Financial Stability Report (FSR) 2023 [Latest FSR Report by RBI]

Financial Stability Report (FSR) is a biannual report released by the Reserve Bank of India (RBI). 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. As per the report, the country's financial system remains stable despite weakening domestic growth despite the risks from global economic uncertainties and geopolitical developments.

The aspirants would find this article very helpful while preparing for the IAS Exam.

Financial Stability Report 2023 (June)

The RBI released the 27th Financial Stability Report in June 2023. The highlights of the report are as under.

- The global economy is facing heightened uncertainty amidst banking system fragility in certain countries, persisting geopolitical tensions and moderating but elevated inflation.
- But in spite of global obstacles, the Indian economy and financial system are showing resilience, supported by strong macroeconomic fundamentals.
- The economy is on a sustained growth path owing to the existing growth momentum, closing the current account deficit and increasing forex reserves, ongoing fiscal consolidation and a robust financial system.
- Healthy balance sheets of banks and corporates are producing a new credit and investment cycle and brightening the prospects of the Indian economy.
- The capital-to-risk-weighted assets ratio (CRAR) and the common equity tier 1 (CET1) ratio of scheduled commercial banks (SCBs) rose to historical highs of 17.1 per cent and 13.9 per cent, respectively, in March 2023.
- SCBs' gross non-performing assets (GNPA) ratio continued its downtrend and fell to a 10-year low of 3.9 per cent in March 2023 and the net non-performing assets (NNPA) ratio declined to 1.0 per cent.
- Macro stress tests for credit risk indicate that SCBs would be able to comply with the minimum capital requirements even under severe stress scenarios. The system-level capital to risk-weighted assets ratio (CRAR) in March 2024, under baseline, medium and severe stress scenarios, is projected at 16.1 per cent, 14.7 per cent and 13.3 per cent, respectively.

Financial Stability Report 2022 (December)

The Reserve Bank released the 26th issue of the Financial Stability Report (FSR) on the 29th of December 2022.

- The report indicates the collective assessment of the Sub-Committee of the Financial Stability and Development Council (FSDC) on risks to financial stability and the resilience of the financial system.

Highlights of the Report

- **Domestic Economy and Markets**
  - The Indian economy is facing significant global headwinds. However, the economy has showcased sound macroeconomic fundamentals.
  - The healthy financial and non-financial sector balance sheets are giving strength and resilience to the financial system stability.
  - Increasing demand for bank credit and early signs of a revival in the investment cycle are benefiting from improved asset quality, a return to profitability, resilient capital and liquidity buffers.
  - These strengths are helping the financial system cope with external spillovers, tightening financial conditions across the world and high volatility in financial markets.
- **Financial Institutions: Soundness and Resilience**
- **Scheduled Commercial Banks (SCBs)**
  - The capital positions of scheduled commercial banks have remained strong.
    - The Capital to Risk-Weighted Assets Ratio (CRAR) and Common Equity Tier 1 (CET1) ratio of SCBs stood at 16% and 13% respectively.
    - The profit after tax of scheduled commercial banks has also witnessed a growth of 40.7% in the first half (H1) of FY 2022-23 due to strong growth in net interest income and a reduction in provisions.

- **Non-Banking Financial Companies (NBFCs)**
  - The NBFCs sector has also recovered strongly post the second wave of COVID-19, with asset quality showing a continuous improvement.

- **Non-performing assets (NPA)**
  - The gross non-performing assets (GNPA) ratio of scheduled commercial banks has steadily reduced to a seven-year low of 5.0% in September 2022.
  - Further, the net non-performing assets (NNPA) have also reduced to a 10-year low of 1.3% of total assets.

  Inflation
  - Inflation, despite being on the higher side, is retreating on account of various monetary policy actions and supply-side interventions.

Concerns Raised by the Report

- **Global economic outlook**

    - Since the June 2022 Financial Stability Report (FSR), the global economic outlook has deteriorated further.
    - International organisations such as the International Monetary Fund (IMF), the World Bank (WB) and the Organisation for Economic Co-operation and Development (OECD) have downgraded their global growth projections.
- **Macrofinancial Risks**
    - The report acknowledged that the global economy is facing significant roadblocks along with recessionary risks.
    - The collective impact of multiple shocks has led to the tightening of financial conditions and increased volatility in the financial markets.
    - Further, the challenges are much harsher for emerging market economies on account of global spillovers, debt fragility, currency volatility and capital outflows.
- **The Reserve Bank's Systemic Risk Survey (SRS)** notes that the risk perception from global spillovers and financial market volatility grew further and remained in the **'high' risk category.**
    - Monetary tightening in advanced economies, geopolitical risks, and uncertainty in global growth are said to be the key drivers of global risks.

Risks to Financial Stability

- Volatility in the exchange rate and strengthening of the US dollar
- Increase in crude oil prices
- Global economic slowdown
- Increase in current account deficit and capital outflows
- Increased inflationary pressures
- Geo-political risks on account of the Russia-Ukraine war

Regulatory Initiatives

- The Financial Stability and Development Council (FSDC), chaired by the Union Finance Minister, met in September 2022 and discussed early warning indicators for the economy.
- The FSDC also held deliberation on enhancing the efficiency of the existing financial systems, issues with respect to governance, strengthening the cyber security framework, issues associated with the financing of the power sector, and inter-regulatory issues relating to Gujarat International Finance Tec-City (GIFT) - IFSC among others.
- Regulators adopted various measures in order to improve the robustness and resilience of the Indian financial system. They include:
    - Reserve Bank of India (Unhedged Foreign Currency Exposure) Directions, 2022
    - Review of Regulatory Framework for Asset reconstruction companies (ARCs)
    - Appointment of Internal Ombudsman by the Credit Information Companies
    - Guidelines on Digital Lending
    - Liberalisation of Foreign exchange (Forex) Flows

- Digital Rupee (e₹)
- Digitisation of Kisan Credit Card

Financial Stability Report 2022 (June)

In June 2022, 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 the 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

Financial Stability Report 2021

The Reserve Bank of India released the 24th issue of the Financial Stability Report (FSR) on December 29, 2021.

Highlights

The highlights of the financial stability report 2021 are as follows:

Macro Financial Risks

- The global economic recovery has been losing momentum in the second half of 2021 in the face of resurfacing COVID-19 infections, the new variant Omicron, supply disruptions and bottlenecks, elevated inflationary levels and shifts in monetary policy stances and actions across advanced economies and emerging market economies.

Domestic Economy and Markets

- On the domestic front, progress in vaccination has enabled the recovery to regain traction after the debilitating second wave of the pandemic, notwithstanding signs of slowing pace more recently.
- The corporate sector is gaining strength.
- Bank credit growth is showing signs of a gradual recovery, led by the retail segment, although the flow of credit to lesser rated corporates remains hesitant.
- Micro, small and medium enterprises (MSMEs) as also the microfinance segment are reflecting signs of stress.

Financial Institutions: Soundness and Resilience

- The capital-to-risk-weighted assets ratio (CRAR) of scheduled commercial banks (SCBs) rose to a new peak of 16.6 per cent and their provisioning coverage ratio (PCR) stood at 68.1 per cent in September 2021.
- The CRAR of urban co-operative banks (UCBs) stood at 12.9 per cent in September 2021 while that of NBFCs stood at 26.3 per cent.

- Macro stress tests for credit risk indicate that the gross non-performing asset (GNPA) ratio of SCBs may increase from 6.9 per cent in September 2021 to 8.1 per cent by September 2022 under the baseline scenario and to 9.5 per cent under a severe stress scenario.
- SCBs would, however, have sufficient capital, both at the aggregate and individual levels, even under stress conditions.

Regulatory Initiatives and Other Developments in the Financial Sector

- Financial regulators are devoting attention to distilling the lessons learned from the pandemic, analysing the ripple effects of rollback of policy support measures and enhancing the resilience of the financial system.
- On the domestic front, Government and financial sector regulators continued with their efforts towards achieving a sustainable recovery and enhancing the resilience of the financial system.

Important Regulatory Measures

- Access for Non-banks to Centralised Payment Systems.
- A Comprehensive Financial Inclusion Index (FI-Index) has been introduced.
- Payments Infrastructure Development Fund (PIDF) Scheme extended to street vendors.
- The three existing Ombudsman Schemes for Banks, NBFCs and System Participants were merged into a single scheme viz., the Reserve Bank – Integrated Ombudsman Scheme, 2021 adopting the 'One Nation One Ombudsman' approach for grievance redressal.

Financial Stability Report 2020

On July 24, 2020, the Reserve Bank of India released the 21st Issue of the Financial Stability Report (FSR). A collective assessment of the Sub-Committee of the Financial Stability and Development Council (FSDC) works this report.

In response to the outbreak of the Novel Coronavirus in India in the year 2020, a combination of fiscal, monetary and regulatory interventions on an unprecedented scale ensured normal functioning of financial markets.

Global Economic prospects faced a downfall in the first half of the year due to the pandemic.

Given below is an overview of the Financial Stability Report 2020. IAS Exam aspirants can refer to the following important points regarding the report:

- **Macro-Financial Risks**
  - The discovery of a vaccine shall impact the further development of financial markets
  - Global geopolitical tensions, overleveraged non-financial sectors, the ongoing losses of jobs and incomes impart heightened uncertainty to the outlook
- Credit growth of Scheduled Commercial Banks slid down to 5.9% by March 2020

- The capital to risk-weighted assets ratio (CRAR) of Scheduled Commercial Banks slid down to 14.8% in March 2020
- The gross non-performing assets (GNPA) ratio fell to 8.5%
- Overall provision coverage ratio (PCR) increased from 61.6% to 65.4%
- **Non-Banking Finance Companies (NBFC's) and Housing Finance Companies (HFC's)**
  - Asset Management Companies/Mutual Funds (AMC-MFs) were the biggest fund providers in the system
  - NBFCs and HFCs were the biggest fund receivers in the system
- To maintain market integrity and resilience in the face of severe risk aversion by market participants during the lockdown, major regulatory measures were taken up by the authorities
- According to the latest systemic risk survey, all major risk groups, viz., global risks, risk perceptions on macroeconomic conditions, financial market risks and institutional positions were perceived as 'high', affecting the financial system.
- Among macroeconomic risks, risks to domestic growth and fiscal housekeeping were perceived to be 'very high', while risks on account of reversal/slowdown in capital flows, corporate sector vulnerabilities, real estate prices and household savings were perceived to be 'high'
- Major Causes of Significant Slowdown in Global Growth
  - The biggest reason was the COVID-19 lockdown which massively slowed down the economic growth
  - Geo-Political Risks
  - Trade tensions

Financial Stability Report 2019

Banks

1. Credit growth of Private banks is in double-digit at 16.5%
2. Credit growth of Scheduled Commercial Banks (SCB) has slowed at 8.7%
3. Gross Non Performing Assets (GNPA) of Scheduled Commercial Banks remained unchanged at 9.3% between March and September 2019.
4. The sturdiness of the Banking sector can be assessed by looking at the Provision Coverage Ratio (PCR) of all SCB's which rose to more than 60%.
5. There is improvement in capital adequacy in state-run lenders after recapitalisation.
6. The size of the inter-bank market continued to shrink.
7. Reduction in the contagion losses of the banking sector due to better capitalisation of Public Sector Banks (PSB's) and reduction in the inter-bank market.

Non-Banking Finance Companies (NBFC's) and Housing Finance Companies (HFC's)

1. The above two are relying more on long term bank loans for their funding.
2. Bad loan ratio of NBFC's increased.

3. Mutual Funds reduced their investment in commercial papers

Increase in Fraud Reporting

1. 21 fraud cases reported were above Rs 1000 crores. It was reported in the 1st half of 2019-20.
2. Total Fraud reported was worth Rs 1.13 lakhs.

Financial Sector: Regulations and Developments

1. The Insolvency and Bankruptcy Board of India (IBBI) is making steady progress in the resolution of stressed assets.
2. To make corporate governance stronger the Insurance Regulatory and Development Authority (IRDA) has undertaken various measures.
3. For the development of payment infrastructure, to improve banks governance culture, for resolution of stressed assets RBI has initiated measures to introduce liquidity management regime.
4. More citizens have been brought under Pension net by the Pension Fund Regulatory and Development Authority.

Major Causes of Significant Slowdown in Global Growth

As per the report, following causes are contributing factors to the slowdown in global growth.

1. Trade tensions
2. Delay in Brexit deal
3. Oil Market Disruptions
4. Geo-Political Risks
5. Impending Recession

Domestic Macro-Financial Risks

1. Reduction in aggregate demand in Quarter 2 of 2019-20.
2. The outlook for capital inflows appears positive.
3. Due to the sustained global slowdown exports from India could be impacted.
4. Current Account Deficit would be under control due to muted energy price outlook

Major Challenge for Domestic Economy

Reviving the twin engines of

1. Consumption
2. Investment

The above factors have played a significant role in dampening business sentiment and consumer confidence.

Frequently Asked Questions about Financial Stability Report (FSR)

Q1. Who publishes Global Financial Stability Report?

Ans: The Global Financial Stability Report is released by the International Monetary Fund (IMF) twice in a year, in the months of June and October.

Q2. How frequently the Financial Stability Report is published and by whom?

Ans: The Reserve Bank of India publishes the Financial Stability Report under half-yearly publications.

Q3. What are the major risks to financial stability according to the Financial Stability Report 2022?

Ans: According to the Financial Stability Report the following are the risks to the stability of the economy:

Volatility in capital flows and exchange rates;
De-globalisation
Faltering of economic recovery;
Aggressive monetary policy tightening by AEs;
De-anchoring of inflation expectations;
Disruptions in global supply chains;
Climate change risk to the asset side exposure of financial sector.

Q 4. What is the significance of the Financial Stability Report?

Ans: The Financial Stability Report reflects the collective assessment of the Sub-Committee of the Financial Stability and Development Council (FSDC) on risks to financial stability and the resilience of the financial system.

Q5. What are Non Performing Assets (NPA), Gross Non-Performing Assets and Net Non-Performing Assets?

Ans: NPA: In most cases, debt is classified as non-performing, when the loan payments have not been made for a minimum period of 90 days.

Gross non-performing assets are the sum of all the loans that have been defaulted by the individuals who have acquired loans from the financial institution.

Net non-performing assets are the amount that is realized after the provision amount has been deducted from the gross non-performing assets.