# ASEAN Banks Now Better Placed to Address Volatility

## Special Report

### Outlook for Bank Ratings and Sector

| Country | Bank Rating Outlook | Bank Sector Outlook |
|---|---|---|
| Indonesia (BBB/Stable) | Stable | Stable |
| Malaysia (A-/Stable) | Stable | Stable |
| Philippines (BBB/Stable) | Stable | Stable |
| Singapore (AAA/Stable) | Stable | Stable |
| Thailand (BBB+/Stable) | Stable | Stable |
| Vietnam (BB/Stable) | Stable | Stable |

Source: Fitch

**Banks in Better Position than in 1990s:** Fitch Ratings believes that the banking systems of Association of Southeast Asian Nations (ASEAN) member countries are better prepared for potential market volatility emanating from US monetary policy normalisation than during the period leading up to the 1997 Asian financial crisis. However, there are pockets of vulnerability, such as in Vietnam due to its high dependence on foreign capital and the banking system's rapid loan growth despite thin capital buffers.

**Safety Nets Improve Resilience**: Enhanced regulatory frameworks and domestic crisis response mechanisms, more proactive macroprudential surveillance and stronger financial profiles in the years since the crisis and the previous Fed rate tightening cycle in 2004-2006 have improved ASEAN banks' resilience to market volatility. ASEAN economies also have stronger buffers and more accommodating macroeconomic policies.

The flexible post-crisis exchange-rate regimes have allowed foreign-exchange depreciation to absorb some of the pressure from trade imbalances and capital flows. The build-up of foreign-exchange reserves since the crisis helps defend against potential significant capital outflows. Stronger external positions and flexible exchange rates have improved ASEAN countries' ability to withstand a capital exodus or credit crunch compared with the pre-crisis era.

**Liquidity Risk Mitigated:** ASEAN corporates have become more averse to short-term borrowing for long-term purposes since the crisis and have actively tapped domestic capital markets. Tighter rules on offshore borrowing, greater funding diversification, banks' enhanced liquidity management and more stringent liquidity requirements under Basel III standards should cushion stresses during periods of credit turmoil in the region.

**Supportive Regulatory Environment:** ASEAN banks have restructured and repaired their balance sheets since the crisis amid economic and banking reforms.

Many marginal banks and non-bank financial institutions were weeded out, and foreign-ownership limits were lifted to speed up industry transformation. Banks have to comply with regulatory limits on holdings of property and other non-financial assets. Domestic credit bureau and deposit insurance schemes were established. The authorities have also improved financial disclosure and implemented Basel III, except in Vietnam, and have introduced stress testing and macroprudential supervision.

**Household Sector More Leveraged:** The household sector in some ASEAN markets is now more leveraged than pre-crisis, especially in Thailand and Malaysia – though aggregate private-sector leverage remains lower than 1997 crisis levels. Macroprudential measures in these markets have tempered households' risk appetites over the previous few years. Barring significant slippage in the employment market or a rapid increase in domestic interest rates, we see limited downside risk to the household sector for most ASEAN countries.

### Related Research

Fitch 2018 Outlook: Asia-Pacific Banks (November 2017)

APAC Banks: Implications of Fed Tightening (May 2018)

APAC Frontier Market Banks Dashboard 2018 (July 2018)


### Analysts

Wee Siang Ng, CFA
+65 6796 7230
weesiang.ng@fitchratings.com

Parson Singha, CFA
+662 108 0151
parson.singha@fitchratings.com

Elaine Koh, CFA
+65 6796 7239
elaine.koh@fitchratings.com

## ASEAN Banking Systems Stronger Post-Crisis

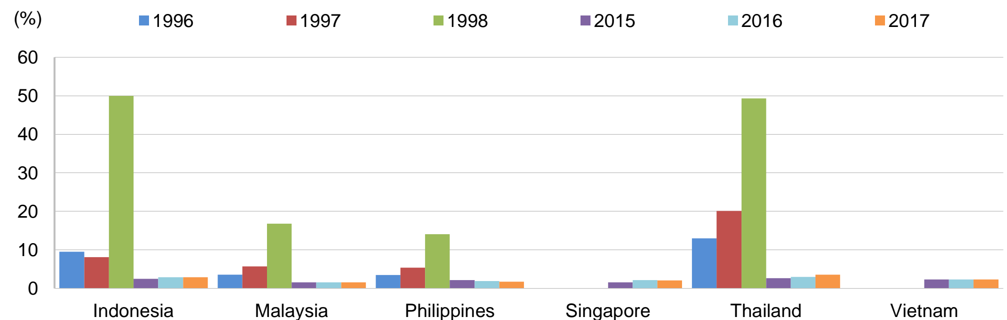
Fitch believes ASEAN banks have made good strides in the aftermath of the 1997 Asian financial crisis. Some challenges remain, but we believe the banks are better prepared for potential market volatility and external shocks now that the Fed has turned towards monetary policy normalisation.

ASEAN countries' strengthened banking system policy frameworks and buffers, as well more flexible exchange-rate regimes, should limit their vulnerability to net capital outflows and absorb pressure from trade imbalances.

### More Flexible Exchange Rate Regimes

Most ASEAN countries no longer peg their currencies to the US dollar, but may still reference it, which pre-crisis had exposed them further to exchange-rate misalignments and speculative attacks. US dollar-denominated loans are also significantly lower today, while hedging is more commonly employed, including through natural hedging, rendering banks less likely to see the magnitude of non-performing loan (NPL) ratios witnessed during the Asian financial crisis.

**Banking System NPL Ratios**




1996-1998 data was unavailable for Singapore and Vietnamese banking systems
Source: Fitch

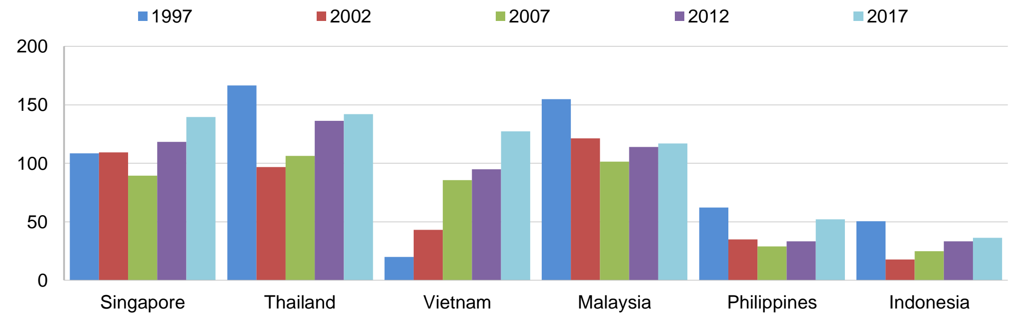
The regions' more flexible currency regimes since the crisis have allowed foreign-exchange rates to absorb some pressure from trade imbalances and capital flows. This, along with gradually deepening onshore market liquidity and emergency currency-sharing arrangements, such as the Chiang Mai Initiative – a multilateral currency swap arrangement – should support the orderly functioning of regional currency markets.

### Less Reliance on Foreign Capital

Large ASEAN corporates have greater access to more developed (relative to pre-crisis) capital markets, making them less reliant on offshore borrowing to finance local expansion and operation. Current account surpluses or vastly reduced deficits have also rendered borrowers less prone to a domestic liquidity squeeze and rapidly rising lending rates, as have improved funding structures – that is, less concentration towards short-term debt – to fund large and long-term projects.

The private-sector credit ratios of all ASEAN countries have increased as a percentage of GDP since the 2007 global financial crisis, but remain low against pre-Asian financial crisis levels (see chart on the following page). The increases since 2007 stemmed from foreign-currency loans, most of which appear to be in US dollars, but ASEAN corporates have become averse to unhedged foreign-currency exposures since the 1997 crisis. We believe rapid credit growth, if sustained for a prolonged period, poses a risk to Vietnam's medium-term financial stability, particularly since its credit/GDP ratio of 127% at end-2017 was extremely high by frontier market standards. See APAC Frontier Market Banks Dashboard 2018.

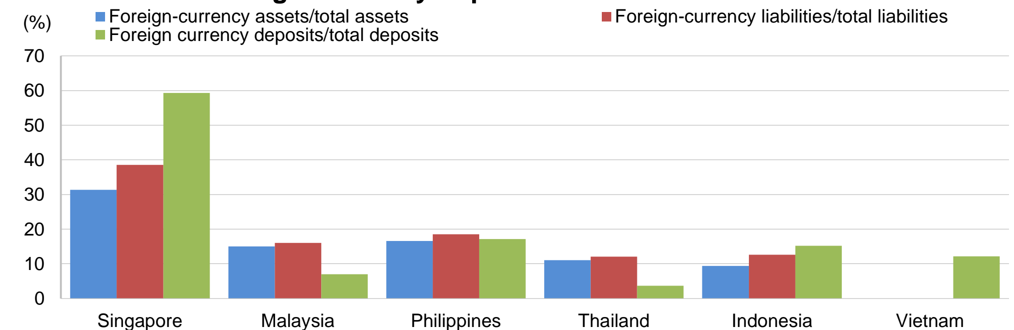
**ASEAN Private-Sector Credit**
(% of GDP)




Source: IMF, Fitch estimates based on national sources

Singaporean private-sector credit and banks' high foreign-currency exposure, with foreign-currency assets accounting for 31% of total assets at end-2017, reflects the country's enhanced status as an international financial centre. Indonesia's exposure, at 9.4% of total assets, is moderate, but the asset quality of its banks is vulnerable to foreign-exchange gyrations. However, Fitch does not envisage region-wide deterioration in asset quality due to more disciplined credit practices, barring large rate hikes.

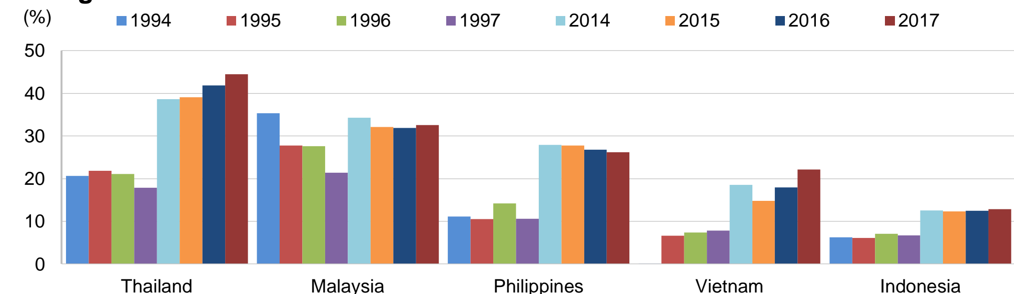
**ASEAN Banks' Foreign-Currency Exposure**




Source: Fitch estimates based on national sources. Asset and liability data are from major banks; deposit data are for banking system

Furthermore, ASEAN countries have now built up their foreign-exchange reserves, which should better position them to deal with a sudden reversal of foreign capital.

**Foreign Reserves/GDP**




Singapore is not included due to its outsized foreign reserves, which have always been higher than that of regional peers. Singapore's foreign reserves as a percentage of GDP stood at 92% at end-2017 and around 75%-80% in the early 1990s.
Source: Fitch, central banks

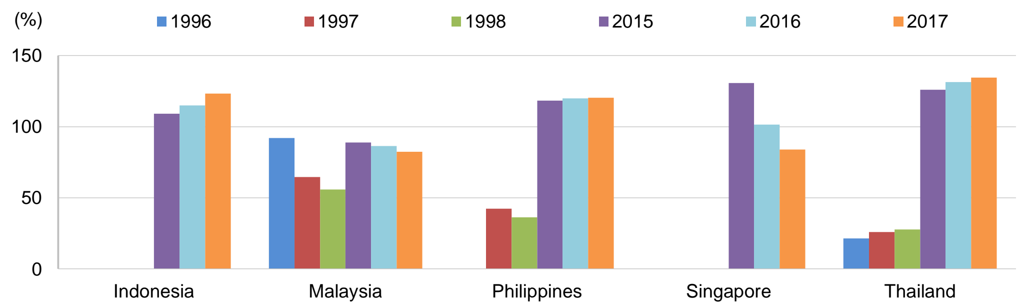
## More Stringent Regulatory Frameworks

The developing regulatory frameworks of the 1990s spawned the prevalence of lax lending practices and rapid growth in bank lending to support economic expansion. Corporates are now generally less geared than in 1997, especially in Thailand and Indonesia, which saw pre-crisis debt/equity ratios in excess of 100%.

More institutionalised risk management, which is sometimes enforced on banks by the regulators, has significantly reduced the amount of short-term bank loans used to acquire unproductive and speculative assets. That said, there is still scope for improvement in risk assessment, especially among state-linked banks.

Measures and incentives have been rolled out to orchestrate industry consolidation, reducing the number of small banks and largely unregulated non-bank intermediaries in the system. Institutional ownership is now more common, giving rise to better governance standards. There are still cases of significant individual or group ownership in the region, which risks undue influence on decision making, but strengthened board and regulatory oversight – including through enforcement of related-party limits – has improved checks and balances.

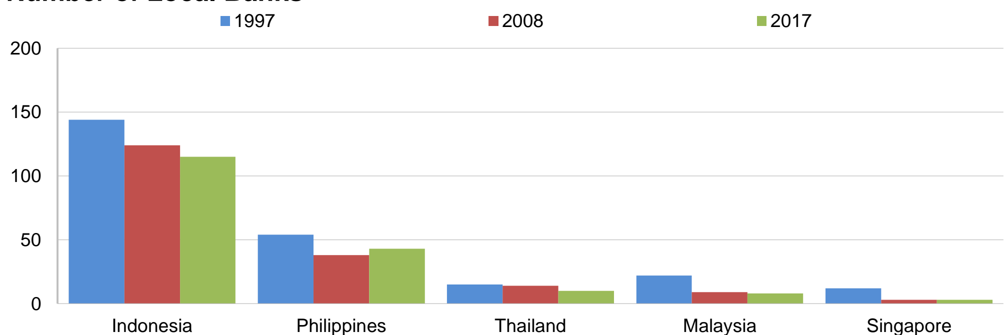
**Banking System Loan Loss Coverage**




1996-1998 data unavailable for Singapore's and Indonesia's banking systems. Loan loss coverege for Malaysia does not include regulatory reserves
Source: Fitch

The authorities moved to restore the health of their beleaguered post-crisis financial systems by rolling out tough structural economic and banking reform. Most banking regulators worked to tighten regulatory frameworks, establish or deepen domestic capital markets, set up domestic credit bureaus and enhance disclosure and transparency. The region's bank fundamentals are now healthier than prior to the Asian financial crisis, particularly in areas such as NPL ratios, loan-loss coverage, capital adequacy ratios and system liquidity.

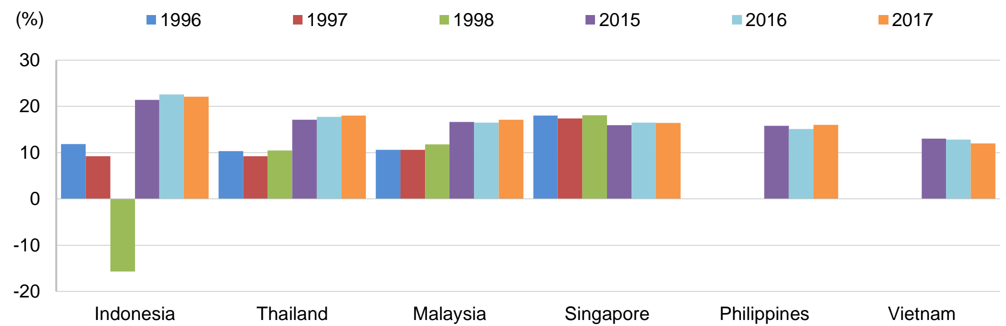
**Number of Local Banks**




The number of banks for the Philippines refers to universal commercial banks.
Source: Fitch, central banks

The regulatory environment has remained supportive since the crisis and banks in the region – except the Vietnamese banks that still operate on Basel I – have adopted Basel III and conducted ad-hoc or periodic stress tests to assess their financial health and resilience. The authorities have proactively introduced macroprudential measures to address emerging risks before they become systemic and we have seen greater cooperation among regional authorities to prevent and manage crises. Broadly, the more rigorous regulatory environment has increased risk awareness, helped build system buffers and bolstered financial institutions.

### Bank System Capital Adequacy Ratios




1996-1998 data unavailable for Philippines and Vietnam
Source: Fitch

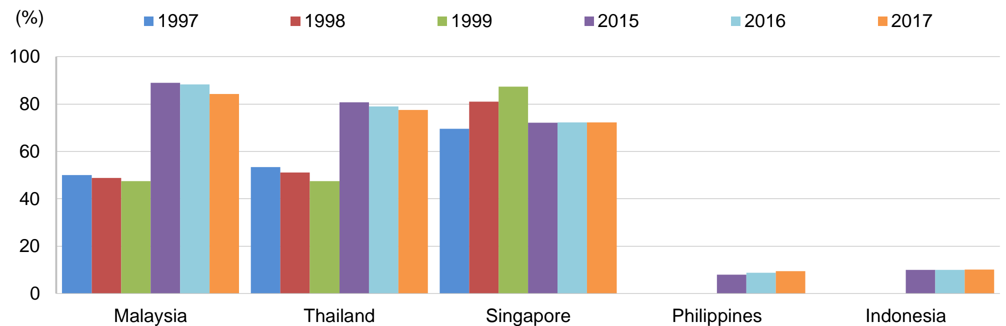
## A More Leveraged Household Sector

Household leverage – expressed as household debt/GDP – rose significantly in most ASEAN economies, particularly in Malaysia and Thailand, since the crisis, but has tapered off in the previous few years due to macroprudential measures.

The ratio for Malaysia had increased to 84% by 2017, from an estimated 50% in 1997, though this was an improvement from its 2015 peak of 89%. We see a similar trend for Thailand, whose ratio reached a high of 81% in 2015, from around 40% in 1997, but has since fallen to 77% in 2017.

We believe the banks are exposed to a steep rise in unemployment and interest rates, neither of which are our base case, but have built buffers that should hold them in good stead to withstand greater stress.

### Household Debt/GDP




1997 data for Philippines and Indonesia unavailable
Source: Fitch, CEIC Data, Bank for International Settlements, central banks

## Appendix – SWOT Analysis of Key ASEAN Countries

### Indonesia

| Strengths | Weaknesses |
|---|---|
| • Sound loss-absorption buffers from healthy profitability and capitalisation.<br>• Margins and industry profitability among region's highest.<br>• Large consumer base should sustain economic growth.<br>• Low reliance on wholesale funding; industry remains largely deposit-funded. | • Inefficient operations, with physical presence and manual inputs often required.<br>• Significant dependence on volatile mining and commodity sectors.<br>• Lagging corporate governance and risk controls.<br>• Lack of geographic diversification.<br>• Dominant franchises of top-four banks make it increasingly difficult for smaller banks to compete. |
| **Opportunities** | **Threats** |
| • Large unbanked and under-banked population.<br>• Rising middle class to sustain retail loan growth.<br>• Significant headroom to increase fee-based products, such as bancassurance and investment funds.<br>• Digitalisation could enhance cost efficiency and revenue.<br>• Expansion beyond Indonesia's borders after Qualified ASEAN Bank negotiations are finalised.<br>• Banking consolidation may improve industry efficiency. | • Competition from non-traditional service providers, particularly in the payments space, could affect profitability.<br>• Regulatory pressure to reduce margins and fees could affect bank profitability.<br>• Rupiah depreciation or instability leading to lower foreign direct investment.<br>• Domestic political risk. |

Source: Fitch

## Malaysia

| Strengths | Weaknesses |
|---|---|
| • Sound loss absorption buffers, including capital and earnings, relative to risks.<br>• Pro-active, credible regulatory oversight.<br>• A diversified and resilient economy in one of ASEAN's more developed, higher-income markets.<br>• Major banks have gained experience in running significant regional operations. | • A mature, saturated and competitive banking market limits pricing power.<br>• Significant reliance on term deposits suggests higher funding-cost sensitivity to interest rate movements. |
| **Opportunities** | **Threats** |
| • Digital technology could enhance franchises, business opportunities and cost efficiencies for nimble banks.<br>• Major banks can leverage their regional presence to capitalise on expanding neighbouring economies.<br>• Sector consolidation could improve medium-term profitability, though deals have been difficult to seal in the past.<br>• Greater acceptance of Islamic banking in the region, if it occurs. | • Digital disruption could erode profits from affected business lines and weaken the franchises of banks that cannot adapt.<br>• Sharply higher rates may pressure the already highly leveraged household sector.<br>• Rising oversupply in certain property segments could raise systemic risks if left uncurbed. |

Source: Fitch

## Philippines

| Strengths | Weaknesses |
|---|---|
| • Core capital requirements are more conservative than global norms.<br>• Robust economic growth likely to be sustained in light of supportive underlying fundamentals.<br>• Liquid banking system.<br>• Banks' strong major shareholders provide periodic capital support for growth. | • A fragmented and competitive market.<br>• Less cost-efficient operations due to need for physical presence.<br>• Lagging risk controls, as evident in operational lapses in the previous few years.<br>• Rapid credit growth that exceeds organic capital generation erodes capital buffers over time.<br>• Conglomerate-dominated economy raises borrower concentration and contagion risks. Family and conglomerate bank ownership leaves room for governance risk. |
| **Opportunities** | **Threats** |
| • Large unbanked population.<br>• Opportunities to increase fee revenue due to rising consumer incomes and financial market development.<br>• Harnessing digital platforms to improve customer reach, services and cost efficiency.<br>• Regional expansion, once Qualified ASEAN Bank negotiations are finalised, is likely to be gradual and mainly affect the largest banks. | • Sustained rapid credit growth could pose asset quality issues if unchecked.<br>• Sharply rising interest rates could weigh on asset quality.<br>• Pressure on franchises and earnings for banks that are slow to harness digital technology or compete with digital alternatives. |

Source: Fitch

## Singapore

| Strengths | Weaknesses |
|---|---|
| • Entrenched domestic deposit franchises support banks strong funding profiles.<br>• Large loss-absorption buffers.<br>• Regulators play an active role in containing financial-stability risks.<br>• Disciplined underwriting standards.<br>• A credible and expanding financial hub allows the system to punch above its weight. | • A mature, saturated and competitive banking market. |
| **Opportunities** | **Threats** |
| • Digital technology to improve cost efficiency over the medium term.<br>• Singapore's rising status as one of Asia's wealth-management hubs.<br>• Expansion to capture opportunities in faster-growing emerging markets. | • Digital banking could affect select income streams as alternatives emerge.<br>• Rising exposure to emerging markets, which would expose banks to more challenging operating environments. |

Source: Fitch

## Thailand

| Strengths | Weaknesses |
| --- | --- |
| • Few competitors among local commercial banks; five large, three mid and six small. All banks can make profits throughout the business cycle.<br>• Sound financial standing; for example, average sector common equity Tier 1 ratio of 15.1% at end-2017 and liquidity coverage ratio of 177% as of end-2017.<br>• Entrenched bank franchises that benefit from a sticky client base.<br>• Prudent regulator that largely adopts standards recommended by the Basel Committee on Banking Supervision. | • Weak economic growth and low interest rates in the previous few years are likely to limit bank profitability.<br>• High system leverage, including high household debt and private-sector credit, compared with other emerging markets.<br>• Some borrower concentration relates to Thailand's largest conglomerates.<br>• Limited regional diversification and weak offshore franchise may limit long-term prospects. |
| **Opportunities** | **Threats** |
| • Growth opportunities as Thai corporates invest more in neighbouring countries.<br>• Long-term room to increase fee-based products, such as bancassurance and investment funds.<br>• Digitalisation should enhance cost efficiency and revenue in the medium to long term. | • Competition in payments, with a push from the regulator, leading to a sharp fall in transfer and ATM fees.<br>• Greater competition from new entities, such as ASEAN banks, after Qualified ASEAN Bank negotiations are finalised.<br>• Increasing competition in low-end segments from non-banks, such as savings co-operatives, personal loan companies and state policy institutions. |

Source: Fitch

## Vietnam

| Strengths | Weaknesses |
| --- | --- |
| • A large young demographic profile.<br>• A benign operating environment that is likely to be sustained in the medium term. | • Weak institutional and regulatory framework, which the country still using Basel I. Risk control (corruption) and corporate governance lapses common.<br>• An opaque and fragmented banking system.<br>• A shallow capital market suggests a strong need for foreign funds to recapitalise the sector through Basel II and strong credit growth.<br>• Persistent regulatory intervention distorts banks' pricing power.<br>• A narrowly defined economy.<br>• Large stock of problem loans, thin capital buffers and weak profitability.<br>• Rapid credit growth could create credit-quality issues.<br>• Credit-driven economic model unsustainable in light of already high system leverage. |
| **Opportunities** | **Threats** |
| • An enhanced operating environment and improved economic policy-making promote macroeconomic stability.<br>• The relaxation of foreign-ownership restrictions may see the entry of strategic foreign banks, allowing the transfer of expertise.<br>• Rising middle class to sustain retail loan growth.<br>• Accelerating state-owned entity privatisation. | • A runaway property market.<br>• External shocks that lead to a sharp depreciation in the Vietnamese dong and a decline in foreign direct investment.<br>• Regulatory pressure lowering lending rates to priority sectors could lead to mispricing of risk. |

Source: Fitch

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTPS://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2018 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.