

A TALE OF FINANCIAL EXCESS AND ONE OF FINANCIAL PRUDENCE

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Many people have been quick to point out that the limited impact of the current crisis on Thailand's financial system, compared to the crisis which hit Asia over a decade ago, is attributable to differences in the causes of the crises and notable structural changes in the Thai financial system.

Many have pointed to excess, specifically excessive credit, excessive leverage and excessive short-term funding, as the main reason behind the current crisis. As the value of the excessive holdings of sub-prime assets by US and European banks collapsed as US house prices tumbled, financing evaporated, first between banks and then to the real economy.

Throughout this episode, Thailand's financial system has remained resilient, with banks healthy and well capitalized. Strengthened banking supervision and increased caution on the part of banks and borrowers, a legacy of the 1997 crisis, have helped to prevent excessive credit growth. In addition, regulatory authorities' use of prudential measures has helped ensure vigilance on the part of banks and helped guard against financial vulnerability in the household sector.

Leveraging in the Thai economy has remained low. A conservative approach towards capital structure by both corporate and banks, another lesson from 1997, has kept debt-to-equity ratios in corporate and loan-to-deposit ratios in banks low, preventing a sudden deterioration in their financial and liquidity positions respectively.

In addition, a conservative approach on the asset side in the run-up to the current financial turmoil meant that banks divested their exposures to foreign assets early on, with current exposure to foreign investments standing at 1.2 per cent of total assets, all of which have been fully provisioned for.

This low leverage is also reflected on the liability side of banks' balance sheets, with banks relying overwhelmingly on a broad base of retail deposits, reducing the banking system's vulnerability to any drying up of short-term financing, which has posed a problem in many countries. Furthermore, the blanket guarantee on bank deposits has prevented panic among domestic retail depositors, minimizing the risk of a bank run.

While it is important to ensure that past problems are not repeated, we need to anticipate new problems as they arise. For example, as the main fallout from the global slowdown is felt by the real sector, both through the slowdown in exports and a decline in tourism receipts, and continued domestic political troubles prevents any substantial growth in domestic demand, the financial system is likely to remain vulnerable.

These factors may pose an indirect risk to the financial system by gradually weakening the asset side of banks as borrowers face tighter conditions and increasing difficulty in servicing their loans. But banks themselves must find a balance between tighter standards and the risk of hurting good but smaller borrowers, who face increasing pressure from high-quality borrowers who may switch funding from abroad to domestic markets, potentially crowding out these smaller names.

Banks and supervisory authorities must therefore continue to remain cautious, exercising prudence in risk management where possible, as the next crisis is likely to arise where it is least expected.

Source: The Nation