FitchRatings

Thai Banks' 2023 Outlook

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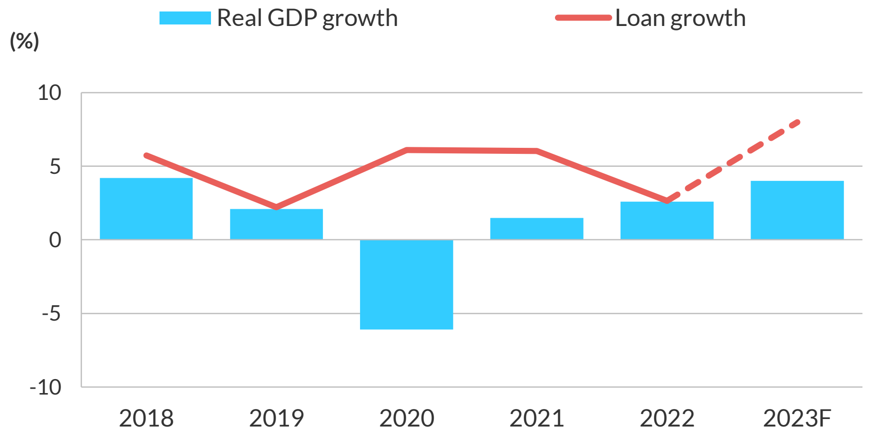
Thai Bank Sector Outlook

Fitch Ratings

Stable Operating Environment for Thai Banks

Thailand: Key Performance Trends
Nominal GDP growth and loan growth

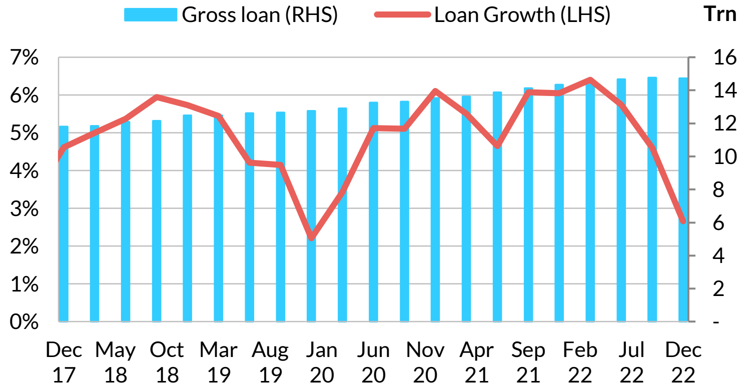


Source: Fitch Ratings, , Fitch Solutions, Bank of Thailand

- Bank operating environment is supported by Thai Sovereign rating of 'BBB+' which reflects robust external finances and a record of strong economic performance.
- Fitch recently upgraded forecast for Thailand to 4.0% in 2023, compared to 2.6% in 2022. GDP growth is lower compared to APAC peers but expected growth in 2023-2024 is better than the 'BBB' median'.
- Inflation should remain under control. Fitch expects interest rate to move up moderately to 2% by end-2023.

Downside Risks from High Leverage

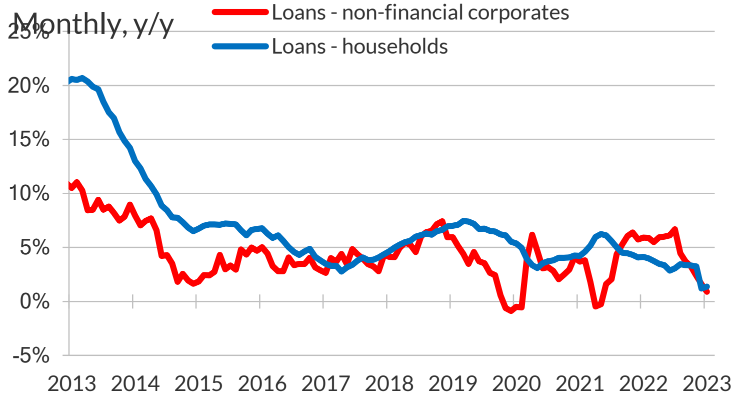
Thai Commercial Banks' loan growth 2017-2022



Source: Bank of Thailand

Thai Commercial Banks - LT Loan Growth Trend

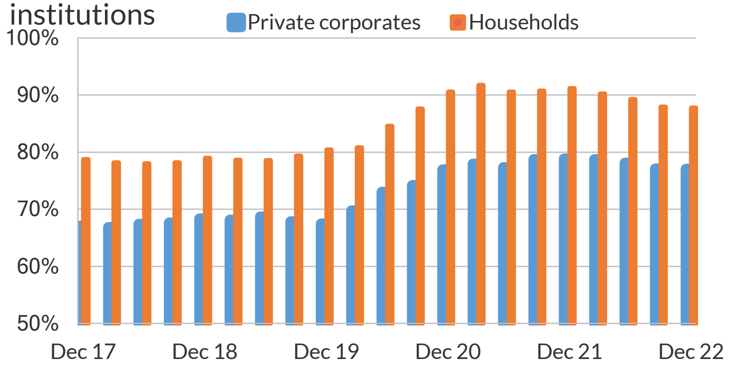
Monthly, y/y



Source: Bank of Thailand

Thai Private-Sector Credit

as % of GDP; including all financial liabilities / institutions

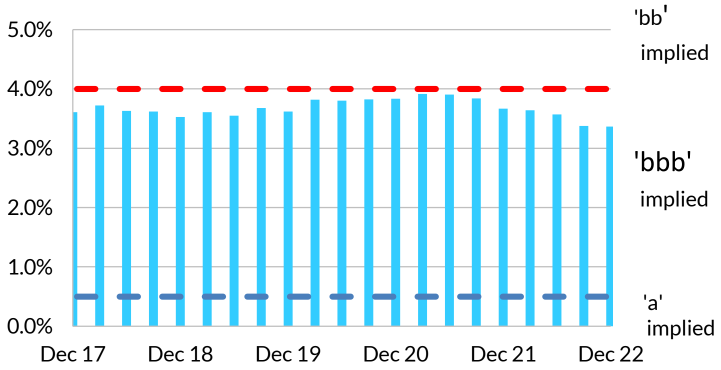


Source: Bank of Thailand, NESDC

- Thai commercial banks' loan growth decelerated to 2.6% in 2022.
- Private sector leverage remain high due mainly to reduced GDP rather than any substantial loan growth.
- The high level of indebtedness in the economy increases downside risks should circumstances be weaker than expected.

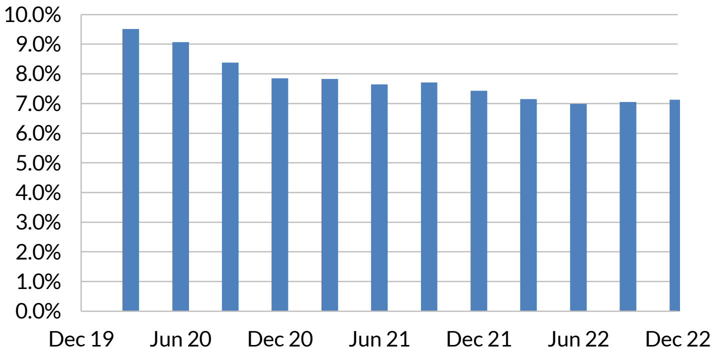
Continued Asset Quality Risks

Thai Banking Sector Asset Quality
Impaired Loans Ratio



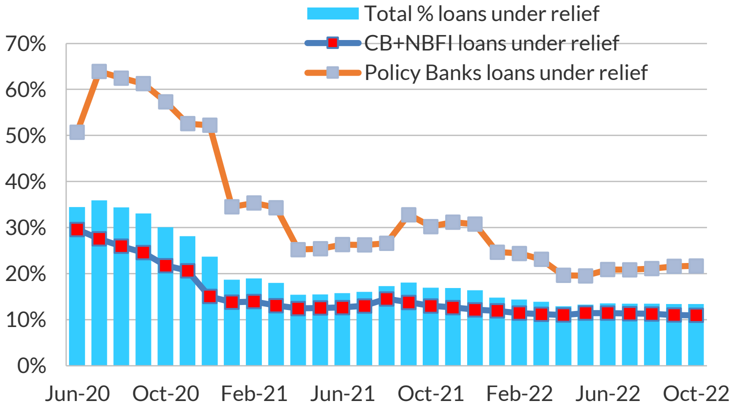
Source: Fitch Ratings, Bank of Thailand

Thai Banking Sector Asset Quality
Stage 2 loans



Source: Fitch Ratings, Bank of Thailand

Financial sector loans under relief

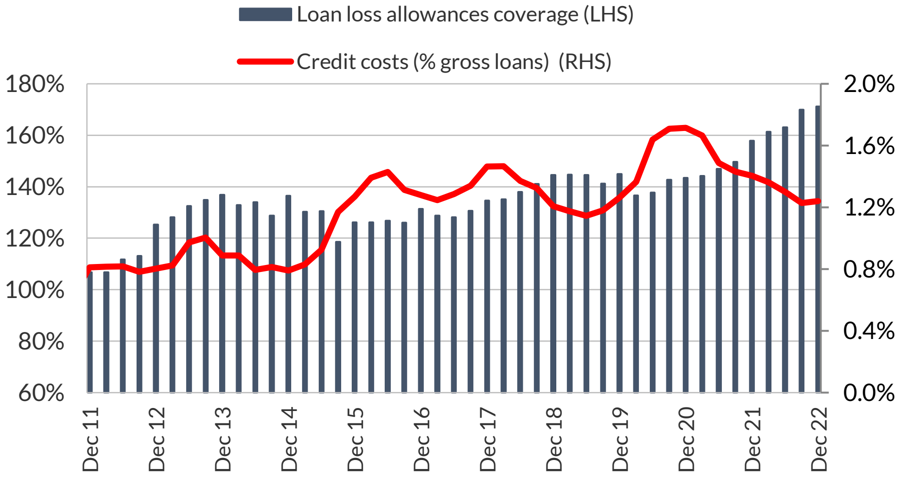


CB = Commercial Banks, NBFI = Non-bank financial institutions
Source: Bank of Thailand, Fitch Ratings estimates

- Impaired loans ratio looks reasonable, but risks remain from restructured loans, which still have the risk of falling into Stage 3.
- SMEs are the most vulnerable segment.
- Stage 2 loan and loan under relief program has consistently decline from its peak during the pandemic.
- Fitch’s base case expectations are that asset quality problems will peak in 2023 as relief measures expire and banks gradually clear their backlog of restructured loans.

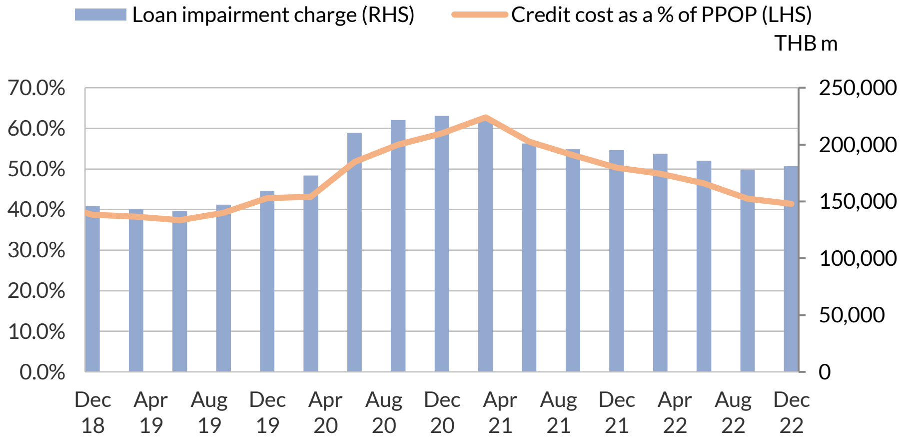
Mitigating Factors

Banks - long-term provisioning trends



Source: Bank of Thailand, Fitch Ratings

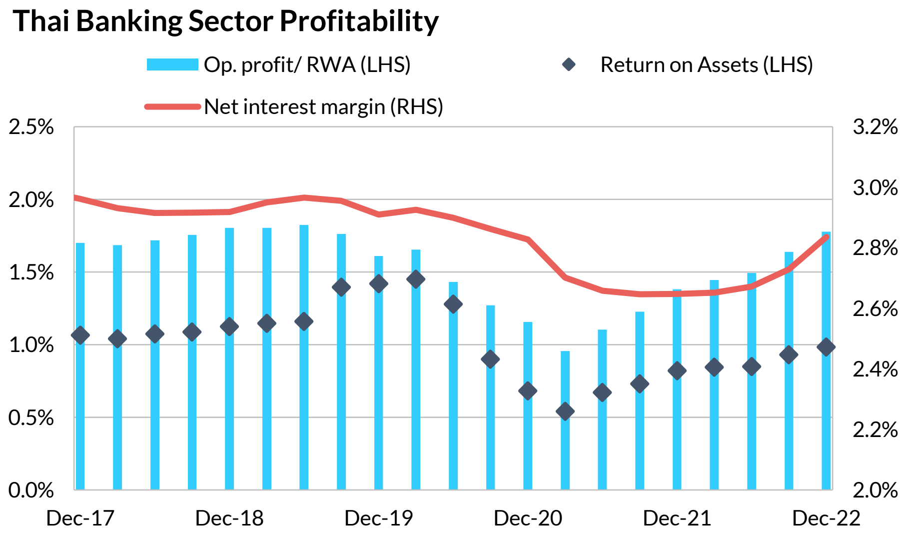
Thai Banking Sector Asset Quality
Credit cost



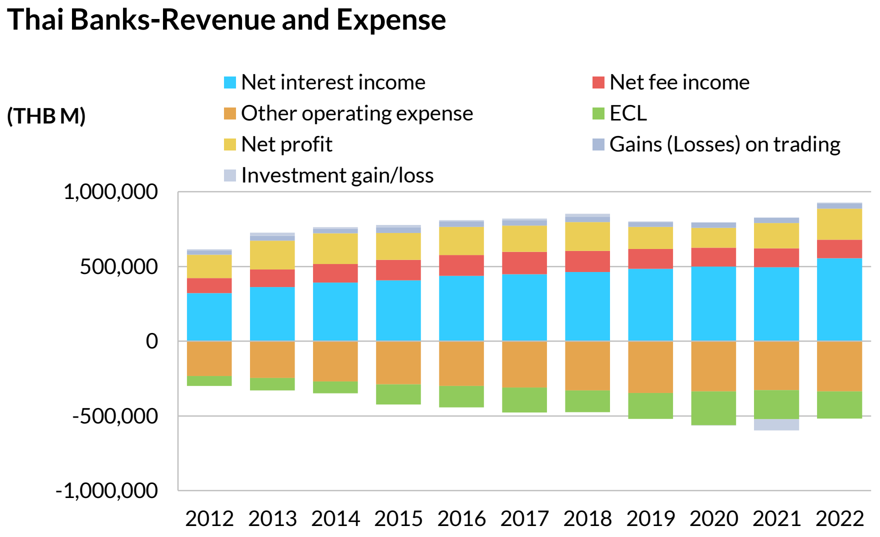
Source: Fitch Ratings, Bank of Thailand

- Thai banks made pre-emptive provisions to build up their reserve buffers against future NPL transitions.
- Fitch expects credit costs have already peaked, but will remain high compared to pre-pandemic levels.
- Current levels of loan loss allowances coverage appear to present a sound buffer against potential downside, and give banks room to write-off bad debts.

Earnings and Profitability to Gradually Recover



Source: Fitch Ratings, Bank of Thailand

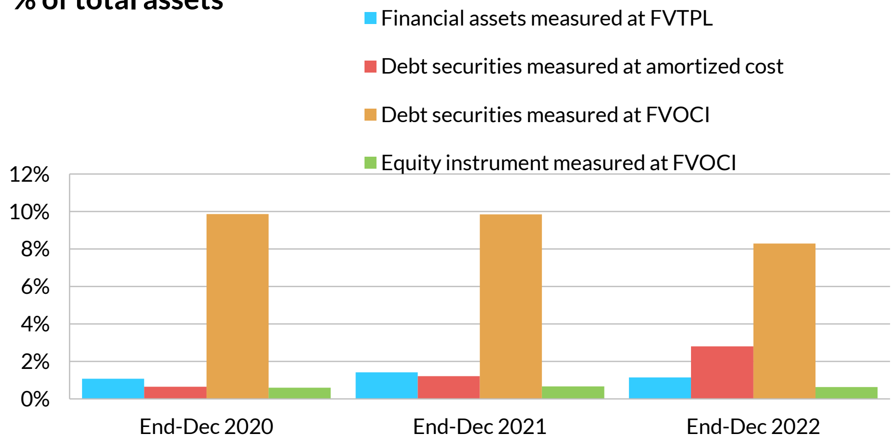


Source: Fitch Ratings, Bank of Thailand

- Stronger economic growth leads to fee-income opportunities and higher interest rates will support NIM.
- Less pressures on provisioning should also support profitability
- Nevertheless, the longer term picture still shows the weak profitability compared to pre-covid.

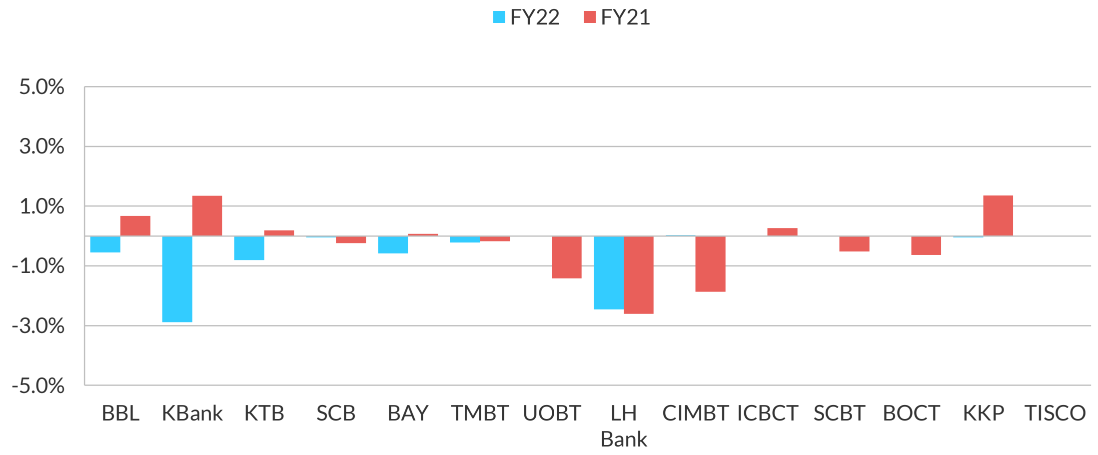
Market Risk Impact on Performance

Thai Banks' Securities Holding
% of total assets



Source: Fitch Ratings, Bank of Thailand

Investment revaluation in OCI / Total equity

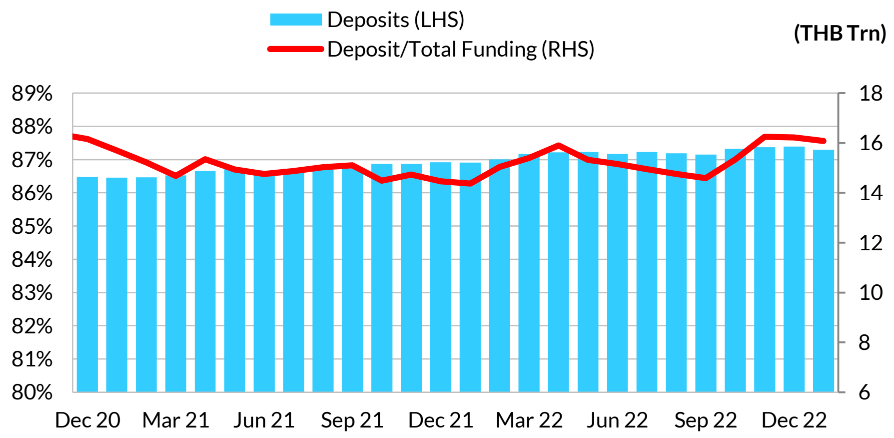


Source: Fitch Ratings, Bank of Thailand

- Rising interest rates are broadly positive for NIM, but potentially negative for investments.
- Market movements can lead to mark-to-market losses either on the P&L or directly on equity.
- The impact of interest rate movements on Thai banks' investment portfolios are still moderate, and losses should be manageable compared with earnings capacity and equity buffers.

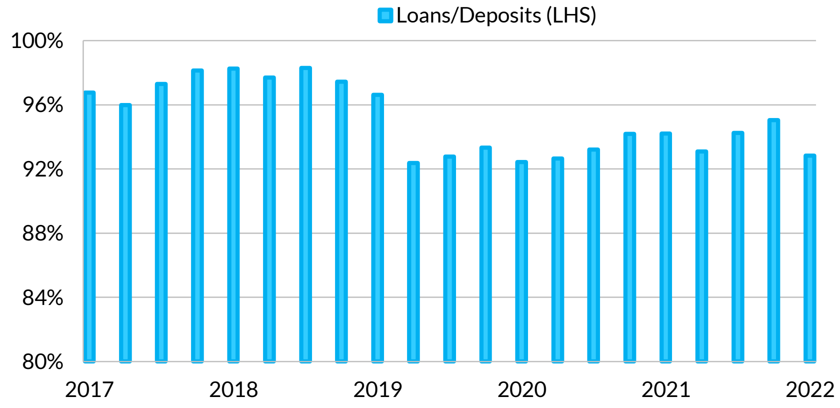
Funding Stability

Thai bank Deposit/Total Funding



Source: Bank of Thailand, Fitch Ratings

Banking Sector liquidity ratios quarterly, to Dec-2022

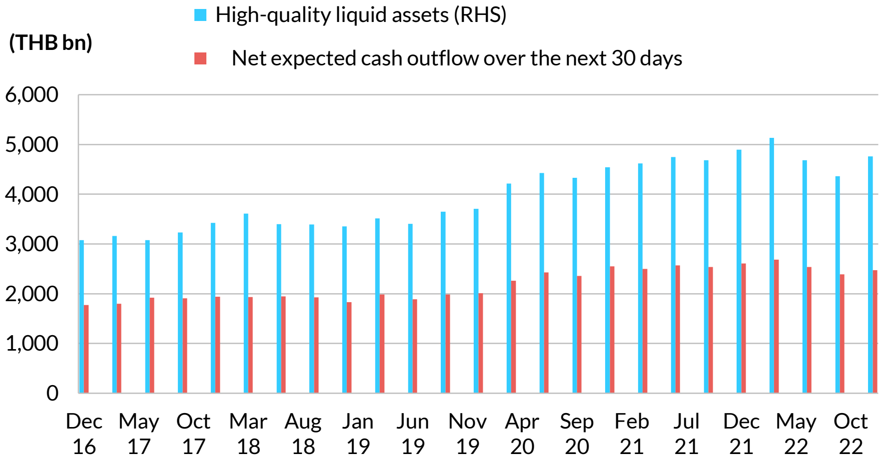


Source: Bank of Thailand, Fitch Ratings

- The Thai banking sector's loans-to-deposits ratio (LDR) while high remains generally stable.
- During market disruptions (e.g. in 2020), flight to quality led to deposit inflows into the system.
- Thai banks generally use deposit funding with little dependence on wholesale or foreign funding.

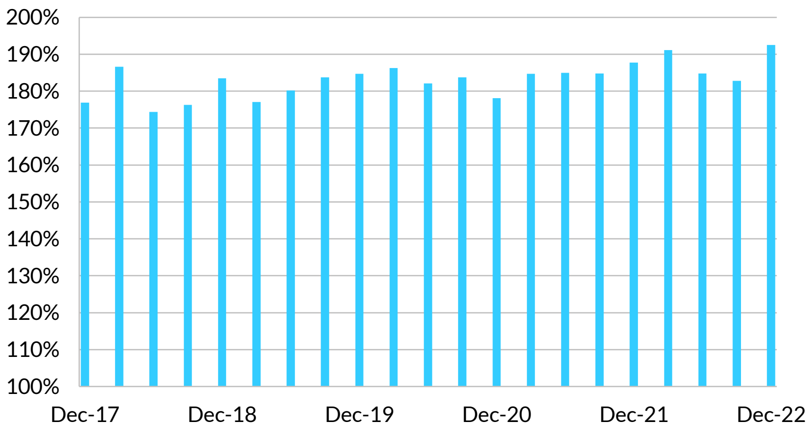
Liquidity Indicators

Thai Banks - High Quality Liquid Asset vs Net expected cash outflow over the next 30 days



Source:Fitch Ratings, Bank of Thailand

Thai Banks - Liquidity Coverage Ratio

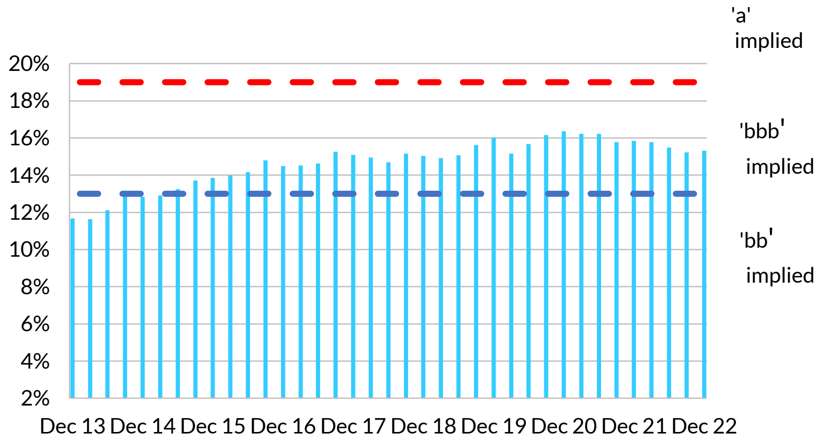


Source: Fitch Ratings, Bank of Thailand

- All Thai commercial banks have to comply with the Basel 3 framework for liquidity— i.e. LCR/NSFR requirements. Banks that fail to meet requirements can face penalties such as additional capital requirements or restrictions on their operations.
- LCR aims to ensure that banks are able to maintain sufficient liquidity to survive financial stress scenarios such as a rapid withdrawal of deposits or a freeze in the wholesale funding market over the 30-day stress period.

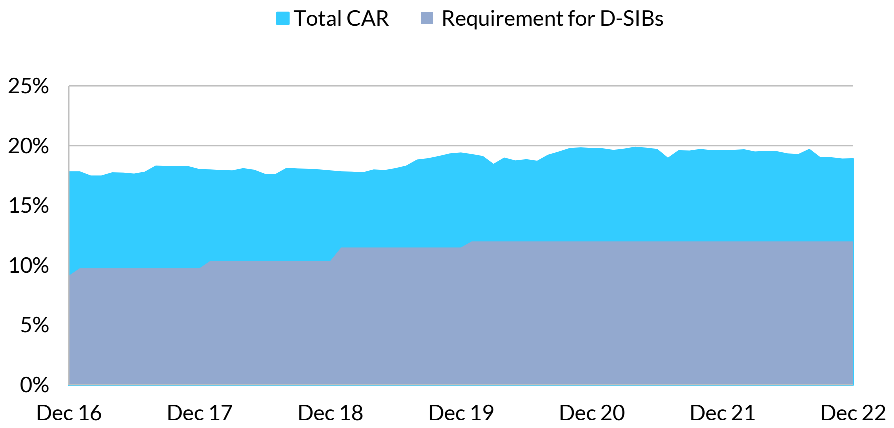
Strong Capital Position

Thai Banks - Long Term CET1 trends



Source: Bank of Thailand

Total Capital Ratio

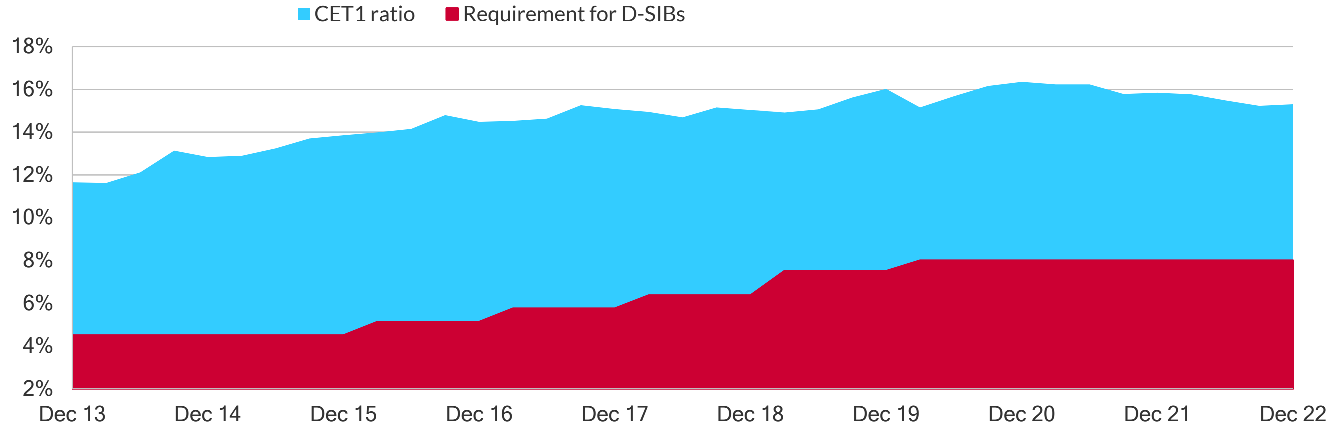


Source: Bank of Thailand

- The sector CET1 ratio has increased over the past several years, reflected most banks' long-term track record of capital accumulation . This provides a good buffer against downside.
- The total capital ratio has improved consistently, as a result of increasing CET1 as well as capital instruments issued over the past three years.

Sound Capital Buffers

Thai Banks - Long Term CET1 trends



Source: Bank of Thailand

- All banks, and the sector as a whole, are well in compliance with regulatory capital ratios.
- Impact from Investment revaluation in OCI is already reflected in Banks’ equity
- Fitch believes that the overall Thai banking system has a financial position that can withstand crises with higher capital than the level set by the authorities.

What to watch?

- While the improving economic environment is a positive factor, high levels of leverage in the system could lead to downside risks on banks' asset quality.
- The near-term challenge is for banks to generate earnings capacity to absorb potential losses from market and asset quality risks
- The medium- and longer-term strategic challenge is for banks to improve profitability without increasing risk appetite
- Banks with strong deposit franchises and low funding costs should benefit more from the rising interest rate environment
- High liquidity buffers remain important to absorb potential liquidity pressures that could come from the volatile market conditions.

Other key sector issues

Virtual Banking License

- Virtual banking presents an opportunity to expand financial service access beyond traditional banks.
- Thailand is among several countries in Asia that are issuing virtual banking licenses to interested operators.

Bank of Thailand's ESG Initiatives

- Bank may face more pressure from regulators, investors, and customers to integrate ESG considerations into their operations.
- ESG factors are now being included in bank regulatory frameworks in many countries.

Part 2

Subordinate and Hybrid Debt Rating Criteria

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Key Concepts

Our ratings of subordinated and hybrid securities depend on three issues:

1) Anchor Rating

- General case: to use the bank's Viability Rating (VR) as the 'anchor'.
- May use support-driven rating, if Fitch believes institutional or sovereign extraordinary support is likely to be extended further down the capital structure

2) Loss severity

- Reflects higher likelihood of weak recoveries compared to more-senior instruments.
- Usually this is gone-concern loss absorption, or triggered at the point of non-viability (PONV).
- Base case: -2 notches (poor recovery)

3) Non-performance risk

- This includes going-concern loss absorption triggers such as non-payment of coupons, or capital conversion / write-down features prior to PONV.
- These features (e.g. in Basel 3 Tier 1 securities) are likely to lead to at least -2 notches.

Examples-Base case notching

	Rating					
Issuer	IDR / National Rating	VR	Basel III Instrument	Anchor Rating	Debt Rating	Total Notching
National Rated Securities: Example Notching						
BAY	AAA(tha)	bbb	Tier 2 subordinated (partial or full write-down)	AAA(tha)	AA(tha)	2
ICBCT	AAA(tha)	N/A	Tier 2 subordinated (partial or full write-down)	AAA(tha)	AA(tha)	2
KTB	AAA(tha)	bbb-	Tier 2 subordinated (partial or full write-down)	AAA(tha)	AA(tha)	2
UOBT	AAA(tha)	bbb-	Tier 2 subordinated (partial or full write-down)	AAA(tha)	AA(tha)	2
UOBT	AAA(tha)	bbb-	Tier 1 subordinated (partial or full write-down)	AAA(tha)	A+(tha)	4
International Rated Securities: Example Notching						
KBANK	BBB	bbb	Tier 2 subordinated (partial or full write-down)	bbb	BB+	2

Basel 3 Tier 2 Rating Approach Summary

Key Requirements from the BOT:

- Capable of loss absorption when the commercial bank cannot continue to operate the business (i.e. at the point of non-viability, or PONV).
- PONV is defined as the point at which emergency capital assistance is rendered by the state.
- At PONV, the B3T2 instrument should be (1) converted to ordinary shares, or (2) is written down.

- Terms and conditions of Thai banks' Tier 2 are in line with Fitch's base case notching – i.e. 2 notches for loss severity, and 0 notches for non-performance risk.

Anchor = VR/IDR
- Base case is the VR.
- Can be Support driven IDR, if Fitch believes that extraordinary support would prevent the bank from reaching PONV

Loss Severity = 2 notches
- Reflects subordination to senior liabilities in a non-viability event.

Non-performance = 0 notch
- No additional notching required as there is no loss absorption feature before PONV.

Basel 3 Tier 2 Rating Approach Summary

Alternative Notching (i.e different from the base case notching)

Fewer notches than the base case	More notches than the base case
Mitigation for Loss severity • The loss severity risk is mitigated by thick Tier 2 and Tier 1 debt buffers>10% RWA • Partial support is likely in a default • Early regulatory intervention takes place • There is a precedent of loss mitigation by authorities	Incremental non-performance risk • Risk of regulator-enforced losses is meaningfully greater than assessment of failure risk captured by Fitch's VR. Likely to be rare; • Bond has a contingent conversion/write-down trigger that creates moderate (1 additional notch) or high (2 additional notches) incremental non-performance risk relative to the anchor.

Basel 3 Additional Tier 1 (AT1) Rating Approach Summary

Key BOT AT1 requirements :

- There should not be any clause that commercial banks must pay interest or any other returns to holders of financial instruments counted as Tier 1 capital. Coupons would not be paid depending on set conditions. Commercial banks also have the power to cancel interest payments or any other return at any time.
- Must be able to absorb losses on going concern basis by either convertible to ordinary shares or write down when the commercial bank has a Common Equity Tier 1 capital ratio below a trigger point, the trigger point must be higher than 5.125% (against the minimum regulatory CET1 requirement of 4.5%)
- The BOT's latest terms and conditions for Tier 1 instruments are in line with Fitch's base case notching – i.e. 4 notches below the anchor, comprising 2 notches for loss severity and 2 notches for non-performance risk.

Anchor = VR/IDR

- Usually VR as it reflects the likelihood of the bank to become non-viable.
- Can be Support driven IDR, if Fitch believes parental support is as likely for junior debt as for senior.

Loss Severity = 2 notch

- Reflects subordination to senior liabilities in a non-viability event.

Non-performance = 2 notch

- Significant non-performance risk on a going-concern basis.

Basel 3 AT1 Rating Approach Summary

Alternative Notching

Fewer notches than base case	More notches than base case
Mitigation for non-performance risk • Extraordinary support (e.g. from institutional or sovereign): Can consider to use support-driven anchor rating, rather than VR, with possible adjustments on notching for non-performance risk. • There is rating compression in ‘BB’/’bb’ range and below. • There are very high constraints to non-performance	Higher non-performance risk • A profits test that may affect non-performance risk • Thin capital buffers (eg <100bp) over coupon omission points; • Low distributable reserves

Conclusion

- The approach for B3T2 ratings of Thai banks is the criteria base case of -2 notches. Past examples show some precedence for using shareholder support-driven ratings for foreign bank subsidiaries as the anchor rating.

- The most likely approach for Thai banks' AT1 instruments based on the BOT's requirements is to apply our base case of -4 notches. AT1 is meant to be loss-absorbing on a going-concern basis, leading to a gap to senior and Tier 2 ratings.

- As per our criteria, the ultimate notching could be narrower or wider based on differences of loss severity and non-performance risk from the base case.

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