

Financial Developments and the Thai Banking Sector♣

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Thank you and Good morning

First let me thank Euromoney for the invitation. It is an honour to be speaking to you today. For the last few years that I have been coming to this forum to speak, I find the session to be very useful as it provides an excellent opportunity for us at the Bank of Thailand to interact and share our views with investors on Thailand's current issues, including our policies. So, it is a pleasure to be here this morning.

My topic today is about financial developments and the Thai banking sector. Given the limitations of time, I want to focus my remark today on two issues. The first is the short-term issue about the current economic and financial conditions, and the policy response that we have had in trying to strengthen the process of recovery. Next, I will speak on the medium-term issue of financial sector reform,

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beginning with how we see the new or the post-crisis financial landscape emerging and our plan to respond to these changes in the context of our financial sector Master Plan.

First, the current conditions.

Latest economic data in Thailand continues to show deterioration in economic activities as evidenced by the estimated decline of 7.1 percent in this year's first quarter GDP growth. However, most recently, while the overall domestic activities remain weak, more positive signs on the real sector are emerging, especially in the monthly April data that show greater stabilization in the pace of contraction on a month-on-month basis, of exports, manufacturing output, capacity utilization, and private consumption, as well as a narrowing of the trade surplus.

On the financial front, recent rally in equity prices is also positive. The rally, which is largely liquidity driven, is indicative of two developments that are taking place in our financial markets at this time: first, the resurgence of capital inflows linked to the return of risk appetite globally; and second, the search for yield by Thai savers, on account of the low nominal deposit rates, which sees savings shifting away from bank deposits to other instruments. Hence, the latest round

of deposit rates increase by banks can be seen as a response to this development.

On liquidity, at this time, liquidity in the Thai banking system remains ample. Loan-to-deposit ratio, including B/E, was at 83.9 percent in April. Bank credit continues to grow on a year-on-year basis, but fell by 2.7 percent since December last year. The decline largely reflects the fall in corporate loan demand on account of the slowing economy. Consumer credit and mortgage loans, on the other hand, continue to register positive growth, and this has provided an important underpinning for consumer spending thus far. Inflation, on the other hand, continues its downtrend in May, and although we see inflation numbers turning negative, the current uptick in commodities and asset prices, together with signs of greater stabilization in the real sector, help lessen the concern regarding deflation risk.

Against this background, the Monetary Policy Committee in its meeting on May 20th held the view that monetary policy has been substantially eased and the current policy rate at 1.25 percent remains supportive of the economy. Two implications must be drawn from this decision. First, given the low policy rate and the ample availability of liquidity, more gains could be made by ensuring that, at the current policy rate, the benefits of past rate reductions are passed on more fully

to consumers and the private sector through corresponding adjustments in the banking system's interest rates. The second implication is that, while the emerging signs of stabilization are positive and are consistent with the developments on a worldwide basis, they must be treated with caution given that the current state of the global economy and financial markets are still far from normal. Hence, the MPC will continue to monitor closely the uncertainty surrounding both domestic and external economic conditions, and stand ready to implement appropriate monetary policy to support economic recovery in the period ahead.

Turning now to the banking sector. The Thai banking sector was able to weather the impact of the global financial crisis with a relatively strong initial position. These strengths are found in the sector's strong capital base, its limited exposure to subprime-related and other toxic assets, and its low reliance on external funding. As a result, the impact of the crisis on the Thai banking system so far has been limited. The Thai banking system is resilient with good fundamentals, and continues to function normally to support the economy.

In the last two quarters, despite the consecutive negative GDP growths, the performance of the Thai banking sector remains

satisfactory. The sector continues to see profits in the last two quarters, while the increase in the non-performing loans has not been large. This robust performance reflects a number of common responses that have been undertaken by the banks to manage the increase in credit and market risks. The responses include paring down of investment in foreign assets, lowering the loan growth target in line with the economy, strengthening risk management and credit standards, paying close attention to liquidity, and acting early to assist clients to adjust to the impact of the shock. These measures have helped banks to contain credit risk, and so far we have seen the gross NPL ratio rising slightly to 5.5 percent in March from 5.3 percent in December.

As for the Bank of Thailand, our approach to bank supervision during this time of global stress is to ensure that the banking system is healthy, and the system continues to operate fully to support the economy with good risk management and adequate capital. So far, this is very much the picture we are seeing. At end of March, the BIS ratio for capital adequacy for Thai banking system is 14.9 percent, of which the level for tier-one capital is 11.8 percent.

On the issue of credit extension, to ensure adequate flows of credit to the economy, our approach has been to rely on market

mechanism by encouraging greater competition amongst banks with regard to interest rates adjustment through a process of close consultation and dialogue. The recent round of bank's lending rate adjustment following the last MPC meeting is a case in point. In addition, to help banks better manage the increased credit risk, a credit guarantee scheme backed by government funding has been set up to promote SME lending by banks. Also, to help resolve problems related to bank lending, the Bank of Thailand has set up a customer-call center to look into problems related to loans application and approval between customers and banks.

Going forward, the slowing economy will continue to put pressure on the asset quality of banks. Therefore, managing credit risk will continue to be an overriding focus of Thai banks this year. To do this effectively, banks need to have in place both a strong capital base and a good risk management system, both of which have been strengthened significantly in the past years in line with Basel II and international best practices. Therefore, this should enable our banks to manage risk adequately going forward while supporting the economy.

Let me now turn to the second topic which is the medium-term issue of financial sector reform. Although the Thai financial sector has proven resilient amidst the global crisis, reform of our

financial sector needs to continue to ensure that the sector is well positioned to fully support the economy, in terms of efficiency and diversity of products. In addition, the current crisis will definitely bring about important changes in the global financial landscape, as well as in the regulatory approach to bank regulation and supervision. This means the reform process must help position the financial sector to adapt to the emerging financial landscape, while contributing to increasing efficiency and the robustness of the financial system.

On this issue, key trends that we can expect to see in the emerging financial landscape will include, on the demand side, consumers becoming more risk averse and having preference for local institutions and for simplicity of transactions and instruments, while demanding greater accountability and transparency. On the banking side, business models of banks will become more conservative, relying less on wholesale funding and on the use of leverage, while giving greater importance to risk management and higher liquidity buffer. And on the regulatory front, more emphasis will definitely be on surveillance with focus on systemic stability, and the roles of systemically important financial institutions including the non-bank. These changes are the key essentials that will define the emerging financial landscape to which we will need to adjust.

To ensure that Thailand reaps the benefits of the changing landscape and is in the position to mobilize resources for investment and support economic growth, the Bank of Thailand is set to launch the second phase of our financial sector Master Plan this year to further enhance efficiency, robustness, and competitiveness of the Thai banking system.

Our Financial Master Plan Phase II aims to promote financial system efficiency so that financial institutions can perform their functions more efficiently, becoming more competitive, with increased financial access to the public. The plan essentially comprises three pillars. The first pillar is to improve the regulatory environment and to reduce the unnecessary regulatory and legacy costs. The focus in this pillar will be on streamlining regulation, and on promoting measures and incentives to deal with legacy NPA and NPL, without compromising prudential oversight or good risk management.

The second pillar is to enhance efficiency by injecting more competition into the financial system. The focus will be on financial liberalization, increasing competition from the current and new players, and promoting greater financial access. The latter will give importance to expanding the retail banking businesses and promoting new microfinance business models and players.

And the third pillar is to substantially improve the economy's financial infrastructure in the areas of risk management, credit information system, legal reform, information technology, and upgrading the quality of human resource. Such infrastructure is crucial for banks so that they can attain greater efficiency and more effective risk management at a lower cost.

I will not have time today to dwell on the details of the plan, let me just say that the plan is now complete and is currently being considered by the finance ministry, and is scheduled to come into effect this year. It is our hope that this continuing momentum of reform will help expand the competitiveness and the growth of the Thai financial sector and the economy in the years to come.

I probably have used up my allotted time. Again, I want to thank Euromoney for the invitation. It has been a pleasure and thank you for your attention.