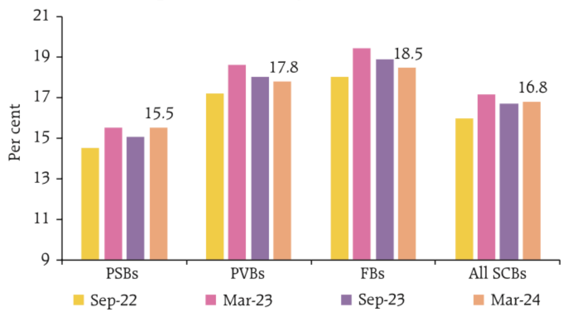


Note: For the classification purpose, advances rated BB (or equivalent) and below have been considered non-investment grade and advances rated BBB (or equivalent) and above have been considered investment grade

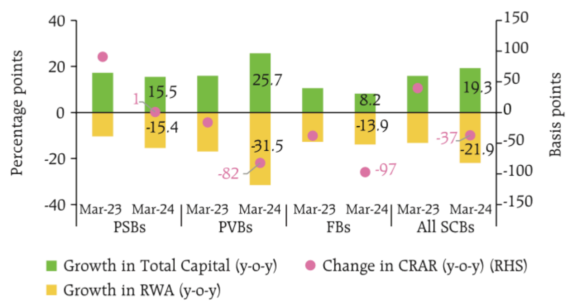
4. Capital Adequacy

- ❖ SCBs maintain strong capital buffers, with the CRAR at 16.8% and the CET1 ratio at 13.9%, ensuring resilience against potential shocks. The capital adequacy ratios reflect the banks' strong financial health and ability to manage risks effectively.

a. Capital to Risk-weighted Assets Ratio

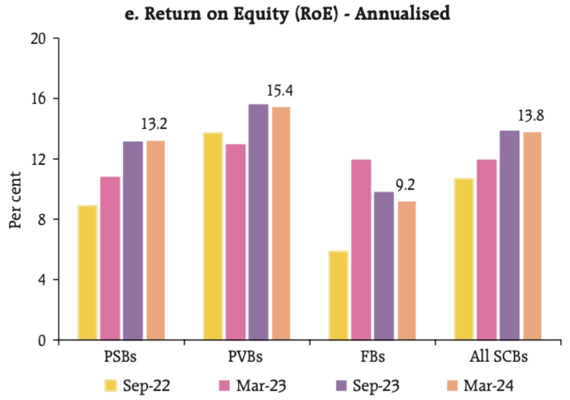


b. Contribution of Growth in Capital and RWA to Change in CRAR



5. Earnings and Profitability

e. Return on Equity (RoE) - Annualised



f. Return on Assets (RoA) - Annualised

- Profitability metrics are robust, with RoA at 1.3% and RoE at 13.8%. Improved net interest margins and strong earnings support overall financial stability. The banks' earnings and profitability indicators highlight their robust performance and resilience.

6. Resilience – Macro Stress Tests

- Stress tests indicate that banks have adequate capital buffers to withstand adverse scenarios, ensuring the stability of the financial system. The macro stress tests demonstrate the banks' resilience to various economic shocks and stress scenarios.

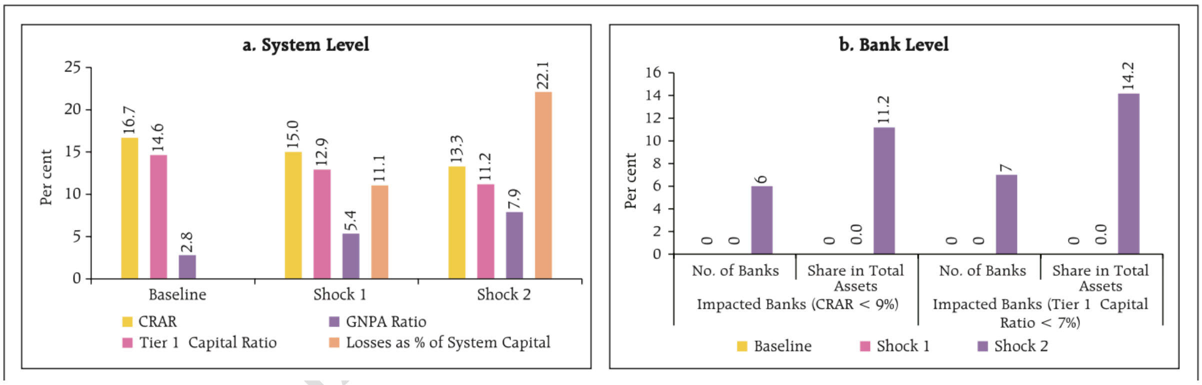
7. Sensitivity Analysis

- Banks exhibit resilience to various stress scenarios, with strong capital positions and robust risk management practices. The sensitivity analysis highlights the banks' ability to manage potential risks and maintain financial stability.

8. Bottom-up Stress Tests: Credit, Market and Liquidity Risk

- Stress tests on credit, market, and liquidity risks affirm the resilience of banks, ensuring they can manage potential shocks effectively. The bottom-up stress tests indicate the banks' strong risk management practices and preparedness for adverse conditions.

Chart 2.11: Credit Risk - Shocks and Outcomes



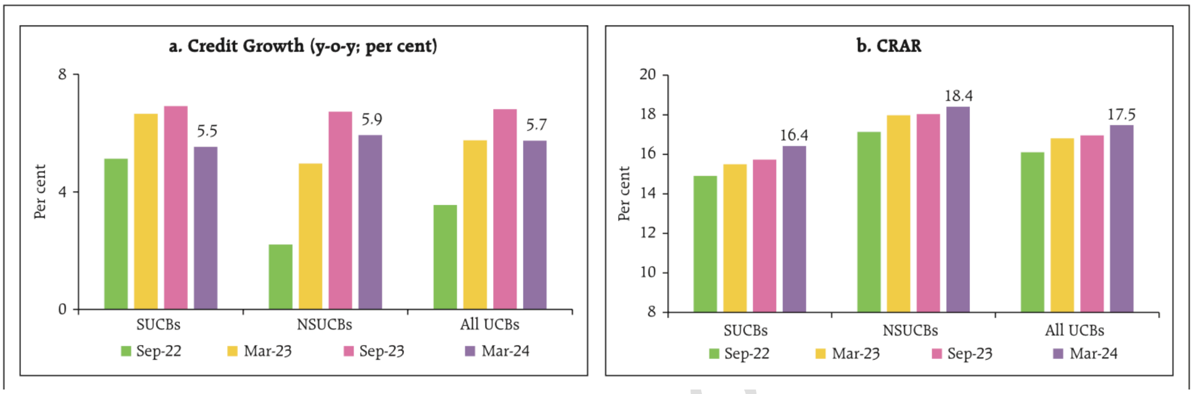
9. Bottom-up Stress Tests: Derivatives Portfolio

- The derivatives portfolio is managed effectively, with stress tests indicating resilience to market volatility and potential disruptions.
- The stress tests on the derivatives portfolio highlight the banks' ability to manage complex financial instruments and mitigate risks.

Primary (Urban) Cooperative Banks

- Urban cooperative banks maintain a CRAR of 17.5%, ensuring financial stability and resilience against potential risks.
- Credit by primary urban cooperative banks (UCBs) recorded a dip in growth (y-o-y) during H2:2023-24 – it stood at 5.7 per cent in March 2024.
- The strong capital adequacy ratios reflect the urban cooperative banks' robust financial health.

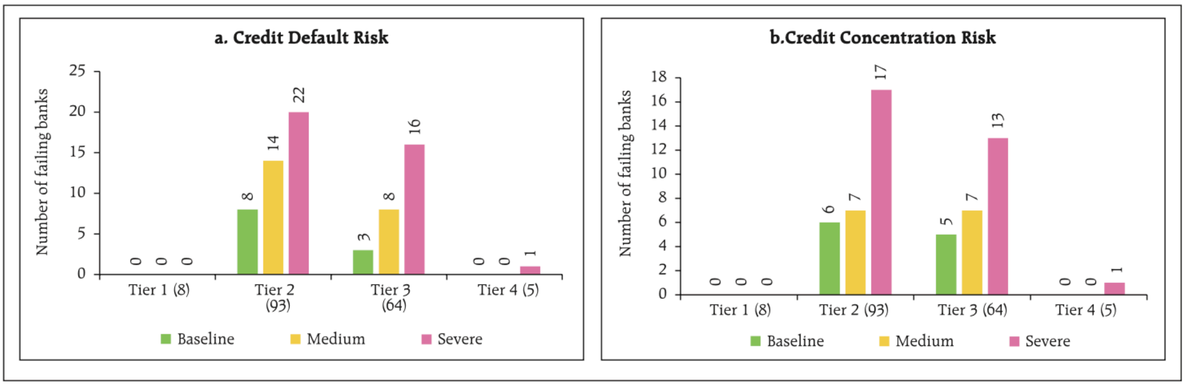
Chart 2.27: Credit Profile and Asset Quality Indicators of UCBs *(Contd.)*



1. Stress Testing

- Stress tests confirm the resilience of urban cooperative banks, with adequate capital buffers and strong financial health.
- The stress tests demonstrate the cooperative banks' ability to withstand economic shocks and maintain stability.

Chart 2.28: Stress Test of UCBs *(Contd.)*

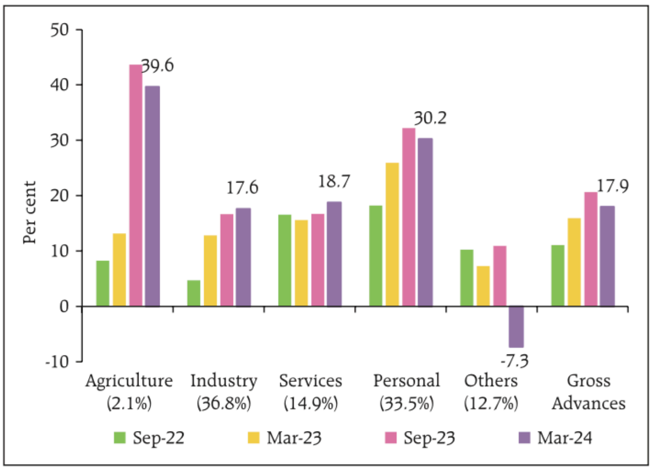


Non-Banking Financial Companies (NBFCs)

Stress Test - Credit Risk

- NBFCs exhibit strong financial health with adequate capital adequacy, despite a marginal decline to 26.6%.
- Stress tests show resilience against credit risks, highlighting the NBFCs' ability to manage potential defaults and maintain stability.

Chart 2.29: Sectoral Credit Growth of NBFCs (y-o-y)



Note: Figures in bracket represent shares in outstanding loans in Mar-24.
Source: RBI supervisory returns and staff calculations.

Stress Test - Liquidity Risk

- NBFCs maintain a solid liquidity position to manage short-term obligations, with stress tests confirming their resilience against liquidity shocks.
- The stress tests on liquidity risk indicate the NBFCs' preparedness for adverse liquidity conditions and their ability to manage cash flows effectively.

Insurance Sector

- The insurance sector's solvency ratio remains above the minimum threshold of 150%, ensuring financial health and resilience.
- Stress testing confirms the sector's ability to withstand shocks, contributing to overall financial stability. The insurance sector's strong solvency ratios reflect its robust financial health and ability to manage risks effectively.

Stress Testing of Mutual Funds

- Stress tests affirm the resilience of mutual funds, with growth in Assets Under Management (AUM) indicating investor confidence. Diversification across asset classes supports stability.
- The mutual funds' stress tests highlight their ability to manage market volatility and maintain financial stability.

Stress Testing Analysis at Clearing Corporations

- Clearing corporations show stability in operations, with stress tests affirming their resilience.
- The stress tests on clearing corporations indicate their ability to manage settlement risks and ensure smooth market functioning.

Financial System Network and Contagion Analysis

- Network analysis reveals expanding bilateral exposures among financial institutions, with SCBs holding the largest share. This interconnectedness within the financial system highlights potential contagion risks, but measures are in place to mitigate systemic risks. Contagion analysis underscores the importance of vigilance in monitoring these exposures to maintain financial stability.

2.3 Regulatory Initiative in the Financial Sector

Global Regulatory Initiatives

Markets and Financial Stability

- Globally, regulatory efforts focus on addressing interconnectedness risks, promoting financial stability through global standards, and improving risk assessments for climate-related and cyber risks.
- Emphasis is placed on harnessing technological advancements for financial services while ensuring security and resilience against potential disruptions.

FinTech and Financial Stability

- Regulatory measures support innovation in financial technology (FinTech) while safeguarding stability. Efforts are made to address risks associated with digital finance and ensure a balanced approach to innovation and risk management.
- The regulatory framework aims to promote a secure and resilient FinTech ecosystem.

Banking and Financial Stability

- Initiatives aim to safeguard the banking system from interconnectedness risks with non-banking financial institutions. Strengthening governance and risk management practices are key focus areas to enhance financial stability.
- The regulatory measures aim to ensure a robust and stable banking sector.

Climate Finance and Financial Stability

- ❖ Regulatory efforts are directed towards improving climate-related risk assessments and enhancing resilience to environmental risks. This includes integrating climate risks into financial stability frameworks and promoting sustainable finance practices.
- ❖ The regulatory initiatives support the financial system's preparedness for climate-related challenges.

Cyber Security and Financial Stability

- ❖ Strengthening cyber resilience frameworks is crucial to safeguarding the financial system against potential disruptions. Regulatory measures focus on enhancing the security of financial institutions and ensuring robust cyber risk management practices.
- ❖ The initiatives aim to build a resilient and secure financial system.

Domestic Regulatory Initiatives

Note in this section the FSR discusses the initiative taken which are through covered from exam perspective under the RBI Circulars, Beepedia & Different Live classes. . Please read it from there also.

Operational Risk Management and Operational Resilience

- ❖ Efforts are underway to enhance governance and risk management practices in financial institutions. Regulatory frameworks are based on the principle of proportionality, balancing innovation and risk management to support financial stability.
- ❖ The measures aim to improve operational resilience and governance standards.

Voluntary Transition of Small Finance Banks to Universal Banks

- ❖ Regulations are in place to facilitate the transition of small finance banks to universal banks, promoting a more inclusive financial system.
- ❖ The regulatory framework supports the growth and expansion of small finance banks into universal banks.

Reserve Bank of India (Government Securities Lending) Directions, 2023

- ❖ Regulatory measures support the development of the government securities market, enhancing liquidity and efficiency.
- ❖ The directions aim to improve the functioning and depth of the government securities market.

Margining for Non-Centrally Cleared OTC Derivatives

- Initiatives are aimed at managing risks associated with non-centrally cleared OTC derivatives, ensuring robust risk management practices.
- The regulatory measures aim to mitigate risks and enhance the stability of the derivatives market.

Investments in Alternative Investment Funds

- Regulations are designed to support investments in alternative investment funds, promoting diversification and stability in the financial system.
- The measures aim to foster growth and stability in the alternative investment fund sector.

Omnibus Framework for Recognising Self Regulatory Organisations for REs

- A framework is established to recognize self-regulatory organizations for regulated entities, enhancing governance and compliance.
- The regulatory initiatives aim to support the development of self-regulatory organizations and improve oversight.

Credit/Investment Concentration Norms – Credit Risk Transfer

- Regulatory measures address credit and investment concentration norms, ensuring effective risk management and stability.
- The initiatives aim to mitigate risks associated with concentrated exposures.

Framework for Dealing with D-SIBs

- A comprehensive framework is in place to manage risks associated with domestic systemically important banks (D-SIBs), promoting financial stability.
- The regulatory measures aim to ensure the stability of systemically important banks.

Regulatory Framework for Index Providers in the Indian Securities Market

- Regulations ensure transparency and robustness in the operations of index providers, supporting market integrity and stability.
- The regulatory initiatives aim to improve the functioning and reliability of index providers.

Introduction of Beta Version of T+0 Rolling Settlement Cycle on Optional Basis

- The introduction of a T+0 rolling settlement cycle aims to enhance market efficiency and reduce settlement risks.

- The regulatory measures support the development of a more efficient and resilient settlement system.

Other Developments

Customer Protection

- Regulatory initiatives focus on improving customer protection, enhancing service standards, and addressing grievances effectively. The measures aim to ensure a high level of customer trust and confidence in the financial system.

Enforcement

- Enforcement measures ensure compliance with regulatory standards, addressing procyclical activities, and fostering efficiency. The initiatives aim to strengthen regulatory oversight and ensure robust enforcement.

Deposit Insurance

- Enhancements in deposit insurance coverage protect depositors and ensure stability and confidence in the banking system. The regulatory measures aim to provide a secure and stable deposit insurance framework.

Corporate Insolvency Resolution Process

- Improvements in the corporate insolvency resolution process support financial stability through effective frameworks. The initiatives aim to enhance the efficiency and effectiveness of the insolvency resolution process.

Developments in International Financial Services Centre

- Regulatory measures promote the development of the International Financial Services Centre, enhancing its role in the global financial system. The initiatives aim to support the growth and development of the International Financial Services Centre.

Insurance

- Regulations support the growth and stability of the insurance sector, ensuring financial health and resilience. The regulatory measures aim to strengthen the insurance sector's regulatory framework.

Pension Funds

- Initiatives aim to strengthen the regulatory framework for pension funds, promoting stability and growth in the sector. The measures aim to enhance the resilience and performance of pension funds.

Systemic Risk Survey

- The most recent systemic risk survey categorizes all major risk groups to domestic financial stability as ‘medium,’ with respondents expressing optimism about the soundness of the financial system.
- Geopolitical risks, tightening of global financial conditions, and capital outflows are identified as significant near-term risks, underscoring the importance of continued vigilance and proactive measures to maintain stability.

——————— The End——————-