

MOODY'S

INVESTORS SERVICE

BANKING SYSTEM OUTLOOK

Thailand

Our outlook on Thailand's banking system remains stable.¹ The outlook expresses our expectations for the fundamental credit conditions in this system over the next 12-18 months.

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Summary Opinion

Our outlook for Thailand's banking system remains stable, reflecting our expectations of solid, although reduced, demand for bank loans, sustained profitability, and strong system-wide capitalization.

Underpinning these expectations is the sharp rebound in the domestic economy that reconstruction and inventory replenishment activities will generate as firms normalize production and the government implements programs introduced after last year's massive floods. This domestic stimulus will temper weak global macroeconomic conditions.

Operating environment. The GDP data of 1Q2012 reinforce our earlier view that a V-shaped recovery can be expected this year, after the floods pushed economic growth deep into negative territory in 4Q2011 (real GDP contracted by 9%² year-on-year). This assumption underpinned our Banking System Outlook³ published in November 2011.

Our central scenario now assumes real GDP growth of 5.0% in 2012 and 5.6% in 2013, up from 0.1% for the whole of 2011⁴. Growth will be driven by domestic consumption and investment, as well as expectations of substantially increased fiscal spending and an accommodative monetary policy.

However, the banking sector's growth will be slower than in 2011 due to difficult global economic conditions. We expect annual loan growth of 5%-10% -- with the infrastructure and manufacturing sectors accounting for the bulk of the new loans -- versus 15% a year ago⁵. This assumes that export-driven lending will be slower than last year.

Domestically, while we cannot rule out the renewal of political unrest during the horizon of our outlook, given that the country remains deeply polarized, we note that the economy and banking sector have proved to be resilient in the face of political conflict in recent years. Therefore, we do not expect the operating environment for banks to be particularly sensitive to political developments.

¹ Outlooks for industries or sectors present Moody's view on the likely future direction of credit conditions in that sector. They do not represent our projection of rating upgrades versus downgrades.

² Source: The National Economic and Social Development Board (NESDP), which compiles Thailand's GDP data, 1Q2012 report

³ See our November 2011 [Thailand Banking System Outlook](#) (137492)

⁴ Source: [Moody's Sovereign Country Statistics for Thailand](#), published 1 June 2012

⁵ Source: Unless noted otherwise, data related to system trends is sourced from the central bank whereas bank-specific figures originate from company reports and Moody's Banking Financial Metrics

Asset quality and capital. Since October 2011, the government has allowed flood-hit commercial, industrial, and individual borrowers to delay debt servicing for six months, permitting banks to reschedule loans and postpone the recognition of non-performing loans (NPLs) to after 1Q2012.

Even though estimates from Moody's-rated banks in Thailand suggest that reported NPLs could rise by up to 50 basis points by end-2012 once regulatory forbearance ends, our analysis indicates that the bulk of the provisions required for these potential NPLs were already made in 4Q2011.

Thai banks also face structural risks posed by large single-party exposures. This is particularly relevant if the economic scenario becomes more adverse than expected and large manufacturing exporters are significantly affected. However, our stress testing shows that Thai banks have the financial flexibility to withstand a substantial deterioration in asset quality.

Under our *adverse scenario*, in which NPLs reach an average of 10% throughout their loan books, our analysis indicates that the capital levels of all Moody's-rated banks will remain within a 7%-16% range.

It would take a *highly adverse scenario*, with average NPLs of 20% (i.e., 7 times current NPL levels) to cause Tier 1 ratios to erode to levels that would require some banks to raise capital by Basel II standards. Such a scenario would leave five banks out of 10 with Tier 1 ratios under 7%.

Funding and liquidity. Despite some weaknesses, we believe that the system's overall funding and liquidity profile is, on balance, stable.

One of the strengths of Thai banks is their resilient liquidity profile -- liquid assets account for 30% of total assets, while customer deposits make up 75% of total funding. And while the system's headline average loan-to-deposit ratio (LDR) was relatively high at 122% at end-2011, there are stabilizing factors that are important to consider.

Such high LDRs have resulted from the banks' promotion of Bills of Exchange (BE)⁶ to retail investors. By not having to pay the deposit insurance premium on BEs, banks were saving on their cost of funds while passing on a portion of the benefits as higher yields to their consumers.

Recently, however, the government has decided to remove these price incentives and tighten regulation in order to shift the retail portion of these savings back under the insured deposit mix. We are already observing a decline in BE issuances and a corresponding improvement in LDRs. Given that BE tenors are up to 12 months, we expect to see a more pronounced shift over the period covered by our outlook. As a reference, adding BEs to the deposit mix would reduce the average LDR to 90%.

At the same time, foreign currency credit growth has by far outpaced the growth in foreign currency deposits. Consequently, the system's foreign currency LDR rose to 210% at end-2011. However, we note that foreign currency loans and deposits constitute a small proportion -- less than 10% -- of total loans and deposits.

While any material change in the domestic banks' dependence on the capital markets is unlikely, the significant foreign currency reserves accumulated at the central bank -- which serve as a buffer against

⁶ Bills of Exchange are term debt instruments that pay higher returns than deposits but are unprotected by deposit insurance, thereby not qualifying as deposits for LDR calculation purposes.

the risk of an external liquidity crisis – will ensure their continued access to US dollars in extreme conditions.

Thailand currently has foreign reserves of more than \$175 billion versus the \$26 billion it had during the financial crisis in 1997. These reserves are more than sufficient to address the system's reliance on foreign currency funds, which we estimate stood at around \$9 billion at end-2011.

Profitability and efficiency. Despite the floods, the profitability of Thai banks was steady throughout 2011, and we expect that it will stay strong on the back of solid loan growth. We expect net interest margins (NIMs) to be somewhat under pressure owing to the competition for deposits, which may increase interest expenses. But, there is potential for an increase in loan rates in areas where demand is strongest, as well as for higher fee income. A reduction in corporate tax to 23% from 30% effective this year will also enhance profitability.

Systemic support. Our assessment of government support will remain stable over the next 12-18 months. Our view that all rated Thai banks would likely receive government support, if needed, leads to an uplift of one or two notches for the debt and deposit ratings of most of these banks.

The ratings uplift is based on the concentrated structure of the banking system and which makes the four largest rated banks -- that account for more than 60% of the country's banking sector assets -- systemically important. There have been several instances of support in the past and we do not expect any changes in either the capacity or the willingness of the authorities to extend support to systemically important banks, if necessary.

The stable outlook for the Thai banking system is consistent with the stable outlook on most individual bank ratings, as well as Thailand's Baa1 sovereign bond rating.

FIGURE 1

Outlook overview

Category	Assessment
Operating environment	Stable
Asset quality	Stable
Capital	Stable
Funding and liquidity	Stable
Profitability and efficiency	Stable
Systemic support	Stable
Overall banking system outlook	Stable

Definition of Banking System Outlook

Banking system outlook publications represent Moody's view on the broad operating environment in which banks of a given system operate and, more specifically, on the influence that macro-economic, competitive, and regulatory trends may have on banks' asset quality and capital and, ultimately, on their funding and profitability.

As such, a “stable” outlook is one that implies an environment that favours sustainable profitability and limited volatility for a period of at least four to six quarters (i.e., for the time horizon of our outlook). A “negative” outlook is one that is characterized by volatility and uncertain conditions. A “positive” outlook is one in which banks are expected to rest on solid ground for the duration of our time horizon and in which banks are expected to grow steadily as a result of a favourable environment during that period.

Rating Universe

- » We rate 10 banks in Thailand, including 8 commercial banks and 2 policy banks. The 8 commercial banks accounted for approximately 89% of the assets in the Thai commercial banking system at end-2011. The other 2 banks – EXIMT and GHB – are specialized financial institutions and policy banks, with 100% government ownership (Figure 2).
- » Their asset-weighted average long-term bank deposit rating is Baa1, while their asset-weighted average standalone credit profile is baa3, reflecting two notches of uplift due to our assumptions of external support.

FIGURE 2

Ratings Universe⁷

Rated Thai Banks	Total Assets (THB Billion)	Market Share by Assets end 2011 (1)	Standalone Credit Strength and Outlook (2)	Foreign Currency Long-term Bank Deposit/(Issuer) Rating and Outlook	Notches of Uplift from Parental Support	Notches of Uplift from Systemic Support
Bangkok Bank (BBL)	2,107	13.8%	C- / baa2 ; Stable	Baa1 / P-2 ; Stable	0	1
Krung Thai Bank (KTB)	1,965	12.9%	D- / ba3 ; Positive	Baa1 / P-2 ; Negative	0	5
Siam Commercial Bank (SCB)	1,878	12.3%	C- / baa2 ; Stable	Baa1 / P-2 ; Stable	0	1
Kasikornbank (KBank)	1,723	11.3%	D+ / baa3 ; Stable	Baa1 / P-2 ; Stable	0	2
Bank of Ayudhya (BAY)	948	6.2%	D+ / ba1 ; Stable	Baa2 / P-2 ; Stable	0	2
TMB Bank (TMB)	719	4.7%	D- / ba3 ; Stable	Baa3 / P-3 ; Stable	0	3
Government Housing Bank of Thailand (GHB)	679	4.4%	E+ / b1 ; Stable	Baa1 / P-2 ; Stable	0	6
United Overseas Bank (Thai) (UOBT)	299	2.0%	D / ba2 ; Stable	Baa1 / P-2 ; Stable	4	0
Standard Chartered Bank (Thai) (SCBT)	284	1.9%	D+ / baa3 ; Stable	Baa1 / P-2 ; Stable	2	0
Export-Import Bank of Thailand (EXIMT) (3)	74	0.4%	-	(Baa1); Stable	-	-

Source: Company data and Bank of Thailand

⁷ (1) Market share is based on the sum of (a) Thai Commercial Banks registered in Thailand (excluding branch offices abroad), and (b) Depository Specialized Financial institutions comprising Government Savings Bank, Government Housing Bank, Bank For Agriculture And Agricultural Cooperatives, Export-Import Bank of Thailand, Small And Medium Enterprise Development Bank of Thailand and Islamic Bank of Thailand; (2) Bank financial strength ratings express a bank's standalone credit strength on a scale from A to E, without taking support considerations into account. Foreign currency long-term bank deposit ratings reflect a bank's standalone credit strength, support considerations, and the country ceiling of Baa1; (3) EXIMT has a foreign currency issuer rating of Baa1 with a stable outlook. The principal methodology used in rating EXIMT, a government-related issuer and a government-controlled financial company with specific policy mandates, is “[The Application of Joint-Default Analysis to Government Related Issuers](#)”.

Key Developments Since the Previous Banking System Outlook

- » The economy suffered a 9% year-on-year contraction in 4Q2011 due to the floods, which reduced full-year growth to a meagre 0.1%. Growth, however, rebounded sharply by 11% quarter-on-quarter, or 0.3% year-on-year, in 1Q2012⁸. This partly reflected monetary and fiscal stimulus from the government – the central bank has lowered policy rate by 50 basis points to the present rate of 3.0% -- and fiscal expenditure commitments worth over \$95 billion.
- » The government has introduced measures to incentivize an increase in deposits by shifting retail savings from Bills of Exchange.

Key Drivers

Strengths

- » Solid ability to generate pre-provision profits, supported by strong domestic growth and sustained loan demand, as well as banks' initiatives to expand their non-interest income sources, such as fees and services, and bancassurance. Net interest margins have stayed between 3% and 3.5%.
- » Good shock-absorbing buffers; most banks have sufficient earnings, provisions, and capital to absorb losses under our adverse scenario.
- » Macro-level foreign currency buffer, as the central bank's significant reserves could be used to support banks in case of a foreign debt market crunch.

Weaknesses:

- » Credit vulnerabilities remain pronounced due to elevated single-party exposures that increase the risk from potential defaults by large borrowers or cyclical movements in certain industries.
- » Foreign currency mismatches make banks dependent on markets and, ultimately, the central bank.

Uncertainties

- » Mostly external risks, especially those that would affect exports, access to capital and debt markets, and inflation.

Operating Environment

Economic environment

Growth Outlook Supported by Post-Flood Rebound

- » Our base-case scenario assumes that GDP growth will rebound to 5.0% in 2012 and 5.6% in 2013, from the near-flat growth in 2011.
- » We expect domestic demand to be the main driver of growth in the coming 12-18 months on the back of the monetary and fiscal measures put in place after the floods. So far, the total initiatives announced (including the government stimulus programme) amount to more than THB3 trillion (\$95 billion), or 30% of nominal GDP. They are:

⁸ Source: The National Economic and Social Development Board (NESDP), which compiles Thailand's GDP data, 1Q2012 report

- fiscal initiatives for rebuilding, including a five-year THB2.3 trillion (\$72 billion) plan for long-term infrastructure development
 - a two-year THB350 billion (\$11 billion or 3.3% of 2011 GDP) plan to invest in improving flood prevention and water management
 - soft loans of THB300 billion (\$9 billion) to flood-affected victims
 - higher minimum wage, tax incentives for first-time home buyers, corporate tax reductions (to 23% from 30%), and increased rice prices for farmers
- » We also expect the reduction in interest rates and general post-flood reconstruction and replacement needs to boost credit demand.
- » On the other hand, external demand will be subdued by the ongoing euro area crisis and the falling regional economic growth, both of which may limit the contribution from exports, which represent 77% of GDP. In 1Q2012, growth in exports slowed to 1% year-on-year⁹.
- » Consequently, we expect loan growth to moderate to an annualized pace of 5%-10% in the coming 12-18 months, compared with 15% in 2011, with growth to be driven mostly by the corporate and consumer sectors. Since end-2011, corporate credit demand for working capital and long-term investments has picked up, in addition to the strong growth in auto loans.
- » Domestically, the biggest risk to the sector is from the lingering polarization over the return of deposed Prime Minister Thaksin Shinawatra from exile and the related constitutional issues. However, economic and political developments have been independent of each other for most of Thailand's modern history. As such, we expect that political instability will continue to have only a limited impact, if any, on economic growth during the horizon of our outlook.

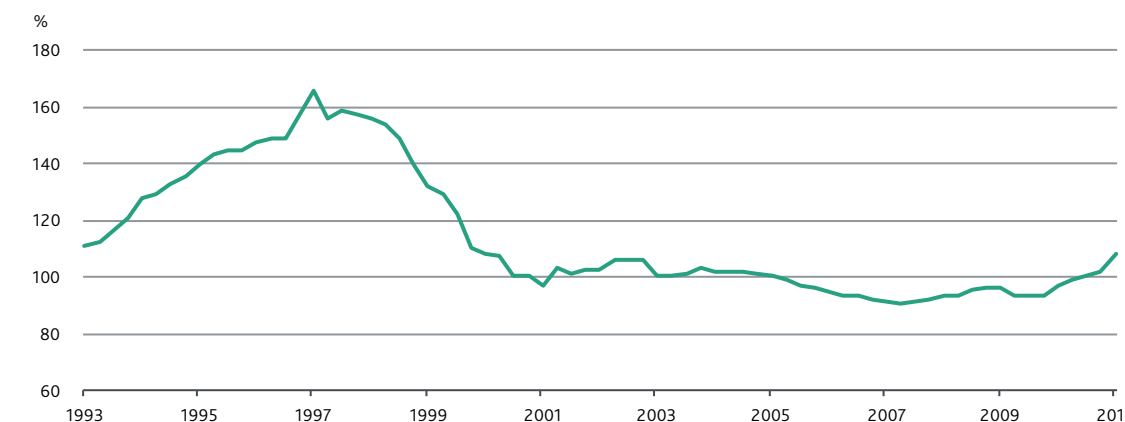
Fiscal and Inflationary Pressures on the Horizon

- » Although beyond the timing horizon of our outlook, credit concerns could arise from the government's multiple post-flood initiatives which pose the risks of prolonged slippage in fiscal discipline and rising inflation, especially if the spending spree is not promptly moderated once a recovery has settled in. The government's fiscal deficit stood at 0.9% of GDP in 2011 and we expect it to increase to 3% of GDP for FY2012¹⁰.
- » Currently slightly below 3%, we expect inflation to surpass the high end of the central bank's target range of 0.5%-3% by the end of the year and continue increasing well into 2013.
- » For the time being, the overall debt leverage of the economy is within safety limits and we have not noted any sign of asset price bubbles. Property prices have also remained stable. Total credit to GDP rose in 2011 (Figure 3), largely due to the denominator effect of flat GDP growth. But this ratio will stabilize at the current level in the coming 12-18 months, driven by the slowdown in lending growth and the recovery in GDP, and remain well below the peak of the mid-90s, i.e. before the Asian financial crisis.

⁹ Source: The National Economic and Social Development Board (NESDP), which compiles Thailand's GDP data, 1Q2012 report

¹⁰ Source: [Moody's Sovereign Country Statistics for Thailand](#), published 1 June 2012

FIGURE 3
Credit/GDP Increased in 2011, but has Remained Constant in the Last Decade



Source: BoT, IMF

Competitive Environment

- » We expect competition for deposits to increase. However, the big four banks – Bangkok Bank, Krung Thai Bank, Kasikornbank and Siam Commercial Bank – account for over 60% of system assets, have strong banking franchises, and will continue to dominate the sector.
- » Given relatively high LDRs compared to regional banks, Thai commercial banks could be under pressure to devise new products in order to attract and maintain customer deposits. While some foreign banks have introduced structured deposits, domestic banks have not yet followed suit. They continue to rely on their strong franchise recognition and the slight adjustment in the prices of plain vanilla products to stay competitive.
- » Large-scale consolidation in the domestic market or big-ticket acquisitions overseas, is unlikely in the coming 12-18 months, as the uncertainty in the global economy will continue to force banks to focus on organic growth.
- » However, the banks will likely continue to expand their branch network in the region, especially the large local banks that have begun expanding in Cambodia, Laos, and Vietnam, as they prepare for greater business opportunities that will arise from the formation of the Association of Southeast Asian Economic Community in 2015. For now, revenue from overseas branches remains a marginal proportion of the banks' total revenue.
- » Increasing pressure on European banks and their respective subsidiaries to shrink their balance sheets overseas and concentrate more on core businesses may also present small-scale acquisition opportunities.

For instance, in 1Q2012, the Hongkong and Shanghai Banking Corporation Limited (Aa2 stable; B/aa3 stable), the Asian subsidiary of HSBC Holdings Plc (Aa3 negative) which is headquartered in London, sold its retail banking and wealth management operations in Thailand to Bank of Ayudhya (Baa2 stable; D+/ba1 stable) in order to focus on its corporate portfolios and invest in wholesale capability.

Systemic Support

- » We assess Thailand as a high-support country. The government's resolve to support the system is evident from the liquidity support the Bank of Thailand (BoT) provided to financial institutions through its unit, Financial Institutions Development Fund, after the Asian financial crisis. The government has not allowed any bank in the country to default in the last three decades.
- » The government has the resources and the willingness to extend support to the banking sector as needed.
- » The authorities' capacity to support the system is based on: (i) the government's financial strength, underpinned by a low debt-to-GDP ratio of around 30% at end-2011, and (ii) the country's flexible exchange-rate regime, which gives the central bank full monetary autonomy.
- » Also, the implementation of the Deposit Protection Agency Act in August 2008 ensured that the deposits of commercial banks were 100% protected by the government. This protection is currently THB50 million (\$1.5 million) per person per bank. We do not have data on the amount of deposits above this coverage limit.

Asset Quality and Capital

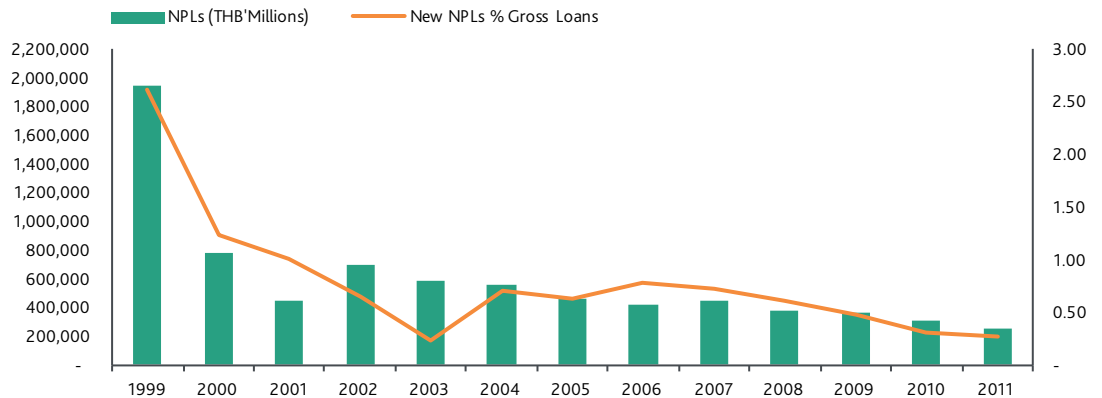
Asset quality

Modest deterioration in asset quality expected, as the impact from the floods surfaces in 2H2012

- » On the government's sanction, many banks allowed flood-affected commercial, industrial, and individual borrowers to delay debt servicing for six months starting October 2011. However, since these measures expired in 2Q2012, NPLs will increase from the current multi-year low (Figure 4) as they will begin to reflect the full impact from the flood.
- » Nevertheless, we expect this deterioration in asset quality to be temporary and manageable. Most of these NPLs relate to temporary supply-chain disruptions (the industrial estates in Ayutthaya, Pathum Thani, Nakhon Sawan and Lop Buri were severely affected by the flood). The key sectors affected include agriculture, automobiles, and electronics industries in the flood-hit areas north of Bangkok, and in the outskirts of the capital.
- » Separately, in a February 2012 report, Swiss Re's Sigma research unit estimated that total insured market loss (claims mostly from foreign insurers, predominantly Japanese) -- from the worst ever Thai floods in more than 50 years -- were the highest ever for a river water flood event at \$12 billion.

We believe that the insurance pay-outs have assisted the flood-affected borrowers, and, in turn, mitigated the extent of asset quality deterioration in the banking system. In addition, the affected Japanese manufacturers, mainly in the auto and electronics industries, continue to be committed to rebuilding their Thai facilities.

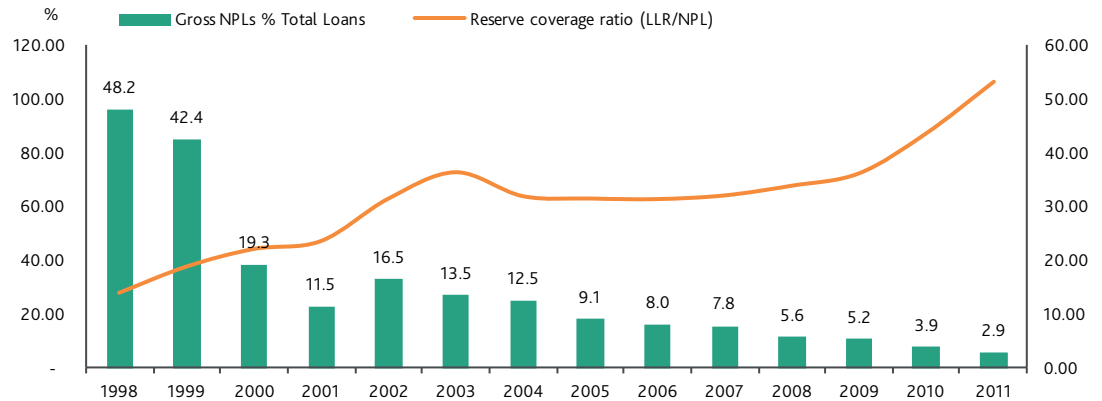
FIGURE 4
NPL Trends for the Thai Banking Industry



Source: BoT

- » While no government data has been published, the Moody's-rated Thai banks that we have surveyed expect NPLs to rise by up to 50 basis points by the end of 2012. BoT data show that, as at end-2011, the industry's NPL ratios were at a new low of 2.9%, and new NPL formation rates were below 0.5% (Figure 5), although these figures do not account for concentration-risk variations that may exist across individual banks.

FIGURE 5
NPL Ratios Against Provisioning Trends Among Thai Banks



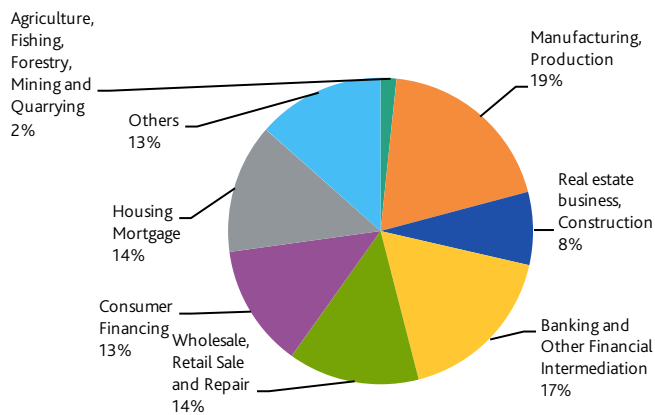
Source: BoT

- » Large single-borrower concentration risks represent an ongoing weakness of Thai banks. The banks' exposure to large corporate borrowers makes them vulnerable to the risk of rapid deterioration in asset quality, should Thailand's corporate sector suffer stress.
- » As of end-2011, the 20 largest borrowers represented between 100% and 200% of our rated banks' Tier 1 capital and between 350% and 750% of their pre-provision, pre-tax income. This compared poorly with most similarly rated global peers.

FIGURE 6

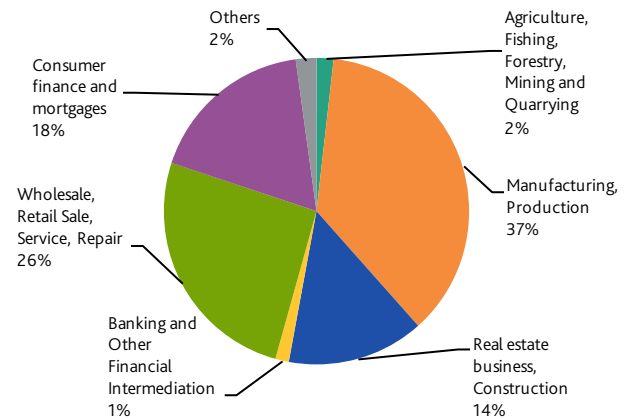
Loan and NPL Breakdown by Industry at end-2011

Loans Breakdown by Industry (%)



Source: BoT

NPLs Breakdown by Industry



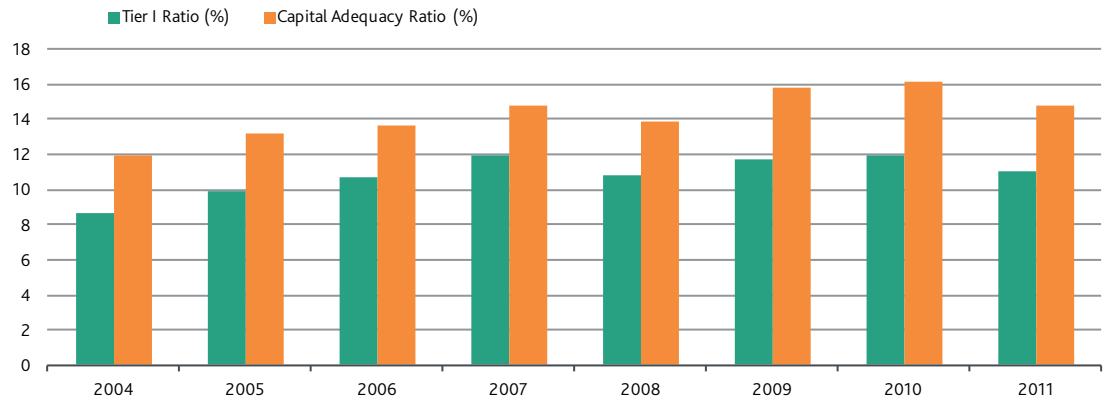
Source: BoT

- » However, the loan portfolios of Thai commercial banks are fairly well-diversified by loan categories and industries. Although loans to the manufacturing and production sector account for only 20% of total loans, they constitute the largest proportion of NPLs at 37% (Figure 6).
- » In the long run, we will likely see banks more inclined to increase their profits by growing higher-yield assets such as consumer loans, which currently constitute almost 30% of total loans, while representing less than 20% of gross NPLs. As at end-December 2003, consumer loans accounted for just 16% of total loans.
- » Also, growth in households' consumer credit has outpaced asset growth since the middle of 2010. As a result, households' debt-to-asset ratio continued to rise – although it still remains lower than neighbouring countries like Malaysia and Singapore -- and reached about 45% at end-2011 versus 42% 18 months earlier, according to BoT. While this is not a concern within the timing horizon of our outlook, there is a longer-term risk that abundant credit in the banking system would undermine financial discipline.

Capital**Adequate capitalization to absorb future expected losses and support growth**

- » In the event of a downside risk scenario, the Thai banks have substantial cushion to withstand a significant shock to asset quality.
- » As at end-2011, the average Tier 1 ratio of Thai banks was 11%, well above the threshold of 4.25% set by the BoT, while total capital adequacy ratio (CAR) was 15% (Figure 7). The decline observed from 2010 to 2011 resulted from the strong loan growth of 2011.

FIGURE 7
Capital Adequacy for the Thai Banking Industry

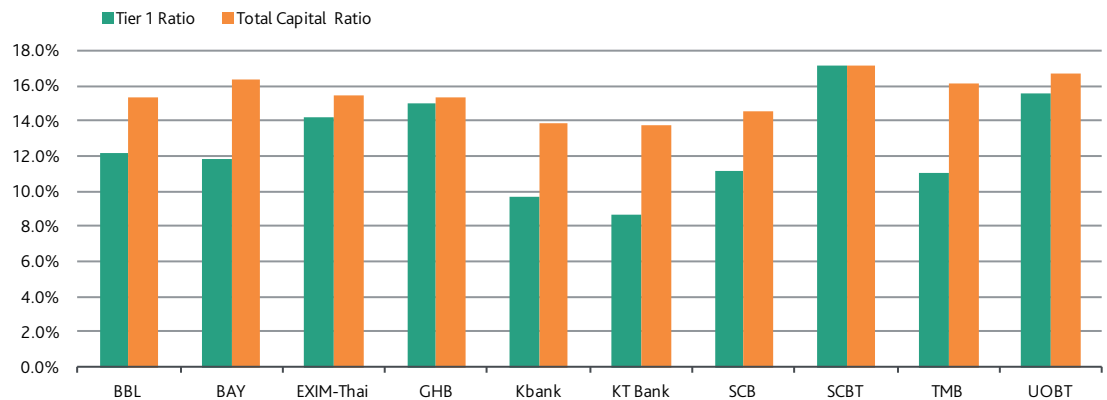


Source: BoT

- » For 2012, we expect system capitalization to remain broadly at 2011 year-end levels (Figure 8), as the banks continue to generate enough earnings to keep capital ratios steady, despite the increase in loans.

Meanwhile, Basel III implementations for Thai banks will follow the timeline set out by the Basel Committee on Banking Supervision (BCBS), between 2013 and 2019. All Thai commercial banks already meet Basel II requirements.

FIGURE 8
Capital Ratios of Rated Thai Banks at End-2011



Source: Rated Thai Banks' Audited Financials

- » Our scenario analysis simulates conditions akin to both a severe recession -- which we call an "adverse scenario" -- as well as the low probability-high impact tail risk deterioration of a more significant magnitude, which we refer to as "highly adverse."

In the adverse scenario, we used NPL levels that are three times greater than currently projected. In the highly adverse scenario, we used probabilities of default and severity of losses for each business sector that are at approximately 50% of the extraordinary historical highs of the Asian financial crisis, when the NPLs of Thai banks exceeded 40% of loans.

We do not take into account a stress scenario similar to the Asian financial crisis because corporate leverage is now significantly lower and companies do not have the large foreign exchange

mismatches between borrowings and cash-flows that were so devastating when the Thai baht was devalued in July 1997. Figure 9 summarizes the impact of both scenarios on the capital levels of individual banks.

FIGURE 9

Rated Thai Commercial Banks: Scenario Analysis

	BBL	KTB	SCB	Kbank	BAY	TMB	UOBT	SCBT	GHB	EXIMT
Standalone Credit Strength; Outlook	C-/baa2; Stable	D-/ba3; Positive	C-/baa2; Stable	D+/baa3; Stable	D+/ba1; Stable	D-/ba3; Stable	D/ba2; Stable	D+/baa3; Stable	E+/b1; Stable	-
Foreign Currency Long-term Bank Deposit/(Issuer); Outlook	Baa1; Stable	Baa1; Negative	Baa1; Stable	Baa1; Stable	Baa2; Stable	Baa3; Stable	Baa1; Stable	Baa1; Stable	Baa1; Stable	(Baa1); Stable
Tier 1 % RWA										
2011	12.21%	8.69%	11.15%	9.63%	11.85%	11.08%	15.54%	17.13%	15.02%	14.16%
3Y Av	12.42%	9.55%	11.67%	9.75%	11.65%	11.57%	17.62%	16.85%	13.18%	16.56%
Adverse	11.9%	7.4%	10.5%	8.6%	10.5%	9.0%	12.9%	16.2%	14.0%	13.6%
Highly Adverse	7.9%	1.8%	5.4%	3.6%	6.5%	6.1%	7.5%	14.7%	13.2%	10.5%

Source: Rated Thai Banks' Audited Financials; Moody's Assumptions

- » Under the adverse scenario, in which NPLs reach an average of 10% throughout the banks' loan books, the capital levels of all Moody's-rated banks will remain within a 7%-16% range.
- » In our highly adverse scenario, average NPLs would reach 20% (including 25% NPLs for large corporations operating in sectors such as agriculture, mining and construction) and lead to significant erosion in Tier 1 capital -- a scenario that would leave only five banks out of 10 with Tier 1 above 7%.

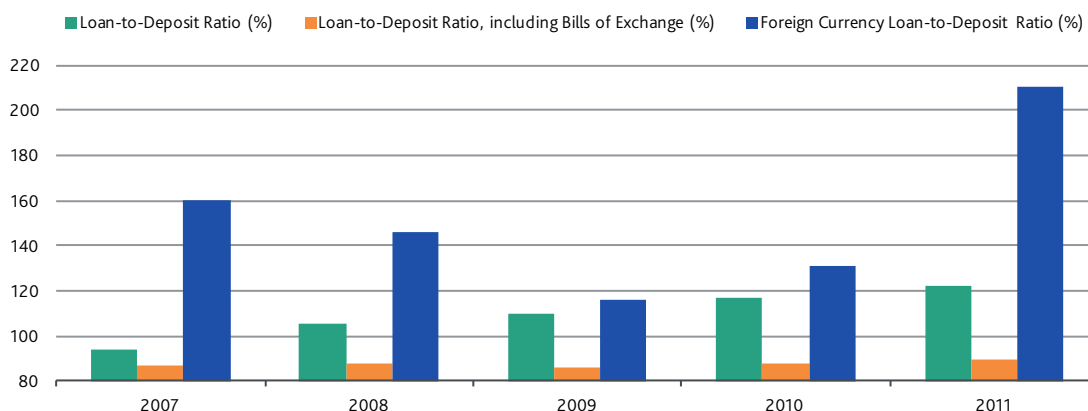
Funding and Liquidity

Funding expected to remain tight

- » We expect that loan growth will continue to outpace deposit growth in 2012, though the gap will narrow from 2011, when loan growth of 15% was more than twice the deposit growth of 7% and led to a jump in LDR at the end of 2011 (Figure 10).

FIGURE 10

Liquidity Indicators for the Thai Banking Industry



Source: BoT; Rated Banks' Audited Financials for 2011

- » The effect of the banks' high LDRs will be alleviated by the new fee structure on BE issuances that the BoT announced in May 2012. From July, the Deposit Protection Agency (DPA) fees on deposits will increase to 0.47% from 0.4%, and a surcharge of the same magnitude (0.46%) will be levied on banks' non-deposit borrowings, including the issuance of BEs, debentures, and securities under repurchase agreements. Related proceeds will go to the servicing of the THB1.14 trillion (\$36 billion) debt of the Financial Institutions Development Fund¹¹ (FIDF).
- » Based on the central bank's statistics, we have already observed migration from BEs to customer deposits and a corresponding decline in the LDR of commercial banks to 120% at end-March 2012, from 122% at end-2011. In addition, the proportion of BEs to total deposits fell to 14% at end-March 2012 from 17% at end-2011. As a point of reference, should all the BEs be converted in conventional deposits, the Thai banking system's LDR would fall to about 90%.
- » While domestic funding conditions will remain tight due to the continued strong demand for loans, we believe Thailand's banking system will remain resilient to external shocks from a fundamental perspective. Customer deposits account for around 75% of the total funding sources. Most of the banks' short-term deposits are sticky and typically roll over, and are therefore a relatively cheap and stable source of funding.
- » Thai banks also maintain solid levels of liquid assets in their books and which provide them with a large cushion to cover short-term liabilities. These liquid assets – which comprise cash, placements with banks, certificates of deposits, and other liquid assets – accounted for almost 30% of the total assets at end-2011, compared with a low of 16% during the crisis in 1997.
- » Foreign currency credit grew 58% year-on-year in 2010 and 61% in 2011, resulting in a system-wide foreign currency LDR of 210% at end-2011. However, we note that foreign currency loans constitute a small proportion – less than 10% -- of total loans outstanding.
- » While we do not expect any material change in the domestic banks' dependence on wholesale markets for foreign currency funding (5%-10% of total funding), their access to US dollars in a

¹¹ The FIDF, a unit of the BoT, was set up to restore confidence among creditors and depositors of affected financial institutions during the 1997 financial crisis and the THB1.4 trillion cost of its blanket guarantee to cover the permanent closure of numerous institutions. Over its 14 years, the BoT and the Finance Ministry have debated which institutions should be responsible for the liabilities. Most recently, the cabinet approved in principle transferring responsibility to the BoT, thereby intensifying the debate and raising criticism of the resolution.

crisis will be ensured by the significant foreign reserves accumulated at the central bank and which serves as a buffer against the risk of an external liquidity crisis.

- » The current foreign reserves of over \$175 billion versus \$26 billion in 1997 are more than sufficient to address the system's reliance on debt markets for foreign currency funds. We estimate total outstanding foreign currency net assets amounted to around \$9 billion at end-2011.

Profitability and Efficiency

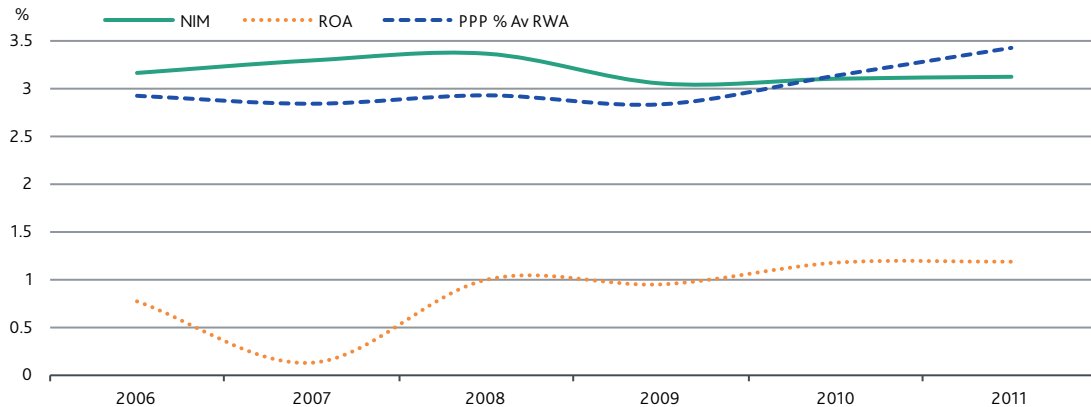
Profitability

Rising costs will exert some pressure on profitability

- » The banking system enjoyed steady profits in 2011 (see Figure 11), despite a worse-than-expected economic slowdown in 4Q2011.
- » For the next 12 to 18 months, we expect banking profits to be driven by strong credit demand, given that the economy will likely recover and various stimulus measures will be implemented.
- » Thai banks have maintained NIMs in the 3%-3.5% range so far. Although competition for deposits, the imposition of higher fees for deposits and BEs, and the current tight liquidity could create challenges, the impact on margins will be mitigated by strong loan demand.
- » Moreover, we expect weaker NIMs to be offset by:
 - Higher fee and commission income: non-interest income has increased in recent years, accounting for 32% of the banks' total operating income in 2011, up from 25% in 2007. We believe that fee and insurance income will likely increase when the government's stimulus spending kicks in.

Banks are also exploring cross-selling opportunities to both retail and corporate clients in areas like bancassurance and unit trusts. The sales of insurance products through bancassurance will continue to accelerate, as banks gain market share from agent-based insurers and insurance awareness increases as a result of the Thai floods and Japan earthquake in 2011.
 - The reduction of corporate income tax to 23% from 30% this year.
- » We expect pre-provision earnings to fall to around 3% of risk-weighted assets, which still compares well with Thai banks' peers in the region.

FIGURE 11
Profitability Indicators for the Thai Banking Industry

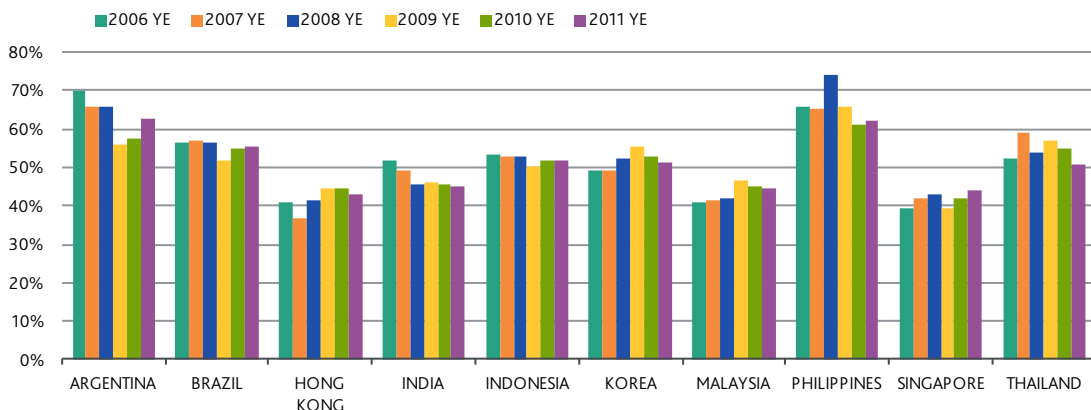


Source: BoT

Efficiency

- » Cost-to-income ratios of rated Thai banks are high compared to regional and developing market peers (except for the Philippines, Indonesia, Argentina, and Brazil), as illustrated in Figure 12. These costs are mainly related to IT system upgrades, new branch openings, and follow-on costs from large investments in the past few years.
- » We do not expect any significant improvement in this area, as banks currently plan to continue investing to stay ahead in an increasingly competitive market.

FIGURE 12
Efficiency Indicators for the Thai Banking Industry



Source: Banks' audited financials; Moody's Banking Financial Metrics

Moody's Related Research

Credit Opinion:

- » [Thailand, Government of](#)

Analysis:

- » [Thailand, April 2012 \(141043\)](#)

Country Statistics:

- » [Thailand, Government of](#)

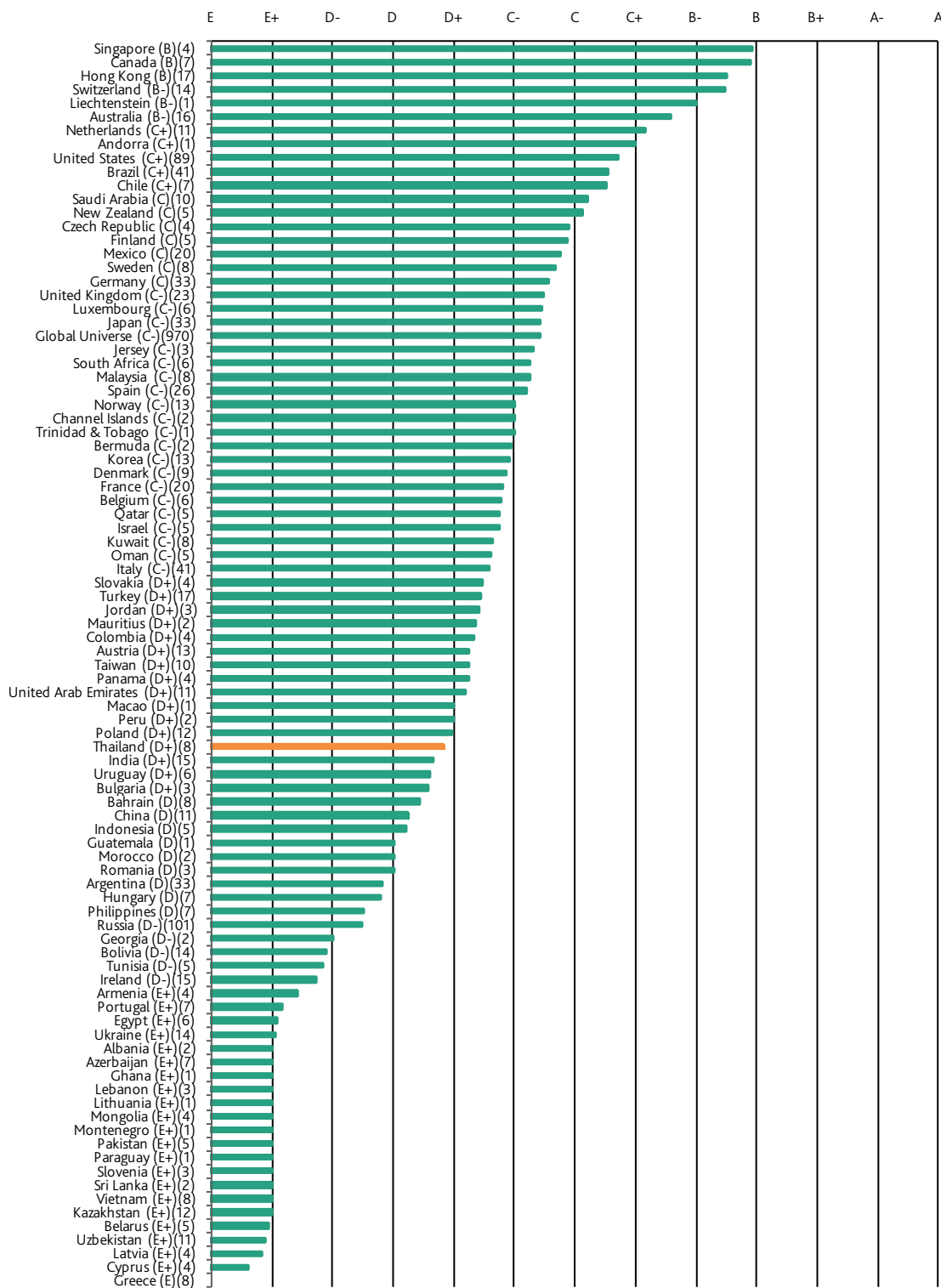
Rating Methodology:

- » [Moody's Consolidated Global Bank Rating Methodology, June 2012 \(143152\)](#)

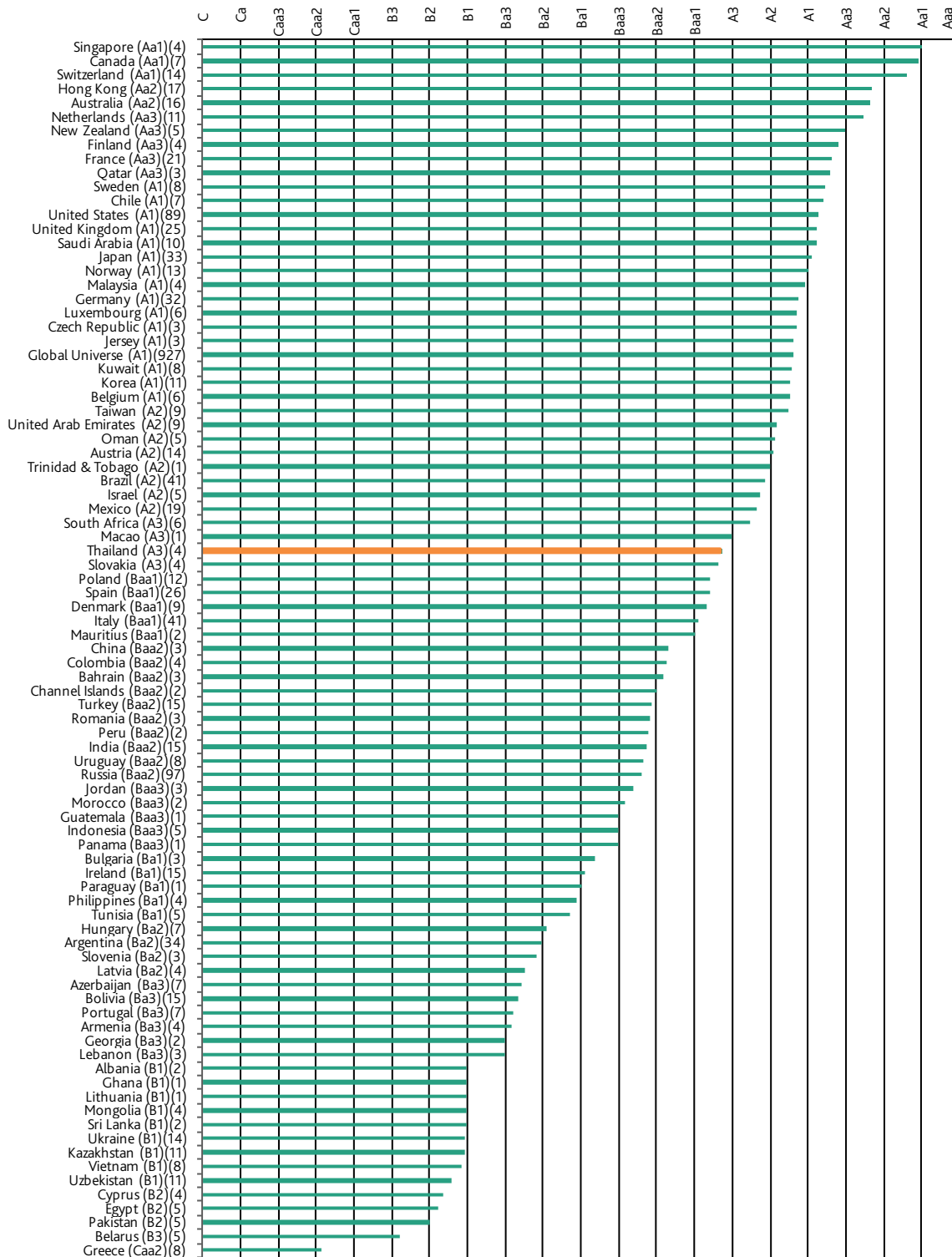
To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Appendix 1: Global Comparison Charts

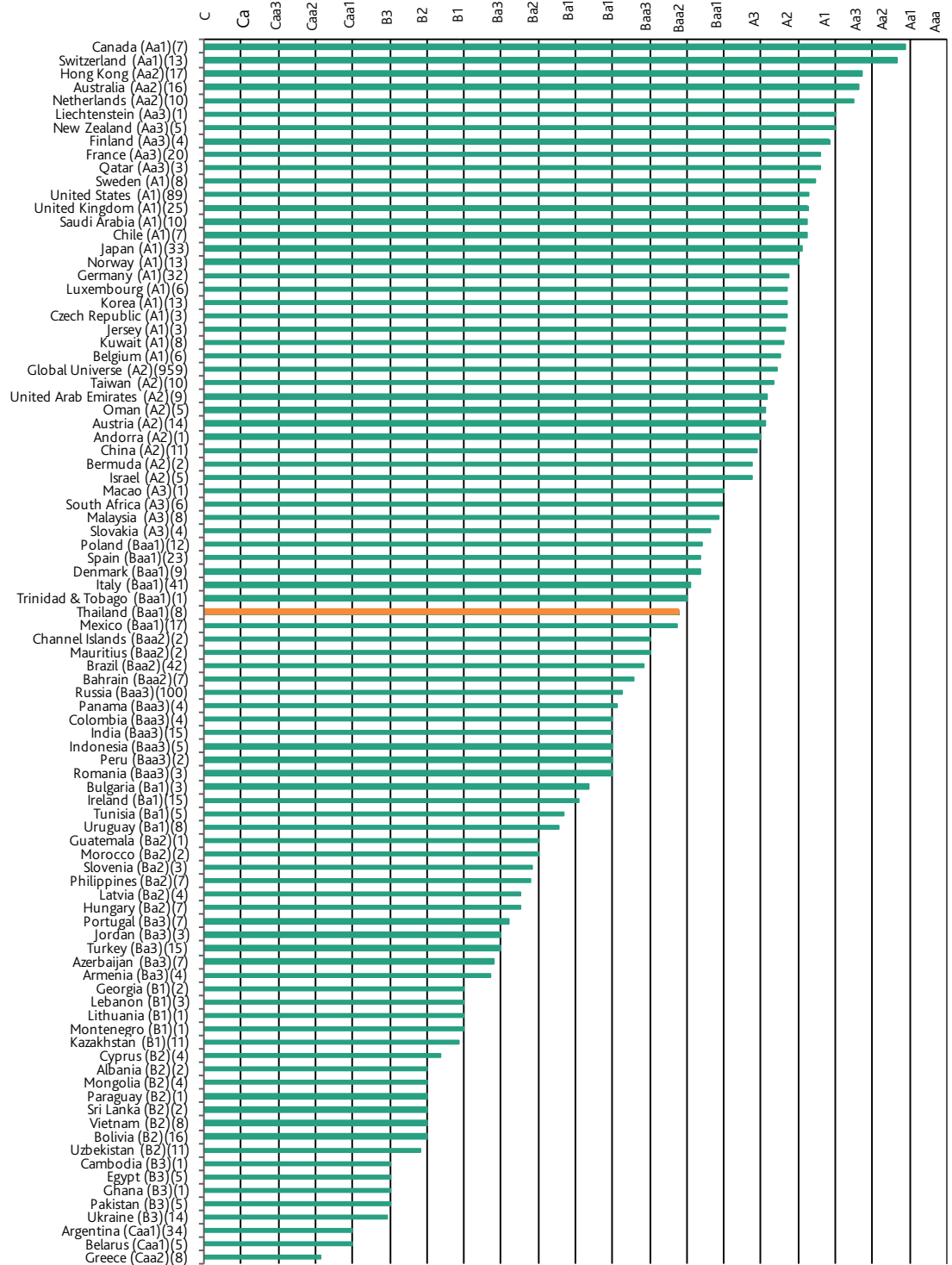
Average* Bank Financial Strength Ratings by Country (as of 1 July 2012)



Average* Long-Term Bank Deposit Ratings by Country (as of 1 July 2012) Domestic Currency



Average* Long-Term Bank Deposit Ratings by Country (as of 1 July 2012) Foreign Currency



Appendix 2: BFSR / BCA Mapping Table

BFSR/Baseline Credit Assessment Mapping	
BFSR	Baseline Credit Assessment (BCA)
A	aaa
A-	aa1
B+	aa2
B	aa3
B-	a1
C+	a2
C	a3
C-	baa1
C-	baa2
D+	baa3
D+	ba1
D	ba2
D-	ba3
E+	b1
E+	b2
E+	b3
E	caa1
E	caa2
E	caa3

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