

4. Financial Stability Conditions and Outlook

Thailand's financial stability conditions improved in 2009 H2 in tandem with the recovery of the world economy and domestic demand which boosted corporate performance, household income, and credit quality of financial institutions. Nevertheless, the global financial markets remained highly volatile, particularly in the fourth quarter after the Dubai World's debt postponement and credit downgrades of several countries. Although these events have had limited impacts on Thailand's financial stability, they may indirectly affect the length and the strength of the global economic recovery in the period ahead.

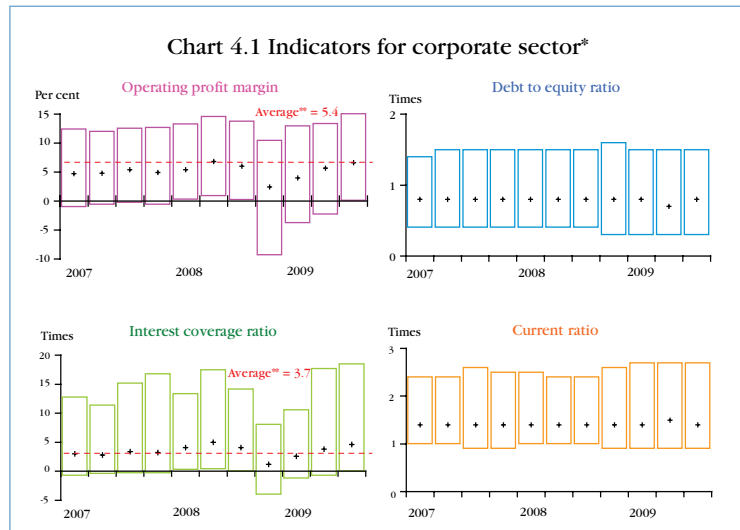
Non-financial corporate sector

In 2009 Q3, the performance of most non-financial companies listed on the Stock Exchange of Thailand continued to improve in tandem with the pickup in the global economy and domestic demand. Corporate profitability and ability to service debt were sound, as reflected by the rebound in operating profit margins and interest coverage ratios which roughly returned to the pre-crisis levels.

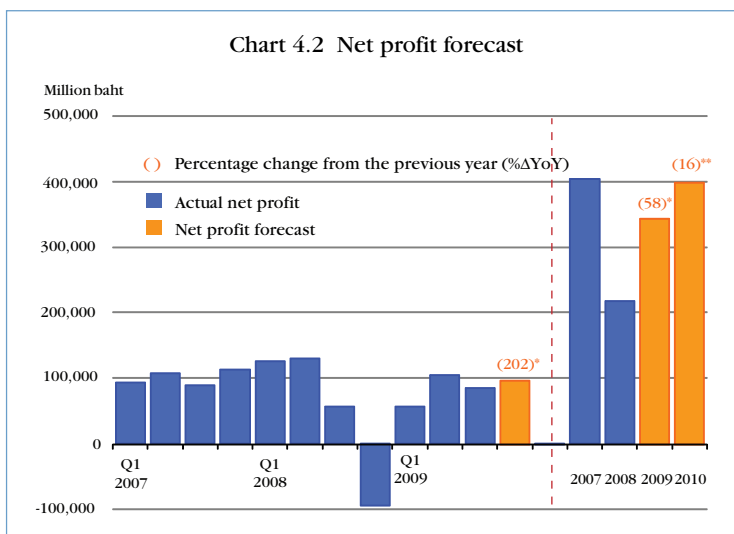
Going forward, risks to corporate sector stability are expected to subside further according to the Security Analyst Association (SAA) Consensus which showed average net profit growth of non-financial listed companies of 202 and 16 percent in 2009 Q4 and 2010, respectively, on the back of the global and domestic economic recovery. Nevertheless, it should be noted

In 2009 Q3, production and supply continued to recover from the previous quarter.

Major risk factors to corporate sector stability in the medium term are the sustainability of the global economic recovery, the Map Ta Phut problem, oil prices and the political unrest.



Note: * Each bar depicts an interquartile range, where upper and lower bounds represent the 25th and 75th percentiles, respectively. The symbol + indicates the median.
 **Average 1997 Q1 - 2009 Q3
 Source: Stock Exchange of Thailand, calculations by Bank of Thailand staff



Note: *December 2009 estimates
 **September 2009 estimates
 Source: Stock Exchange of Thailand and Securities Analysis Association, calculations by Bank of Thailand staff

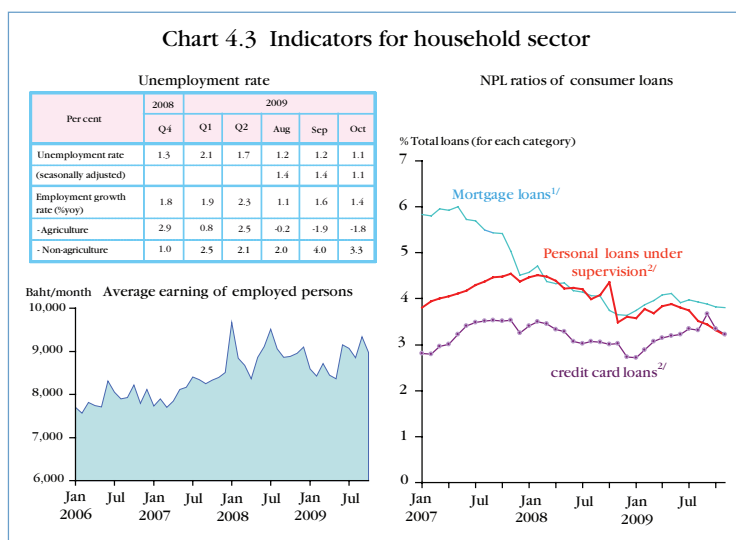
that the recovery of the world economy remains fragile, as observed for instance by the postponement of Dubai World's debt repayment and the downgrades of sovereign credit rating of countries with excessive public debt burden such as Greece, Spain, and Mexico.

The fragile global recovery together with domestic issues such as the suspension of investment projects in the Map Ta Phut industrial area, the political uncertainty, and the increasing oil price trend present major risk factors to the stability of the corporate sector in the period ahead.

Household sector

Risks to household's income and employment continued to decrease as reflected by the October 2009 labour market data which showed a decline in the seasonally-adjusted unemployment rate from 1.4 per cent over the previous two months to 1.1 per cent. Meanwhile, both non-agriculture employment and average earnings of employed persons continued on an upward trend in line with the increase in labour demand associated with the economic rebound.

Risks to household employment decreased on the rebound of the labour market.



Source: National Statistical Office

Note: ^{1/} Commercial bank's loans
^{2/} Total loans from commercial banks and non-banks

Source: Bank of Thailand

Households' ability to service debt improved.

The improvement in household income helped increase households' ability to service debt, as reflected by the decline in the NPL and the delinquency (one to three months past due) ratios of mortgage and credit card loans. Going forward, the MPC judges that the outlook for household sector stability is largely conditional on the economic recovery. In addition, households' ability to service debt may also be affected by the expected higher costs of living.

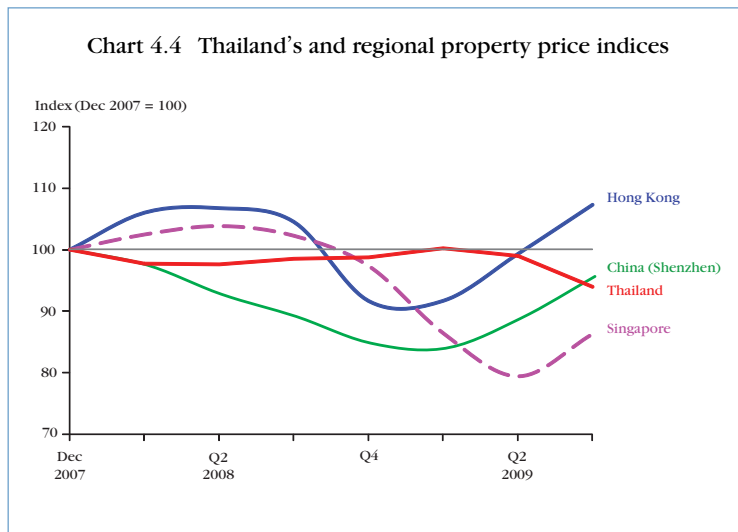
Real estate sector

Risk of a bubble in the real estate sector remains low.

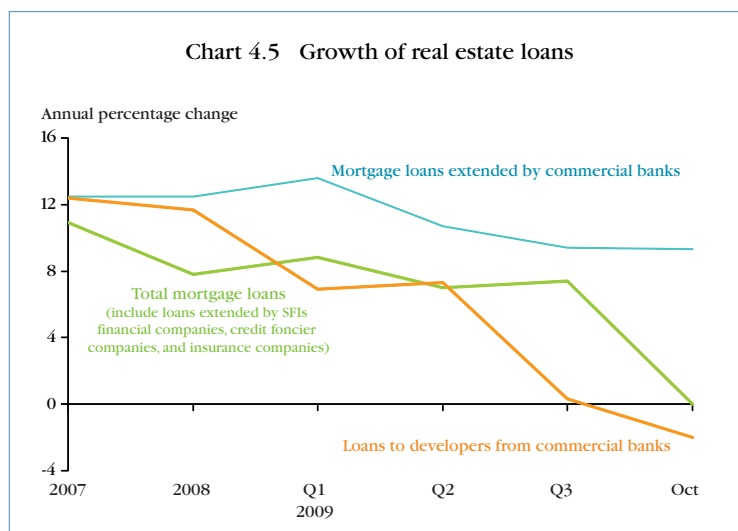
Real estate sales in 2009 Q4 increased significantly due to improved consumer confidence following the economic recovery and the government measures to stimulate the real estate sector - most notably tax reduction for home buyers in 2009 and reduction of fee and special business taxes, scheduled to expire in March 2010 - which provided tax incentives for consumers to speed up their residential property purchases. Nevertheless, the MPC judges that the increased housing demand was driven by fundamentals, with limited speculation, if any^{1/}.

On the supply side, housing supply expanded in line with demand as developers accelerated the completion of their real estate projects before the expiration of the tax incentives. Another impetus for developers was a brighter prospect of the economy which brought about the relaunch of several pending projects that had been postponed in 2009 H1.

^{1/} Consistent with views of developers according to the survey of Business Information Exchange program between the Bank of Thailand and businesses.



Source: CEIC and REIC, calculations by Bank of Thailand staff



Source: Bank of Thailand

Overall, the MPC's assessment is that the likelihood of a bubble in the Thai property sector remains low. While house prices in several regional countries had started to move back to their pre-crisis levels, Thailand's housing price index still drifted downward. Furthermore, cautious credit extension by financial institutions means one less factor fuelling bubbles. Nevertheless, the protracted period of eased monetary condition and the economic upswing may increase the likelihood of the emergence of a property market bubble.

Nevertheless, the protracted period of eased monetary condition and the firming economic recovery pose risks to asset price bubbles in the period ahead.

Financial institutions

The commercial banking system's operating performance and capital position remained sound.

The latest operating performance data showed that the financial health of the banking sector remained sound. Net profits of the Thai banking system in 2009 Q3 totalled 23.5 billion baht, up 26.4 per cent from the previous quarter owing primarily to a decrease in provisioning following the economic recovery. Meanwhile, Thai banks' capital position remained strong, as reflected by the BIS ratio in November 2009 at 16.2 per cent, up further from the 2009 Q2 and well above the minimum requirement of 8.5 per cent. All of these should help the Thai banking sector to withstand various shocks in the future. As for the Dubai World debt postponement, the direct impact has been minimal as the system's lending and investment exposure to the Dubai World Group is very limited. Still, there may be some indirect

**Table 4.1 Thai Bank's Financial Soundness Indicators
(at the end of 2009 Q3^{1/})**

Key indicators (%)	2008			2009		
	Q2	Q3	Q4	Q1	Q2	Q3
1. Capital adequacy						
1.1 Regulatory capital to risk-weighted assets (8.50) ^{2/}	15.0	15.3	13.9	14.7	15.6	16.1
1.2 Regulatory tier 1 capital to risk-weighted assets (4.25) ^{2/}	11.5	11.9	10.7	11.1	11.5	12.1
2. Asset quality						
2.1 Non-performing loans to total loans	7.01	6.5	5.7	5.9	5.8	5.7
3. Earning and profitability						
3.1 Return on assets (ROA)	1.2	1.2	1.0	0.9	0.9	1.0
3.2 Interest margin ^{3/} to gross income ^{4/}	72.1	73.9	74.1	70.9	69.5	69.2
3.3 Non-interest expenses to gross income	52.2	53.5	55.2	58.0	55.8	55.5
4. Liquidity						
4.1 Liquid assets ^{5/} to total assets	20.4	18.7	17.9	18.9	19.3	18.6
4.2 Liquid assets to short-term liabilities ^{6/}	27.4	24.4	23.6	24.8	25.5	24.8
Number of banks	14	14	14	14	14	14

Note: ^{1/} Based on "Peer Group" data

^{2/} Minimum regulatory capital to risk-weighted assets

^{3/} Interest margin = Interest income and dividend - Interest expenses

^{4/} Gross income = Interest margin + Non-interest income

^{5/} Liquid assets = Cash and deposits + Securities purchased under resale agreements + Investment in securities (net)

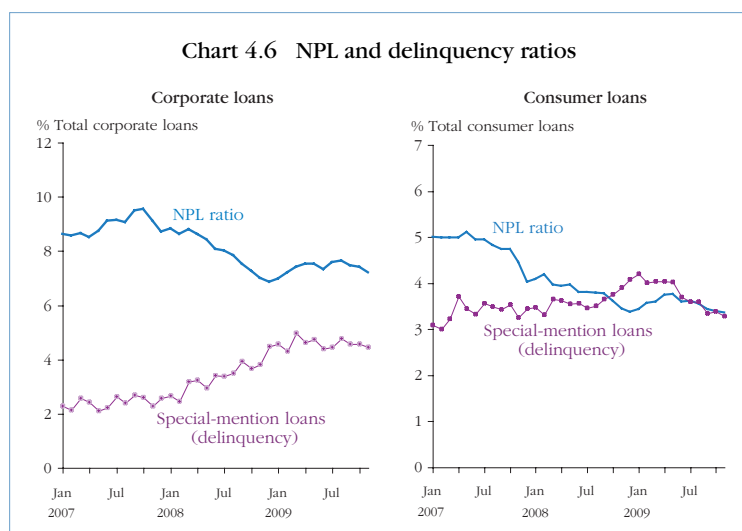
^{6/} Short-term liabilities = Deposits (Liability side)

Source: Bank of Thailand

impacts from loans to firms with investment and business activities in Dubai which the MPC will continue to monitor closely.

During the past few months, Thai banks' credit quality showed continuous improvement as observed by the declining NPL ratios of both corporate and household loans. Defaults as proxied by the ratio of special-mention loans (one to three month past due) to total loans also decreased. However, the MPC still has some concerns on the pace and the sustainability of the economic recovery which could have serious implications for financial stability conditions. In particular, the suspension of investment projects in the Map Ta Phut industrial area may affect construction activities and other related industries. Although the preliminary assessment showed that its direct impact is limited, the Map Ta Phut incidence may indirectly affect confidence and threaten the sustainability of the economic recovery.

Credit risk of Thai banks began to decline as a result of improvements in economic condition.

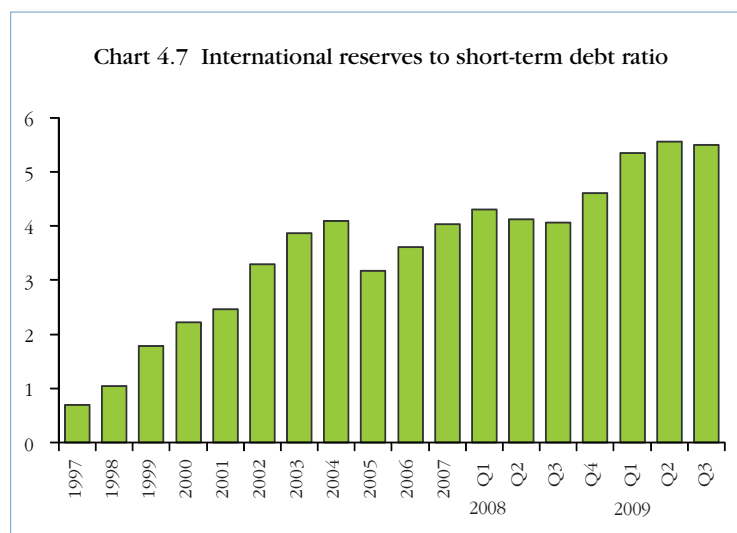


Source: Bank of Thailand


External sector

External stability remained strong.

Thailand's external stability remained strong, as reflected by a high level of international reserves. As of October 2009, the ratio of reserves to short-term debt stood at 5.4 which should help cushion fluctuations in capital flows to a certain extent. Nevertheless, the MPC will continue to monitor capital flows developments closely, for up to now the global financial market remains volatile as evidenced by the disorderly adjustments in the foreign exchange and the stock markets in response to Dubai World's debt postponement and the credit downgrades of countries with weak fiscal positions which reflect the vulnerability in the global financial markets.



Source: Bank of Thailand



In summary, even though the recent economic recovery appears more concrete and supportive to overall financial stability conditions, the MPC deems that the ongoing global economic recovery remains fragile while the domestic recovery is still subject to several risk factors which have to be monitored closely. Furthermore, concerns over the acceleration of asset prices during the economic upturn is an area in which the MPC regards seriously and will step up the surveillance efforts going forward.