

#### 4. Financial Stability Conditions and Outlook

Thailand's financial stability remains solid as the economic recovery from late 2009 to 2010 Q1 has helped strengthen the balance sheets of both firms and households, enabling them to ride out the impact of the political unrests in April and May. Meanwhile, financial institutions as a whole continue to be strong.

In the MPC's view, major risks to Thailand's financial stability include the strength of the economic recovery, which continues to rely much on the global recovery, and volatility of the global financial markets which can be influenced by lingering concerns over the European sovereign debt crisis. Moreover, despite no evidence of existing financial imbalances due to an extended period of accommodative interest rates, close monitoring of possible financial imbalances is still a priority given the positive outlook of the economy.

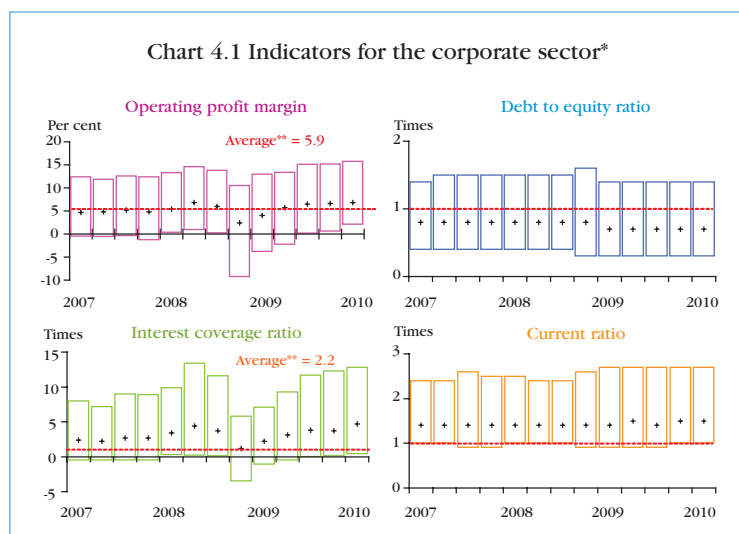
##### *Non-financial corporate sector*

In 2010 Q1, profits of non-financial companies listed on the Stock Exchange of Thailand continued to improve in line with the economic recovery. In particular, the median operating profit margin stood at 6.8 per cent, while the ability to service debt was strong, with the median interest coverage ratio of 4.7 times. Meanwhile, current liquidity and the debt to equity ratio of these firms remained at healthy levels.

*Corporate profits continued to improve in 2010 Q1 in line with the economic recovery.*

Although the global economic rebound had brought a significant rise in the number of foreign tourists towards the end of 2009, helping to improve the overall quality of loans to the hotel and restaurant sector,

domestic political unrests in 2010 Q2 raised the delinquency ratio of that loan portfolio back up in April and May 2010, as the tourism industry was strongly affected by the situation. However, other industries were affected only slightly, as reflected by the stable delinquency ratio of other corporate loans. Thus, with easing political tensions and good economic prospects, both globally and domestically, the MPC anticipates a continuation of strength in the non-financial corporate sector. This view is consistent with the SSA Consensus report on 18 June 2010, with corporate profitability expected to grow by 22 per cent year-on-year in 2010, up from the estimate of 20 per cent in the survey conducted in April.

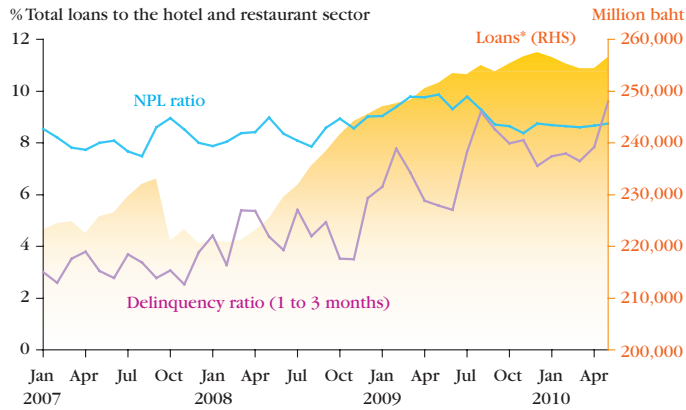


Note: \* Each bar depicts an interquartile range, where the upper and lower bounds represent the 25<sup>th</sup> and 75<sup>th</sup> percentiles, respectively. The symbol + indicates the median.

\*\*Average 2000 Q1 - 2007 Q4

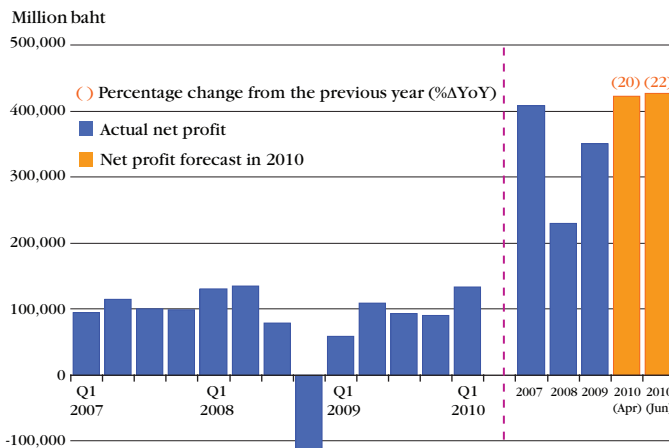
Source: Stock Exchange of Thailand, calculations by Bank of Thailand

**Chart 4.2 NPL and delinquency ratios of the hotel and restaurant sector**



Note: \*Loans from commercial banks registered in Thailand including Thai commercial bank branches located abroad  
 Source: Bank of Thailand

**Chart 4.3 Net profit forecast**



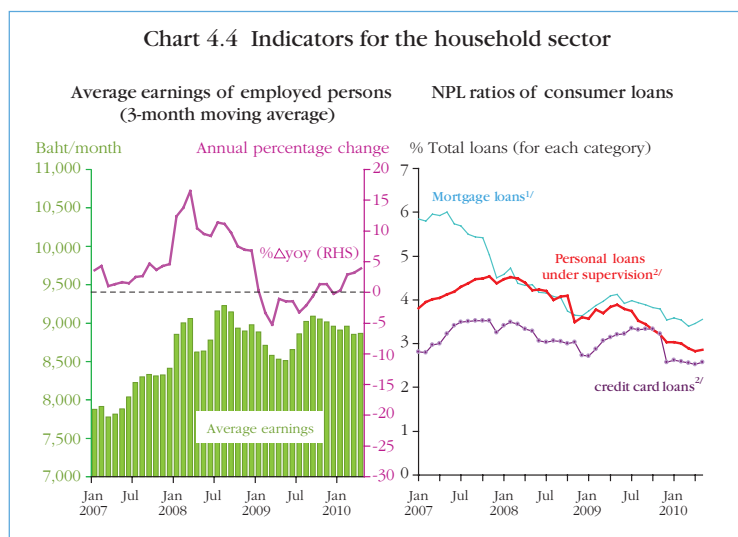
Source: Stock Exchange of Thailand and Securities Analysis Association, calculations by Bank of Thailand

Going forward, a major risk to corporate profits and stability is the fragility of the world economic recovery due to concerns over the fiscal positions and health of the financial sectors in some European countries. Should the problems spread to major economies in Europe, Thailand's export sector could be eventually affected. In addition, the slow resolution of the Mab Ta Phut dispute and lingering political uncertainties pose risks to foreign investors' confidence, the recovery of the tourism industry, and private consumption.

### Household sector

*Risks to household income have diminished, while households' ability to service debt has improved.*

The economic recovery and tightening labor market have helped reduce the risks to income and employment, thereby improving households' financial positions. With positive year-on-year growth in real household income, households' ability to service debt has also improved, as reflected by a stable NPL ratio of consumer loans compared with the preceding quarter.



Source: National Statistical Office

Note: <sup>1/</sup> Commercial banks' loans  
<sup>2/</sup> Total loans from commercial banks and non-banks  
 Source: Bank of Thailand

The MPC judges that the strength of the Thai economic recovery would have a significant bearing on households' financial health. Therefore, uncertainties in the global economic recovery, on which the Thai economic recovery continues to rely, and lingering domestic political instability as well as the possibility of droughts are potential threats to household sector stability in the coming periods.

### *Real estate sector*

In 2010 Q1, the real estate market was exceptionally active due to the approaching termination of the real estate stimulus measures. Thus, compared with that quarter, activities in 2010 Q2 appeared to be slowing down. In addition, part of the demand was deterred by the political tensions. As the political situation eventually improves, the real estate market is expected to pick up in the second half of 2010, boosted in part by purchases that have been postponed from 2010 Q2.

The MPC assesses that the probability of a real estate bubble is still low. Although prices of office buildings in Bangkok climbed up between 2009 H2 and 2010 H<sup>1/</sup>, a survey of real estate developers' opinions<sup>2/</sup> indicates that the price increase was supported mostly by real demand and the odds of oversupply were low. In addition, credits supplied to and bond issuance by real estate firms continued to contract year-on-year. As a result, factors in support of a bubble formation were limited. Nevertheless, rising construction material prices could push upwards the production cost and property prices in the coming periods.

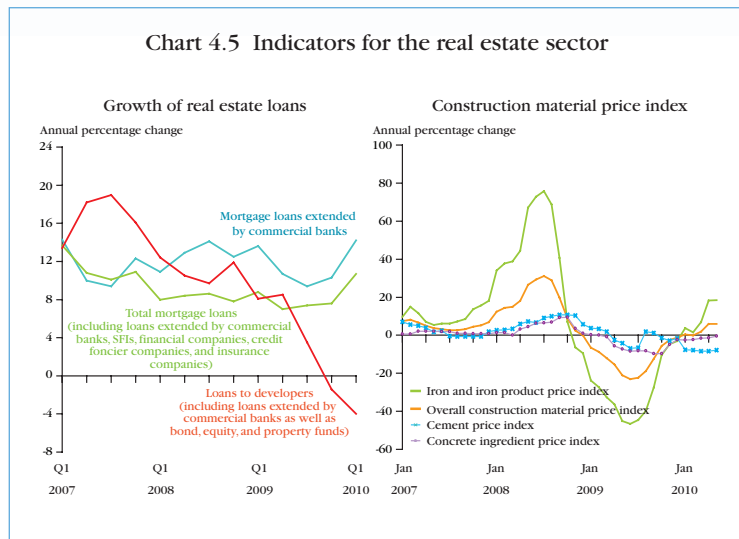
*Probability of a real estate bubble remains low.*

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<sup>1/</sup> Condominium price index calculated by the Real Estate Information Center and the Thai Condominium Association.

<sup>2/</sup> The Economic/Business Information Exchange Programme between the Bank of Thailand and the Business Sector.

Chart 4.5 Indicators for the real estate sector



Source: Stock Exchange of Thailand, Securities and Exchange Commission, and Thai Bond Market Association; calculations by Bank of Thailand

Source: Trade and Economic Index Bureau; Ministry of Commerce

## Financial institutions

*Profitability and capital of commercial banks remained strong in 2010 Q1.*

Economic expansion in the preceding quarters helped strengthen financial institutions in 2010 Q1. In particular, capital was maintained at a high level, with the capital adequacy ratio of Thai financial institutions as a whole standing well above the minimum requirement of 8.5 per cent. Moreover, profitability of financial institutions was comparable to that of the previous quarter. Even though liquidity slightly declined, it was consistent with the economic recovery and greater demand for credits.

Key indicators (%)	2008	2009				2010
	Q4	Q1	Q2	Q3	Q4	Q1
<b>1. Capital adequacy</b>						
1.1 Regulatory capital to risk-weighted assets (8.50) <sup>2/</sup>	13.9	14.7	15.6	16.1	15.8	15.7
1.2 Regulatory tier 1 capital to risk-weighted assets (4.25) <sup>2/</sup>	10.7	11.1	11.5	12.1	11.7	11.7
<b>2. Asset quality</b>						
2.1 Non-performing loans to total loans	5.7	5.9	5.8	5.7	5.3	5.0
<b>3. Earning and profitability</b>						
3.1 Return on assets (ROA)	1.0	0.9	0.9	1.0	1.0	1.1
3.2 Interest margin <sup>3/</sup> to gross income <sup>4/</sup>	74.1	70.9	69.5	69.2	69.4	68.5
3.3 Non-interest expenses to gross income	55.2	58.0	55.8	55.5	56.8	56.1
<b>4. Liquidity</b>						
4.1 Liquid assets <sup>5/</sup> to total assets	17.9	18.9	19.3	18.6	19.4	18.3
4.2 Liquid assets to short-term liabilities <sup>6/</sup>	23.6	24.8	25.5	24.8	26.2	25.3
<b>Number of banks</b>	<b>14</b>	<b>14</b>	<b>14</b>	<b>14</b>	<b>14</b>	<b>14</b>

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

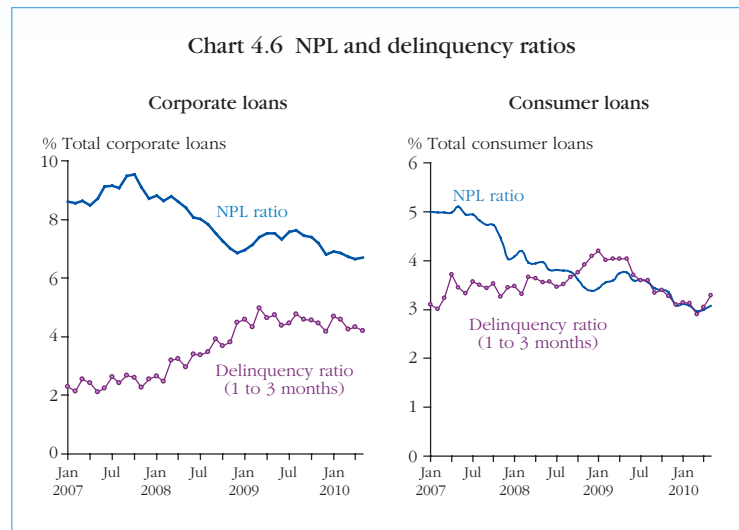
5/ Liquid assets = Cash and deposits + Securities purchased under resale agreements + Investment in securities (net)

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

Source: Bank of Thailand

The quality of commercial banks' loan portfolios remained strong in 2010 Q2. Although the political unrests had a considerable impact on some business sectors, such as tourism, the non-performing loan (NPL) ratio of corporate loans as a whole stayed comparable to the previous quarter, and so did the delinquency rate as reflected by the ratio of over-due loans (1-3 months) to total corporate loans. Meanwhile, consumer loans saw some increases in the NPL and delinquency ratios in April and May 2010, but the ratios were nonetheless low.

*Credit risks of financial institutions continue to be low.*



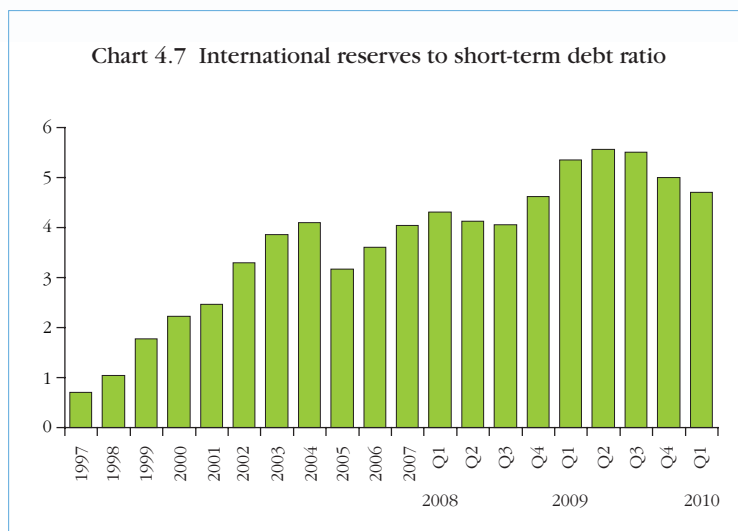
Source: Bank of Thailand

In sum, currently strong balance sheets of financial institutions and good credit quality are likely to support the stability of financial institutions going forward. Nevertheless, the MPC gives priority to the ongoing monitoring of risks, particularly credit quality of sectors affected by the political unrests and the possible relaxation of credit standards during a period of exceptionally low interest rates, which could lead to higher credit risks in the future.

### *External sector*

*External stability remains strong.*

Thailand's external position remains strong. Although short-term debt has risen, international reserves continue to be substantially higher than the outstanding amount of short-term debt. Besides, the rise in short-term debt is accounted for by an increase in low-risk liabilities, including inter-company loans of foreign bank branches for currency hedging transactions and trade credits in tandem with growing imports.



Source: Bank of Thailand

During the first two months of 2010 Q2, heightened risk aversion in association with deteriorating political conflicts and concerns over the European sovereign debt crisis resulted in net capital outflows as investors reduced their holdings of Thai bonds and equities. Nevertheless, a healthy external position and easing political tensions towards the end of the quarter kept the overall impact on external stability low.

Looking ahead, capital flows may continue to be volatile. While foreign investors are likely to be inclined to invest in Asia where the growth potential is high, concerns over the sovereign debt problems in Europe are likely to keep investor confidence quite fragile and sensitive to the evolving circumstances. Despite so, the MPC judges that the currently strong external position will help cushion the risks of volatile capital flows in the periods to come.