The Big Picture: RBI’s Financial Stability Report

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Why in News

The **Reserve Bank of India (RBI)** has released the **23rd edition of its Financial Stability Report (FSR).**

> The Report discusses issues relating to development and regulation of the financial sector.

Key Points

- **Financial Stability Report:** The FSR which is **published biannually** reflects the collective assessment of the **Sub-Committee of the Financial Stability and Development Council** (FSDC - headed by the Governor of RBI) on risks to financial stability and the resilience of the financial system.
- **Impact of Vaccination:** As per the RBI, Policy support & **Vaccination** have been nurturing global recovery though the **second wave of Covid-19** has dented domestic economic activity.
- **Gross NPA for Banking Sector:** The latest report suggests that the gross **Non-Performing Assets (NPAs)** for the whole banking sector is expected to slip but not as great a level as mentioned in previous **FSR.**
- **MSME Sector at Risk:** In the retail loans and the loans given to the **MSMEs** sector, the NPA level or the quality of credit may actually deteriorate in the months to come which will adversely impact consumer credit.
    - The stress level forecast for the banking sector is seen to be improving and the banks seem to be having better capital provisioning. But the MSME sector is facing stress which is an issue of concern.

23rd Financial Stability Report

- **Gross NPA Ratio:** The **Gross Non-Performing Assets (NPAs)** ratio was found under control at 7.5% as of March 2021, contrary to all expectations of NPAs increasing due to the pandemic.
    - The stress tests indicate that under normal conditions the NPA ratio will increase to 9.8% by March 2022.
- **NPA Ratio under Stress Cases:** Under the medium stress scenario, where **GDP** growth is at 6.5%, the gross NPA ratio could rise to 10.36%.
    - Under the severe stress scenario, where GDP growth is at 0.9%, the gross NPA ratio for the banking sector may rise to 11.22%.
- **Rise in Fiscal Deficit:** As per the **budget 2020-21**, the fiscal deficit was at 9.3%. The **fiscal deficit** is likely to increase.
    - As per the recent data, a burden of around Rs. 3 lac crore is likely to be added which will increase the fiscal pressure to about Rs. 14 lac crore which further adds 3-4% to the fiscal deficit of 9.3%.
- **Increased Dependence on Govt. Securities:** One more important area of concern is the increasing dependence of the banking sector on government securities.
    - Banks are finding recourse in investing their liquidity in government securities.

- **RBI's Assistance amid the Crisis:** There are two major factors that have led the GDP in negative growth; **Gross Fixed Capital Formation** and **Private Final Consumption Expenditure.**
    - It is the expenditure incurred on the final consumption of goods and services by the resident households and non-profit institutions serving households.
    - During this period, RBI has provided support to the banking sector in terms of credit support.
    - RBI has provided collateral support and has opened new credit lines.

        The **plan of giving moratorium** during tough times and rolling back the same has helped to keep things under check.

Way Forward

- **RBI's Advice:** The FSR is advising the banks to reinforce their capital and liquidity positions to fortify themselves against potential balance sheets stress.
- **Generating Demand in Economy:** What is now required is to generate demand in the economy. The banks and the significant leaders in the economy have a key role to play in this. When the demand begins to rise, only then economic recovery can occur.
- **Second Generation Reforms:** The second generation reform needs to be initiated. The most important segment of the second generation reform is the rural development including agriculture & allied sectors and small scale industries.

    Reviving the rural economy furthers the scope of overall economic growth.
- **Increasing the Efficiency of Public Sector Banks:** The difference between the Private Sector and Public Sector Banks is almost 5% points in terms of NPA.
    - In the case of private sector banks, the NPA in a baseline scenario will get to around 6% whereas in the public sector banks it will be almost double; 12%.
    - The public sector banks need to be made more efficient, if necessary the **ownership changes (privatisation) need to be done too.**

        It needs to be noted that the private sector banks have responded better to the economic crisis and have proven themselves to be comparatively less affected by the Covid-19 pandemic.
- **Bringing Bad Banks in Action:** In order to bring the banking industry out of this challenging time, the creation of **Bad Banks** is the most crucial step that needs to be taken.
    - A bad bank is an **Asset Reconstruction Company (ARC)** or an Asset Management Company (AMC) that takes over the bad loans of commercial banks, manages them and finally recovers the money over a period of time.
    - Similar to this, in 2002, the **SARFAESI Act** was enacted for hiving off the bad assets which led to a significant decline in NPAs.
- **Meeting the Financial Needs:** Stronger capital positions, good governance and efficiency in financial intermediation can be the touchstones of this endeavour so that financing needs of productive sectors of the economy are met while the integrity and soundness of banks and financial institutions are secured on an enduring basis.