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.** ▪ 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. ▪ **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. ▪ **Loss Assets:** Uncollectible assets with little or no hope of recovery,

	requiring full write-off.
Gross NPA (GNPA)	▪ The total amount of NPAs without deducting the provisional amount. ◦ 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. ◦ GNPA ratio is the ratio of the total GNPA of the total advances. ◦ 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)