# Financial Stability Report, June 2024

**For Prelims:** **Reserve Bank of India**, **Non-Performing Assets**, **Bad Loan**, **Digital Personal Loan**, **SARFAESI ACT, 2002**, **Capital Adequacy Ratio**, **Inflation**, **Disinflation**

**For Mains:** Issues Related to Banking Sector, Difference in NBFC and Banks.

**Source: RBI**

### Why in News?

The **Reserve Bank of India (RBI)** bi-annual **Financial Stability Report (FSR) for June 2024** underscores India's robust financial resilience amid global uncertainties while **highlighting concerns over the proliferation of digital personal loans** and their impact on financial stability measures.

## What are the Key Highlights of the FSR for June 2024?

- **Global Macrofinancial Risks: The report states that the global economy and financial system are exhibiting resilience amidst heightened risks and uncertainties.**
  - The **International Monetary Fund (IMF)** projects global growth to remain steady at 3.2% in 2024, while the **World Bank** forecasts a lower rate of 2.6%.
  - Near-term prospects are improving, but risks remain from the last mile of **disinflation, high public debt**, **stretched asset valuations,** **economic fragmentation,** **geopolitical tensions,** **climate disasters,** **and** **cyber threats.**
  - **Emerging market economies (EMEs)** remain vulnerable to external shocks and spillovers.
- **Domestic Macrofinancial Risks: Strong macroeconomic fundamentals and a sound and stable financial system have supported the sustained expansion of the Indian economy.**
  - Moderating **inflation,** a strong external position, and ongoing fiscal consolidation are anchoring business and consumer confidence.
  - Domestic financial conditions are strengthened by **healthy balance sheets** across financial institutions, marked by strong **capital buffers**, improving asset quality, adequate provisioning, and robust earnings.
- **Improved Asset Quality: The** GNPA ratio **of** scheduled commercial banks (SCBs) **has moderated to 2.8% in March 2024, the lowest in 12 years. The** net non-performing assets (NNPA) ratio **has also improved to a record low of 0.6%.**
  - Under the baseline stress scenario, the GNPA ratio is expected to improve further to 2.5% by March 2025.
  - If the macroeconomic environment worsens significantly, the GNPA ratio could rise to 3.4%.
  - The GNPA ratio for Public Sector Banks (PSBs) may increase from 3.7% in March 2024 to 4.1% in March 2025 under a severe stress scenario.
  - Agriculture continued to have the highest GNPA ratio at 6.2%, while personal loans at 1.2%. Yet **RBI** remains concerned about **potential financial issues arising from** individual borrowers, particularly those accessing **personal loans through digital apps.**

- **Deposits and Credit Growth: Deposit growth picked up in the second half of FY24, reaching 13.5% in the quarter ending March 2024.**
    - **Private sector banks saw the highest deposit growth at 20.1%**, followed by foreign banks at 15.1% and PSU banks at 9.6%.
    - Overall credit growth remained healthy at 19.2%, though slightly lower than the previous half-year.
    - Consumer loans moderated due to RBI regulations, but still remained the largest component of the lending portfolio at 32.9%.
- **Capital Adequacy and Profitability:**
    - SCBs maintain strong capital buffers, with **capital to risk-weighted assets ratio (CRAR)** remaining stable at 16.8%, with PSBs seeing an improvement and private/foreign banks witnessing a slight decline.
        - CRAR is a measure of a **bank's available capital as a percentage of its risk-weighted credit exposures**. It is used to ensure that banks have enough capital to handle potential losses and avoid insolvency.
    - **Return on assets (RoA) and Return on Equity (RoE)** are close to decadal highs at 1.3% and 13.8%, respectively.
        - **ROA is a profitability ratio** that measures how well a company uses its assets to generate profit. It's calculated by **dividing a company's net income by its total assets** and is expressed as a percentage.
        - **ROE is a key metric for assessing a company's financial health** calculated as the company's net income divided by equity financing. It helps in understanding how efficiently shareholder equity has been used to generate profits.
- **Stress Test Results: Banks have shown substantial resilience to stress, with SCBs well-capitalised to handle macroeconomic shocks in both medium and extreme stress scenarios.**
    - A stress test is an analytical tool used by RBI to assess how a bank or financial system can withstand adverse economic scenarios.

## Note

The FSR is a biannual publication by the RBI. It reflects the collective assessment of the **Sub-Committee of the Financial Stability and Development Council (FSDC),** which is headed by the Governor of the RBI. The report evaluates the resilience of the Indian financial system and identifies risks to financial stability

## What are Non-Performing Assets?

| Category | Description |
|---|---|
| **Definition** | ▪ An asset becomes NPA when it **ceases to generate income for the bank.** It is usually a **loan or advance** where the principal or interest payment remains overdue for a certain period of time. **For most loans, this period is 90 days.**<br>▪ For agricultural loans, short-duration crop loans will be treated as NPA if the principal or interest instalment remains overdue for two crop seasons. Long-duration crop loans will be treated as NPA if the principal or interest instalment remains overdue for one crop season. |
| **Types of NPAs** | ▪ **Sub-standard Assets:** NPAs for a period less than or equal to 12 months.<br>▪ **Doubtful Assets:** An asset is classified as doubtful if it stays in the substandard category for 12 months. A doubtful loan shares the same weaknesses as substandard assets.<br>▪ **Loss Assets:** Uncollectible assets with little or no hope of recovery, |

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|---|---|
| | requiring full write-off. |
| **Gross NPA (GNPA)** | ▪ The total amount of NPAs without deducting the provisional amount.<br>◦ Banks set aside a percentage of the loan amount as a provision. In Indian banks, the standard rate of provisioning for loans ranges from 5 to 20%, based on the business sector and borrower's repayment capacity. For NPA, 100% provisioning is required according to **Basel-III standards.** |
| **Net NPA** | ▪ Gross NPA minus the provision amount. |
| **NPA Ratios** | ▪ It gives an idea of how much of the total advances are not recoverable.<br>◦ GNPA ratio is the ratio of the total GNPA of the total advances.<br>◦ NNPA ratio uses net NPA to determine the ratio to the total advances. |

## Why are Digital Personal Loans a Concern?

- **Rise of Digital Personal Loans:** Personal loans disbursed via digital apps have the highest share of overdue accounts, raising alarms for financial stability.
  - Up until the mid-2010s, banks frequently **lent massive loans to big industries.** However, many of these loans turned sour, with **bad loans peaking at 10% in 2017.**
  - Following 2017, banks reduced lending to industries and **increased focus on the retail sector, including personal loans, credit card receivables, and housing loans.**
  - The implementation of the **Insolvency and Bankruptcy Code, 2016,** helped banks recover bad loans, contributing to their improved health.
  - The mid-2010s saw a proliferation of **instant loan apps, targeting younger, digitally savvy consumers and leading to a potential debt trap.**
  - In the past 11 years, the digital lending market has grown significantly, reaching an **estimated USD 350 billion by 2023.**
- **Impact on Banking Sector:** The share of **retail loans has grown significantly, surpassing both industrial and service loans** in outstanding amounts.
  - The alarming growth of retail loans prompted the **RBI to implement regulatory measures,** although the overall GNPA ratio for personal loans has been consistently reducing, reaching 1.2% in March 2024.
  - The proliferation of instant loan apps has led to a **debt trap for many consumers**. These apps often tempt users to take more loans than they can manage, leading to financial distress.
- **RBI's Concerns: Slippages, or fresh additions of bad loans, from retail loans (excluding home loans) have been increasing rapidly, forming 40% of fresh NPAs in FY24.**
  - Delinquency levels, especially for personal loans below Rs 50,000, remain high. Many of these loans were sanctioned by NBFC-Fintech lenders through digital apps.
  - The delinquency rate is highest among borrowers under **25 years at 5%. For the 26-35 age segment,** it is 3%, 36-45 years at 2%, and over 45 years at 1%. Urban and rural areas both report a 3% delinquency rate, while metro and semi-urban areas have a 2% rate.

## Digital Personal Loans

- These are loans offered through mobile applications or online platforms. Unlike traditional banks, these **lenders leverage technology for a streamlined application process**, often with minimal paperwork and near-instantaneous approvals.
  - This ease of access caters to a wider population, including those who might not have easy

    - access to traditional banking services.
    - Digital lending platforms reach unbanked or underbanked populations, promoting financial inclusion, a key government objective in India.

## What can be Done to Recover Digital Personal Loans?

- **Financial Technology:** Encourage Fintech companies to develop recovery tools such as **automated repayment plans** and debt consolidation options.
    - Continuously monitor loan performance and identify potential delinquencies early.
- **Creditworthiness Assessment:** Explore alternative **credit scoring models** that consider factors beyond traditional credit history, like income stability and **financial behaviour patterns.**
- **Improved Efficiency:** Digital NPA recovery processes can be streamlined compared to traditional methods. **Automating tasks like communication and data analysis frees up resources for other areas.**
- **Legal Recourse:** Utilise Debt Recovery Tribunals (DRT) to facilitate the recovery of dues. And leverage legal frameworks like **Lok Adalat and SARFAESI ACT, 2002 for efficient recovery**

***Drishti Mains Question:***

**Q.** Examine the trends in non-performing assets (NPAs) in India and the implications for the banking sector's health.

**Q,** Evaluate the rise of digital personal loans in India. What are the key factors driving their popularity, and what risks do they pose to financial stability?

### UPSC Civil Services Examination, Previous Year Question (PYQ)

***Prelims***

**Q. Which of the following statements best describes the term 'Scheme for Sustainable Structuring of Stressed Assets (S4A)', recently seen in the news? (2017)**

**(a)** It is a procedure for considering ecological costs of developmental schemes formulated by the Government.

**(b)** It is a scheme of RBI for reworking the financial structure of big corporate entities facing genuine difficulties.

**(c)** It is a disinvestment plan of the Government regarding Central Public Sector Undertakings.

**(d)** It is an important provision in 'The Insolvency and Bankruptcy Code' recently implemented by the Government.

**Ans: (b)**