RBI’s Financial Stability Report

Why in news?

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The Reserve Bank of India’s biannual Financial Stability Report has once again flagged the fact that risks to the banking sector remain worryingly “high”.

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What the central bank’s assessment says?

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- The central bank assessed that the risks have stayed “elevated due to continuous deterioration in asset quality, low profitability and liquidity.”
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- Given the central role commercial lenders have in the financial system — serving to harness public savings and direct the flow of crucial credit to the most productive industrial and infrastructure sectors — any systemic risk to the banking industry has the potential to ripple across the entire economy.
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- The new assessment iterates that there has been no perceptible improvement in the health of domestic banks, even six months after the RBI’s previous report had highlighted the sector’s high vulnerability on account of the increase in capital requirement and worsening asset quality, spotlighting the need for urgent policy interventions.
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How the bad loan problem is tackled?

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- Some measures have been initiated and others are in the pipeline, including a **draft Financial Resolution and Deposit Insurance Bill** to address bankruptcy situations in banks and other financial entities.
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- Still, there is every reason to prioritise the restoration of the sector’s health

as some of the risks inherent in banks may already be getting transferred to other segments of the financial markets, according to the RBI's report.
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- A survey, of experts and market participants, conducted by the RBI in October-November reveals that among institutional risks, credit growth and cyber risk were seen as two key "high risk factors".
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- The bank suggested that the "unhealthy parts of the troubled banks" could be separated from the healthier assets and put into a 'bad bank' to prevent systemic contagion.
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- With the RBI pointing out that banks saddled with bad loans were likely to remain "risk-averse" and find themselves lacking the capital needed to lend more to meet credit demand in the economy, the regulator and the government will need to work in close concert to expeditiously resolve this vital legacy issue.
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