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