Financial Stability Report 2022

Recently, the Reserve Bank of India published the 25th issue of the Financial Stability Report (FSR) which contains inputs from all financial sector regulators. This year's report primarily comprises an overview of foreign regulatory and supervisory procedures. It represents the collective analysis of the Financial Stability and Development Council's (FSDC) Sub-Committee on threats to financial stability and the resilience of the financial system.

Highlights of the Report

- **Non Performing Assets:**
    - Concerning non-performing assets (NPA), the banking system's asset quality has improved, with the GNPA ratio falling from 7.4% in March 2021 to a six-year low of 5.9% in March 2022.
    - **Reason:** Banks have lowered the GNPA ratio through recoveries, write-offs, and slippage reductions.
    - The capital to risk-weighted assets ratio (CRAR) of scheduled commercial banks (SCBs) has reached a new high of 16.7%.
- **Provisioning Coverage Ratio (PCR):**
    - The proportion of funds set aside by a bank for bad debt losses is known as the PCR. A high PCR might help banks protect themselves against losses if NPAs begin to rise rapidly.
    - It increased from 67.6% in March 2022 to 70% in March 2022.
- **Systemic Risk Evaluation:**
    - Global spillovers and financial market volatility were elevated to the 'high' risk category in the Reserve Bank's most recent systemic risk survey (SRS) in May 2022.
    - The key drivers of global risks are believed to be global economic uncertainty, commodity price changes, geopolitical situations, and monetary tightening in advanced economies.
- **Banking Industry:**
    - Banks' capital and liquidity levels have also been strengthened, while asset quality has improved.
    - Banks and non-banking financial firms both have enough capital buffers to withstand shocks.
    - Non-banking financial firms (NBFCs) maintain adequate capitalization.
    - Bank loan growth has been continuously increasing and is already in the double digits.
- **Markets and the Domestic Economy:**
    - High-frequency indicators in the Indian economy suggest a steady but unevenly strengthened recovery in the first quarter of 2022-23.
    - Market risks are developing as a result of foreign portfolio investment outflows and the strong strengthening of the US currency.
- **Regulatory Initiatives and Other Financial Sector Developments:**
    - Improving regulation of nonbank financial intermediation is a top objective.
    - The evolution of the crypto ecosystem, as well as the larger significance of technology in financial services, are attracting more attention.

Concerns Raised by the Report

- **Fintech Risks:**

  - The Indian fintech business is one of the world's fastest-growing Fintech markets. India has the greatest rate of fintech adoption in the world (87%) and will get $8.53 billion in financing during 2021-22.
  - According to the report, the introduction of fintech has exposed the banking sector to new risks such as data privacy, cyber security, consumer protection, competition, and compliance with AML (anti-money laundering) laws.

- **Risk from BigTechs (big technology firms):**
  - BigTechs (large technology enterprises) represent a danger to financial stability since they may scale very quickly and cause significant disintermediation of existing institutions.
  - Furthermore, complex interconnected operational links between BigTech enterprises and financial institutions may result in concentration and contagion concerns, as well as difficulties pertaining to possible anti-competitive behaviour.
- **Macroeconomic Financial Risks:**
  - The global economy's outlook is shrouded by ambiguity as a result of the European conflict, central banks' front-loaded monetary policy normalisation in reaction to stubbornly rising inflation and numerous waves of the COVID-19 pandemic.
  - Stagflation risks are increasing for both emerging economies and advanced economies, as tightening financial conditions threaten to slow development and increase inflationary pressures.
  - Global spillovers include an increase in US interest rates and the possibility of a recession, the Ukraine conflict and an increase in oil prices.
- **Others:** Disruptions in global supply chains, de-globalisation, and climate change all pose risks to the finance sector's asset side exposure. Other than this cryptocurrencies are also a threat as anything that derives value based on make-believe, without any underlying, is just “speculation under a sophisticated name”.

Steps to strengthen the financial system:

On the domestic front, efforts to strengthen the financial system's resilience continue.

- Regulators have taken a number of steps to strengthen financial intermediaries, promote the digitization of the economy, grow market sectors, increase retail investor access and safeguard depositors'/investors' interests.
- The rapidly changing financial landscape compels regulators to be vigilant in order to not only protect the financial system from shocks but also to harness its potential to fuel economic development.