

UPSC Syllabus Topic: GS3- Indian economy- mobilisation of resources (banking sector)

Centre for Advanced Financial Research and Learning (CAFRAL): Insights from the NBFC Sector

CAFRAL, established by the Reserve Bank of India, serves as an independent body conducting research on India's financial sector, with a focus on non-bank financial companies (NBFCs). The recent CAFRAL report on the NBFC sector highlights several significant trends:

Positive Trends:

1. **Stronger Capital Position:** The Capital to Risk-Weighted Assets Ratio (CRAR) has seen a substantial increase, rising from 22.9% in 2019-2020 to 27.6% in 2022-23. This improvement indicates enhanced financial stability within the sector.
2. **Enhanced Asset Quality:** Both gross and net non-performing asset (NPA) ratios have consistently decreased, reflecting healthier loan portfolios and improved overall asset quality.
3. **Economic Importance:** The report underscores the crucial role played by the NBFC sector in supporting India's economy, especially Micro, Small, and Medium Enterprises (MSMEs). It highlights the sector's resilience post the 2008 Global Financial Crisis, providing vital credit support when traditional banks faced challenges with Non-Performing Assets (NPAs).

Concerns Raised by the CAFRAL Report:

1. **Rising Bank Financing for NBFCs:** There is growing apprehension about the increasing dependence of NBFCs on bank financing. This heightened reliance raises concerns, as financial stress or defaults within the NBFC sector could potentially impact the stability of the banking sector, leading to broader financial implications.
2. **Systemic Contagion Risk:** The report underscores the need for preventive measures to address the risk of systemic contagion. Any financial issues within one NBFC could have a cascading effect, spreading to other financial institutions and potentially impacting the broader economy. This emphasizes the importance of maintaining stability to prevent a chain reaction of financial problems.
3. **Monetary Policy Shocks:** Recognizing recent shifts in monetary policy from loose to tight in response to rising inflation, the report highlights the potential impact of abrupt policy changes. Such shifts can catch businesses off-guard, impacting the NBFC sector and the broader financial landscape.

Terminology Used:

- **Capital to Risk-Weighted Assets Ratio (CRAR):** A ratio that measures a bank's capital against its risk-weighted assets and present liabilities. It plays a crucial role in ensuring the stability and effectiveness of global financial systems.
- **NPA (Non-Performing Asset):** A loan or advance where the borrower has not made the principal or interest payment for a duration of 90 days or more, indicating financial stress or default.