# Bandid Nijathaworn: How strong are Thai banks to weather the turmoil?

Keynote address by Dr Bandid Nijathaworn, Deputy Governor of the Bank of Thailand, at the Fitch Thailand's 2008 Annual Conference, 10 September 2008.

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Thank you, Chairman.

First, let me thank Fitch Thailand for the invitation to address this year's conference as a keynote speaker. Our topic this morning is "How strong are Thai banks to weather the turmoil?" My answer is short and simple: Thai banks are strong enough to weather the current global turmoil. The sector is also well positioned to support the economy. This is the message I gave six weeks ago when we had a press briefing at the Bank of Thailand. Although conditions in the global economy and financial markets have changed somewhat since then, it is the same message of resiliency and strength that I want to echo to you this morning.

I agree with the two previous speakers that global financial market conditions and growth prospects have further weakened especially in the past two months. In financial markets, we continue to see falling share price indices and increased spreads in a large number of US dollar products, including high-quality US corporate bonds, money market spreads, and bank credit default swaps. Doubts about additional losses by banks in major economies also persist and this has made it more difficult for banks to raise capital. As a result, funding costs for households and businesses in the major economies have risen as banks continue to tighten credit standards, which is not positive for growth. On account of this, global growth prospects seem to have further weakened, while the decline in oil price have helped ease concerns about global inflation. Future direction of the oil price, however, is still very much uncertain.

The global economy and conditions in the global financial markets, therefore, have become more challenging, and they are likely to have important implications for emerging markets through the usual trade and financial channels. This is, therefore, an important area that we need to pay close attention to in the next few months.

Under the current global setting, a decline in oil price will be positive for emerging markets like Thailand, and as a group, the growth prospect of emerging markets should remain satisfactory given their abilities to support domestic demand. But questions remain about individual economies on how resilient they would be in the face of such shocks, including the banking sector.

In the Thai case, our assessment is that the Thai banking sector is strong enough to weather the current turmoil. This conclusion is supported by the following five important reasons.

<u>First</u> and foremost is the low direct exposure that the Thai banking sector has to sub-prime credit and CDO. CDO exposure of Thai banks at the second quarter of last year was less than 0.3 percent of total asset. Banks with CDO exposure have already made full provision and recognized losses in line with IAS 39, and presently all sub-prime related CDO positions have been unwound. More importantly, Thai banks also do not have investment in US GSE securities. This is another positive point that will help insulate the banks from any further spillovers. Reflecting this, the direct impact of the turmoil so far, on the Thai banking sector, has been limited.

<u>Second</u>, on the issue of liquidity and financing, banks in Thailand are predominantly domestic-owned. Hence, they rely more on deposit funding rather than external funding. Domestic funding is a more stable source of funding and is not affected by the turmoil. This feature will help cushion Thai banks from the effects of the global credit crunch.

Third, fundamentals of the Thai banking system have improved and the key fundamentals are sound and resilient. As a sector, banks in Thailand have enjoyed good profits for the past seven years and are well capitalized with the BIS capital adequacy ratio at 15.2 percent at end of June this year. Over the years, better risk management, improved asset quality, greater provisioning coverage against losses, and the regulatory and supervisory frameworks that meet international standards, have significantly improved the overall risk profile of the sector.

As for the most recent quarter, net profit of 57 billion baht was registered in the second quarter of this year. Loan growth in July increased to 11.8 percent while deposits including bill of exchange grew by 1.9 percent. Liquidity in the system remains adequate, with loan/deposit ratio excluding interbank transactions at 90.1 percent in July. On asset quality, gross NPL ratio edged downward to 6.4 percent in June. These numbers show that the performance of the Thai banking sector is quite robust, and is well positioned to support the economy.

Fourth, a more difficult picture to assess is the impact of the turmoil on the economy and how this would translate into the impact on the banking sector. So far, notwithstanding the less helpful global environment, the Thai economy has performed relatively well, with growth averaging 5.7 percent in the first half of this year. But going forward, market participants expect the economy to become more affected by the slowing global economy.

Our own forecast also sees growth to be less buoyant in the second half of the year, reflecting a more adverse impact on exports. But overall, the momentum of growth should not be too adversely affected given the support that growth could gain from domestic demand which is being supported by high farm income, continued credit availability, and supportive fiscal policy. Moreover, lower oil prices and monetary policy that focuses on inflation should provide a stable price environment conducive to domestic demand and to export competitiveness. Also, continued current account surpluses, lower external indebtedness, and high domestic savings have made the economy's financial conditions more stable, by reducing its dependency on capital flows.

In all, our view is that the improved economic fundamentals and the more flexible policy regime should place the economy in a better position to weather the current turmoil without too much impact on growth and economic stability. And with growth continuing, the performance of the banking sector will also benefit.

My last point is that the ability of the Thai banking sector to weather the turmoil is also confirmed by our recent stress-testing exercise which covers credit risk, market risk, and liquidity risk, linked to a macroeconomic impact scenario. The result indicates that the Thai banking system is quite resilient. Thai banks can withstand sharp economic slowdown and unfavorable market volatility quite well. This is a result of strong profitability and capital accumulation, as well as prudent credit and investment policies over the years.

And for our part, given the increased uncertainty in the external environment, the Bank of Thailand will continue to monitor our banking sector and financial markets closely, and to move forward in our regulatory reform to enhance the risk management and the efficiency of the banking system. In the near-term, what we have in the pipeline is a full implementation of Basel II by 2010, which includes the introduction of Pillar I by the end of this year, implementation of Pillar III by the middle of next year, and the introduction of Pillar II by 2010. In addition, to strengthen supervisory framework in line with financial and risk structures of financial groups, consolidated supervision will be phased-in in two steps: first is to introduce qualitative measures this year which have already been done, and the second is the implementation of the quantitative measures by 2010.

To conclude, conditions in the global economy and global financial markets have become more challenging. So, this calls for a time of greater caution as we move forward. Also, this means the ability of the banking sector to withstand shocks will be an important prerequisite for any economy in managing the spillovers from the slowing global economy and volatile financial markets. In the Thai case, the strength and the resiliency of the banking sector is with us, and thus they should be well placed to weather the turmoil, without adverse effects on their roles in supporting the economy and in maintaining financial stability.

Thank you for your attention.