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RISK MANAGEMENT IS UNDERRATED

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RBI – FSR

MAKING SENSE OF STABILITY

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Introduction

The June 2024 RBI's Financial Stability Report checked the systemic stability of the Indian financial system in the context of global setting and provided a status paper on current health of the Indian financial system.

The report is exhaustive and interesting read for students of finance, practitioners, young bankers, economists, investment professional and a wide variety of folks interested in macro matters in India.

EERIMA has attempted to parse this comprehensive report and bring forth critical elements of interest and provide a summary of the document. In addition, our attempt is to take a peek into the near future on the ramifications of this current macroeconomic setting in mid-2024 over the next 12-15 months.

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Overview

The aim of the RBI's FSR is to check the financial systems preparedness to the following critical elements of

1. Global Macrofinancial risks
2. Domestic Macrofinancial risks
3. Soundness of the financial institutions
4. Regulatory initiatives
5. Assessment of systemic risks

The crux of the report lay in informing the reader that we could be in a 'Goldilocks' moment for India. But again, the daddy (RBI) is watchful.

Global Setting

RBI's assessment of the global macroeconomic setting forms, to some extent, our domestic monetary policy and/or it's calibration in the near term. So short term interest rates, money supply and macro level regulations and related decisions have some impact on how the global macro setting is behaving or likely to behave. The June 2024 FSR, therefore, has assessed the global macro picture in a very objective manner. A gist of the report is encapsulated in a tabular form. Several critical parameters have been highlighted with data points in the report.

Global macro and its assessment

METRIC	EMERGING MARKETS	DEVELOPED MARKETS	REMARK
Global Public Debt	Concerning	Concerning	Inflationary impact can continue. Explains sticky consumer inflation.
High/Elevated Interest Rates	Concerning	Concerning	Relatively high economic hardship on economies unable to cope with high inflation/consumer prices
High Debt / High Liquidity (Elevated Asset Prices)	Very Concerning	Alarming	Risk of Asset bubble => Tightening=>Risk off=> Deflation.
Global CRE Asset Prices	Moderate	Concerning	High NBFC exposure can lead to failures. Though moderate risk.
Geopolitical Risks	Concerning	Moderate	Episodic. Can cause sharp asset price drawdowns.
Private Credit Risks	Low	Moderate	No great cause for alarm yet. Better than expected corporate B/S
Cyber Risks	Concerning	Moderate	Severity and disruption is likely to only increase with time. EM's likely to be adversely impacted.

Source: RBI Financial Stability report, June 2024; EERIMA Digitools

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Domestic Setting

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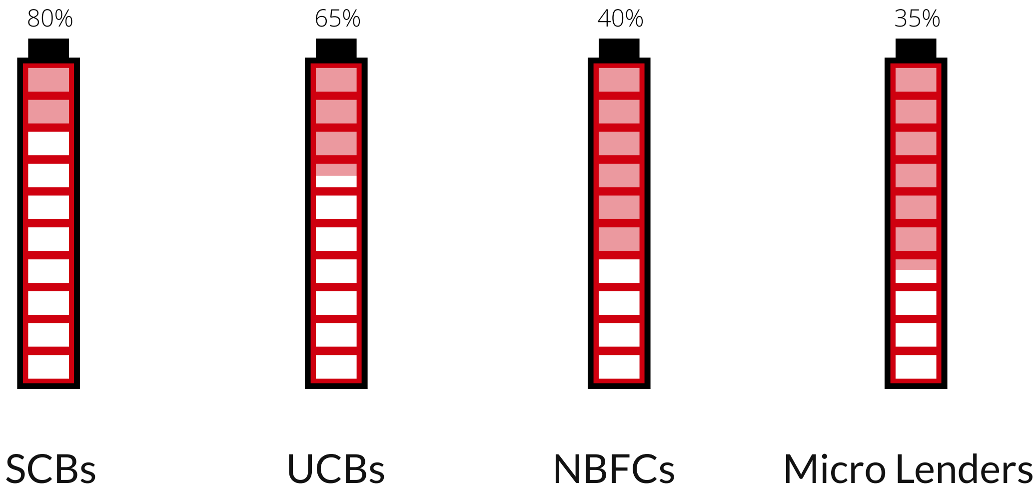
Domestic macro and its assessment

METRIC	ASSESSMENT	OUTLOOK	REMARK
Inflation	Sticky	Controlled	RBI is extremely comfortable with the current and projected inflation numbers.
GDP (Growth)	Stable	Positive	Vis-a-vis global macro, RBI's assessment and positive outlook for the GDP. Projected at 7.2% for FY25.
External Sector	Stable	Positive	Balanced external sector is aided by services.
FX Market	Stable	Neutral	Stable USD/INR aided by REER; mild exchange pressure has aided domestic macro.
Corporate Sector	Improving	Positive	Deleverage B/S, broad based demand and improving earnings improved corporate health.
Govt. Finances	Improving	Positive	Fiscal consolidation, buoyant tax collection, improved quality of spending are key highlights
Household finances	Mild Stress	Neutral	Financialization of savings is slow. Concentration of savings in physical assets and liquidity issues persist.
Money Markets	Mild Stress	Neutral	Low volatility and high liquidity meant risk-on trade. Healthy corporate earnings have not created a bubble, yet.
Banking Sector	Improving	Positive	Banks have cleaned balance sheets, de-levered, raised capital and appear adequately funded.
NBFCs	Stable	Neutral	Capital buffer is adequate, however, stress tests show some area for concern

Source: RBI Financial Stability report, June 2024; EERIMA Digitools

Soundness - Institutions



Source: EERIMA Digitools

The FSR has great details in terms of each category of the deposit and non-deposit taking institutions basis on the assessment on the following parameters:

1. Asset Quality
2. Credit quality of large borrowers
3. Capital adequacy
4. Earnings and profitability
5. Stress tests and its results

Each category of the institutions was assessed on these parameters and the report is comprehensive in assessment on these. In summary, due to the overwhelming large share of business done by SCBs (scheduled commercial banks), the systemic stability remains high so far in 2024, since SBCs appear to have passed/improved on each of these metrics as compared with 2022-23 and have passed the stress tests without any great hiccups.

Interconnectedness & Contagion risks

The Indian financial system is fairly interconnected and at a level 5 complexity. It is comparable to any of the large, developed country or a G-7 nation. The FSR highlights the following observations with respect to the contagion risk in the financial system as per the current assessment.

1. The interconnectedness of the financial system in India is fairly high and therefore systemic shock can cause damage if unchecked early.
2. However, despite fairly high interconnectedness, the large financial institutions (SCBs, NBFCs, AMCs and Insurance companies) are robust in their regulatory compliance, asset management and credit scoring mechanism
3. RBI's independent contagion study which has tested institutional network on solvency and liquidity indicates that failure of the large institution and it's impact on the network remains fairly controllable in the current context.
4. The risks which emanate from risky/smaller institutions would not have any significant bearing on the large institutions and the system as a whole.

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Summary

The RBI FSR has been a definitive document from the central bank on the systemic stability / vulnerability of the financial system in India. The June 2024 edition is no different than the previous editions, however, the conditions that prevail currently could appear to be the 'Goldilock' moment or the system in particular and the economy in general. There is certainly an exuberance in the financial systems in terms of institutional report card on performance, financial health and stability.

That said, the RBI is unwavering in its commitment to protect, preserve and aid prosperity of the financial system by keeping its guard up is commendable. We believe that the following could be critical parameters that the central bank will keep a hawk's eye.

1. Institutional stress and its systemic impact
2. Macro level credit risks impacting the system
3. Tighter regulation on a micro segment level, including one-off items targeting particular segment/institution
4. Longer for higher on policy rates at least in 2024.

More Information

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