Financial Stability Report - RBI

Why in news?

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Reserve Bank of India has recently released the financial stability report.

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What are the highlights?

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- **NPA** - RBI report warns that the gross non-performing assets (GNPAs) could rise.
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- The *GNPAs* of scheduled commercial banks could rise from 11.6% in March 2018 to 12.2% in March 2019.
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- This would be the highest level of bad debt in almost two decades.
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- It is more worrying for GNPAs of banks under *prompt corrective action framework*.
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- It is expected to rise to 22.3% in March 2019, from 21% in March 2018.
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- **Capital** - GNPAs will increase the size of provisioning for losses and affect banks' capital position.
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- The capital to risk-weighted assets ratio of the banking system as a whole is expected to drop.
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- It could come down from 13.5% in March 2018 to 12.8% in March 2019.
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- **Bank frauds** - RBI notes that more than 85% of frauds could be linked to PSBs.
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- But, their share of overall credit is only about 65%.
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- The PSBs are far more prone to fraud than the private banks.

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- This is significant in light of the recent Punjab National Bank scam.
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- It is possibly due to the corporate governance issues in public sector banks.
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- This also largely contributed to the weak lending practices, the core of the NPA crisis.
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What are the concerns?

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- **Banks** - NPA crisis has affected the banking system and impeded credit growth in the economy.
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- It was expected to be reaching to the lowest levels.
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- But RBI report comes as a caution to the health of the banks and the economy.
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- **Economy** - Economy has registered a healthy growth rate of 7.7% in the recent quarter.
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- The deteriorating health of banks is in contrast to the recovering economy.
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- **External risks** - The RBI, however, has warned about the rising external risks.
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- It poses a significant threat to the economy and to the banks.
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- Credit has already started to flow out of emerging markets such as India.
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- This is due to the\n
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  i. tightening of monetary policy by the US Federal Reserve
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  ii. increased borrowing by the U.S. government
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- **Prices** - The increase in commodity prices is another risk on the horizon.
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- This could pose a significant threat to the rupee and the fiscal and current

account deficits.
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- All these factors could well combine to increase the risk of an economic slowdown.
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- It could, in turn, exert pressure on the entire banking system.
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What is the way forward?

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- RBI expects improvement in the capital position of banks with
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i. the government's recapitalisation plan for banks
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ii. the implementation of the Insolvency and Bankruptcy Code
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- But beyond these, government should consider changes to aspects of operational autonomy and the ownership of PSBs.
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- The governance reforms at PSBs, if implemented, can help improve their financial performance.
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- It could also reduce their operational risks.
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Source: The Hindu

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Quick Facts

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Gross and Net NPAs

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- Gross non-performing assets (GNPAs) refer to the sum of all the loans that have been defaulted by the borrowers within the provided period of 90 days.
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- The net non-performing assets are the amount that results after deducting provision for unpaid debts from gross NPA.
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- The GNPAs does not amount to the actual loss of the organization.
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- But net non-performing assets amount to the actual loss, as the provision for unpaid loans has already been deducted.
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Prompt Corrective Action (PCA)

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- PCA is primarily to take appropriate corrective action on weak and troubled banks.
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- The RBI has put in place some trigger points to assess, monitor and control banks.
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- The trigger points are on the basis of CRAR (a metric to measure balance sheet strength), NPA and ROA (return on assets).
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- Based on each trigger point, the banks have to follow a mandatory action plan.
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- It prohibits them from undertaking fresh business activities such as opening branches, recruiting talent or lending to risky companies.
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- RBI could take discretionary action plans too apart from these.
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