

Financial Stability Report

RBI issued Report on Financial Stability, June 2018. Foreword of the report as under:

“The past is never dead. It isn’t even past “– William Faulkner’s words sound prophetic as the world stands on the eve of a decade since the collapse of Lehman Brothers. While the tremors of financial rumble are still heard in some parts of the global economy, substantial progress has overall been made. The world as we see it now is less leveraged, the banking sectors more capitalised and the regulatory infrastructure more robust. At the same time, the post-World War II consensus on the global order – especially on trade front – appears to be under strain. In parallel, large advanced economy central banks are normalising or planning to normalise their extraordinary monetary interventions, with important implications for the global economy and financial markets.

Domestically, the economy appears to be gathering strength although global commodity price swings and turbulent capital flows are a constant reminder to our fast-growing economy that there can be little scope for complacency, if at all any. Some of the structural vulnerabilities of the banking sector in the form of legacy impairments are finally being tackled headlong. The revised framework of February 12th for dealing with stressed assets issued by the Reserve Bank should incentivise early identification and resolution of credit risk. The Insolvency and Bankruptcy Code (IBC), 2016 is emerging as the lynchpin for resolving stressed assets in a time - bound manner. These developments bode well for allocative efficiency and financial stability in the medium term even if there is some short-term pain in the process.

The ongoing churning in the financial sector following the operational-risk related incidents, the prompt corrective action (PCA) on under-capitalised banks to prevent further deterioration and gradually nurse them back to health, and the disintermediation underway from bank to non-bank finance are all inevitable given the circumstances but need to be monitored carefully. At such juncture, the Government’s front-loaded recapitalisation programme for the beleaguered public sector banks (PSBs) should impart robustness to the financial sector as a whole; however, governance reforms and market capital-raising appear to have again taken the backseat at the PSBs.

Some of these salient developments and attendant risks are documented in the Report. Starting with global and domestic macroeconomic assessment, the report moves on to a health check of the financial system through the lens of stress tests and contagion analysis, which – while not being projections or forecasts – capture the state of the financial system under adverse but plausible scenarios. Such assessment of financial stability is key to taking right measures so as to evolve our financial sector to be more resilient following a difficult decade in the banking sector; it will help ensure, as Robert Browning said “My sun sets to rise again”.

(Foreword of the Report)

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