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RESERVE BANK OF INDIA

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RBI releases Financial Stability Report : December 2012

The sixth issue of the [Financial Stability Report \(FSR\)](#) of the Reserve Bank of India is being released in an environment of global macroeconomic instability and uncertainty. Economic growth in India has moderated in recent quarters, buffeted by global headwinds and domestic policy uncertainties. Growth, however, needs to accelerate if the momentum of poverty reduction, employment generation and pay off from the demographic dividend is to be accelerated. The Report reflects the collective assessment of the Sub Committee of the Financial Stability and Development Council (FSDC) on risks to financial stability.

Highlights:

- (1) Global risks remain elevated due to delays in resolution of issues like the European sovereign debt crisis and the imminent US fiscal cliff.
([Para 1.2-1.6; Chapter: I](#))
- (2) Risks to domestic growth arise from structural impediments such as fall in domestic savings, persistently high inflation, regulatory and environmental issues. These have caused a fall in investment demand and moderation in consumption spending leading to decline in growth.
([Para 1.17-1.21, Chapter 1](#))
- (3) External sector imbalances remain a worry. Rising gold imports have worsened the current account deficit. Domestic savings have been falling. Moreover, a lower proportion of household savings is channelled towards financial products.
([Para 1.25-1.27 and Box 1.1; Chapter 1](#))
- (4) Financial markets remained largely stable but exchange rate volatility was high relative to that of some peers and advanced economies. Financial sector dominated the corporate bond issuance, reducing effective disintermediation.
([Para 1.24 and 1.31 ; Chapter I](#))
- (5) Corporate sector's ability to service debt has been falling since 2009-10. Some industrial groups with greater exposure to key infrastructure sectors like power have witnessed high growth in leverage in recent years.
([Para 1.36-1.39; Chapter I](#))
- (6) The Reserve Bank's latest Systemic Risk Survey conducted in October 2012 among bankers, consultants, academicians, etc. revealed concerns about the evolving global risks such as the fall in global growth and sovereign risk/contagion and a host of domestic factors like the increasing fiscal deficit, deterioration in growth outlook and bank asset quality. Respondents, however, remained confident about the stability of the domestic financial system.
([Para 1.40-1.42 ; Chapter I](#))

- (7) Distress dependencies between banks have remained largely unchanged in the period under review.
(Para 2.3-2.7, Chapter II)
- (8) While there has been no major shift in the pattern of interconnectedness or contagion risks in the system in the recent periods, an assessment of the impact of the liquidity contagion in the Indian banking system has been attempted for the first time in this issue of the FSR.
(Para 2.19-2.23, Chapter II)
- (9) Asset quality of the banking system came under stress during the period under review with greater recourse to restructuring. Banking sector, however, remained resilient to credit, market and liquidity risks and capable of withstanding macroeconomic shocks, given their comfortable capital positions.
(Para 2.32-2.37 and 2.40-2.49; Chapter II)
- (10) Regulatory reforms initiated in the wake of the global financial crisis are in various stages of implementation across countries. Some reforms may have unintended consequences for emerging markets.
(Para 3.1-3.4; Chapter III)
- (11) The recent deterioration in asset quality and regulatory changes requiring higher provisions may pose challenges for banks in India as they migrate to Basel III.
(Para 3.6; Chapter III)
- (12) Potential risks posed by procyclicality of margin movements at central counterparties (CCPs) in various market segments will need to be monitored. There are challenges in migrating all OTC derivative transactions to central clearing given problems in standardisation, insufficient liquidity and opacity in pricing information of some products/markets.
(Para 3.37-3.40; Chapter III)
- (13) Financial Inclusion, Financial Literacy and Consumer Protection have been recognised as intertwining threads in pursuit of financial stability. This edition of the FSR, for the first time, discusses the various regulatory initiatives to achieve this objective.
(Para 3.62-3.77; Chapter III)