Economic Intelligence Cell
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Macro Insights
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FSR-Dec'22-RBI

Reserve Bank released the 26th issue of the FSR, which 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.

Highlights:

- ☞ *The pandemic tested financial sector resilience in unparalleled ways.*
- ☞ *The financial system has, emerged healthier than was the case after the global financial crisis.*
- ☞ *Indian banks' asset quality may deteriorate but lenders have enough capital to withstand a severe shock.*
- ☞ *As the economic outlook remains clouded, the global regulatory regime, which was on a pause mode with regards to ushering in more robust architecture, is putting the process back on course.*
- ☞ *Significant regulatory and supervisory attention to understand the layered impact of climate change on the economy and financial sector is also an ongoing endeavour.*
- ☞ *Domestically, efforts to develop the regulatory architecture to increase resilience of the financial sector continue apace.*
- ☞ *The resilience of open-ended mutual funds, managing debt overhangs in the non-financial corporate sector and management of stressed assets remain policy priorities going forward.*
- ☞ *The new area of sustainable finance is also receiving due importance.*

Summary:

Highlights of FSR-Dec'22 are given below:

<u>Chapter 1:- Macro financial Risks</u>

1. Global economic outlook has deteriorated. Risks to financial stability have become accentuated as central banks have aggressively front-loaded monetary policy tightening synchronously across countries.
2. Indian Economy remains vulnerable to formidable global headwinds, which act as a drag on the domestic economic recovery.

Key Takeaways For The Banking Sector

1. Bank credit growth (y-o-y) by SCBs reached 17.5% in Sept’22.
2. Loan books of PSBs grew at their fastest pace since Sept’13. Lending by private sector banks (PVBs) continued to outpace that of PSB counterparts.
3. Accumulation of deposits in the past few years has enabled banks to fund the growing credit demand. Banks have also been drawing down their HQLAs to fund credit growth.
4. The GNPA ratio stood at 5.0% in Sept’22, down from 5.7% a quarter ago. Reduction in slippages or fresh accretions to NPAs was a major contributor to the reduction in overall NPAs.
5. With the rise in risk-weighted assets, capital levels have reduced both CRAR and CET1 ratios have declined, though they remain well above regulatory requirements.
6. MSME sector turned around in H2:2021-22 and sustained this momentum in H1:2022-23. Lending by PVBs grew strongly, whereas PSBs recorded a relatively moderate growth.

Chapter 2:- Financial Institutions: Soundness And Resilience

1. Credit and Deposit Growth: SCBs’ credit growth (y-o-y), which started picking up during H2:2021-22, sustained its momentum and gathered pace to touch a decadal high of 17.4% as on Dec 16, 2022, a level last observed during 2011. Aggregate deposits recorded some moderation, growing at 9.4% as on Dec 16, 2022.
2. Asset Quality: The GNPA Ratio of SCBs continued to decline and stood at a seven-year low of 5.0% in Sept’22. All SCBs’ Net NPA ratio also declined by 70 bps in Mar’22 to 1.7%.
3. Sectoral Asset Quality: The asset quality of all SCBs improved across sectors and broad based improvement in GNPA ratio in respect of the industrial sector, though it remained elevated for gems and Jewelry and construction subsectors.
4. Capital Adequacy: The capital to risk weighted assets ratio (CRAR) of SCBs declined by 77 bps from Mar’22 level on account of increase in risk weighted assets (RWAs) as lending activity picked up during H1:2022-23.
5. Earnings & Profitability: Net interest margin (NIM) of SCBs witnessed an improvement of 20 bps between Sept’21 and Sept’22. Profit after tax (PAT) grew 40.7% in Sept’22, led by strong growth in net interest income (NII) and significant lowering of provisions.

Chapter III: Regulatory Initiatives in the Financial Sector

1. The extant regulatory framework on ARCs has been amended to strengthen governance norms, enhance transparency and disclosures, strengthen prudential requirement and increase the efficacy of Asset reconstruction companies (ARCs).
2. Regulations Review Authority 2.0 (RRA) made recommendations on reduction of regulatory burden, rationalization of reporting mechanism and streamlining of regulatory instructions.
3. CICs brought under the Internal Ombudsman (IO) framework.
4. Exports and Imports may be denominated and invoiced in INR; the exchange rate between the currencies of two trading partner countries may be market determined; and settlement of trade transactions under this arrangement shall take place in INR.
5. A pilot for e₹ in the wholesale segment (e₹-W) for settlement of secondary market transactions in government securities was launched on Nov 1, 2022 with the participation of nine banks. The first pilot e₹ in the retail segment (e₹-R) was launched on Dec 1, 2022 in select locations in a closed user group comprising customers and merchants.
6. Pilot project on digitalisation of KCC lending is expected to play a pivotal role in facilitating credit flow to the unserved and underserved rural population by making the credit process faster and more efficient.
7. Standard operating procedure (SOP) for Interoperable Regulatory Sandbox (IoRS) issued to facilitate testing of innovative products/services whose business models/activities/features fall within the regulatory ambit of more than one financial sector regulator.

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