

## **Financial Stability Report June 2019 - RBI**

### **Why in news?**

The Reserve Bank of India recently released the 19th issue of the Financial Stability Report (FSR).

### **What is the FSR?**

- The FSR reflects the collective assessment of the Sub-Committee of the *Financial Stability and Development Council* (FSDC) on risks to financial stability.
- It gives a picture of the resilience of the financial system.
- The Report also discusses issues relating to the development and regulation of the financial sector.
- The report analyses the overall state of the various segments as well as highlights the risk-related issues that could cause potential challenges.

### **How is the banking system performing?**

- The Financial Stability Report notes that the state of the banking system is encouraging.
- The gross non-performing asset (NPA) ratio is 9.3% for all banks as of March 2019.
- This is likely to come down to 9% by March 2020.
- More importantly, the asset recognition process is completed and from now on, the NPAs will be on new credit is given and not on earlier lending.
- Credit growth of scheduled commercial banks (SCBs) picked up, with public sector banks (PSBs) registering near double-digit growth.
- Capital adequacy of the SCBs improved after the recapitalization of PSBs.
- The PSBs have, in particular, improved the Provision Coverage Ratio to 60.8% as against an average of 60.6% for the entire system.
- In all, the growth in credit has picked up for PSBs which is a sign that they are on the road to normalcy.
- The fact that NPAs are under control means that the other parameters will only improve.
- Lower NPAs mean fewer provisions which in turn improve profits and remove pressure from the net worth and hence further demand for capital.
- The RBI has also indicated that the recovery rate for the cases under the IBC

is around 40-45%.

- This is definitely better than the ratios of less than 20% that was the norm prior to the implementation of the IBC.
- **Need for caution** - The report points out that the problem areas in terms of NPAs still remain.
- In metals, mining and engineering, the NPA ratios are above 25%.
- In construction, gems and jewellery and auto that follow next, the ratios are 21.8%, 21.5% and 18.4% respectively.
- It is to be seen as to how the new [norms of dealing with stressed assets](#) by the RBI work out for these sectors.

### **What is RBI's observation on NBFCs?**

- **Significance** - The FSR highlights the Non-Banking Financial Companies' importance in the country's financial system.
- Around 70% of their liabilities are raised from the public, with a size of Rs 28.8 lakh crore.
- Compared with the banking assets size of roughly Rs 140 lakh crore, the NBFC sector forms around 20%.
- This conveys the importance of this sector, as it caters to the needs of several corners where probably banks are less interested.
- **Performance** - As per the report, in general, the well-run NBFCs have no problem and are progressing smoothly.
- However, those which started off with a fundamental asset/liability management (ALM) mismatch have faced a series of challenges.
- More regulation which involves putting structures in place which are already in progress is the possible solution in this regard.
- **Loan share** - The combined loan share of the NBFCs and HFCs (Housing Finance Companies), in comparison with the joint share of banks, is fairly impressive.
- So, they are as important as the banks when it comes to providing finance to the household segment.
- **Concerns** - The worrisome part is that the delinquency rates (wrongdoings) tend to be higher.
- It thus calls for a higher degree of introspection in the NBFC sector.
- **Contagion effect** - Given the size of the housing finance companies (HFCs), they tend to be the largest of the NBFCs.
- Now, their combined strength makes them comparable to the banks.
- This means that any major shock or failure can also have far-reaching implications for the financial system.
- This has already been witnessed in case of the mutual fund industry which

has been affected by their investments in a paper issued by the NBFCs.

- Their dominance in the corporate bond market is well-known and the progress here too will be impeded in case of such a shock.
- Given these, surveillance is the way out to ensure that the NBFCs continue to grow in a disciplined and secure manner.

**Source: Firstpost, Business Line**

## Quick Facts

### Financial Stability and Development Council

- FSDC was established in 2010 with Union Finance Minister as its Chairman.
- Its members include -
  - i. the heads of financial sector regulators (RBI, SEBI, PFRDA, and IRDA)
  - ii. Finance Secretary, Department of Economic Affairs
  - iii. Secretary, Department of Financial Services
  - iv. Chief Economic Adviser
  - v. Chairman of the Insolvency and Bankruptcy Board
- FSDC has two core functions:
  - i. to perform as an apex level forum to strengthen and institutionalize the mechanism for maintaining financial stability
  - ii. to enhance inter-regulatory coordination and promote financial sector development in the country
- It focuses on financial literacy and financial inclusion.
- It monitors macro-prudential supervision of the economy and also assess the functioning of the large financial conglomerates.
- The FSDC sub-committee is chaired by the Governor of RBI.

**Related News:** [Financial Stability Report January 2019](#), [Significance of the NBFC Sector](#)