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Tighter credit conditions set to reverse recovery in credit risk profiles of ASEAN banks

by [NUS-CRI Market Monitoring Team](#)

- **NUS-CRI Agg PD shows that the credit profile of ASEAN banks has largely improved in 2023, driven largely by improving credit metrics and strong capital positions of banks domiciled in Vietnam and Indonesia.**
- **NUS-CRI Forward PD suggests that the region is likely to feel the lagged impact of higher-for-longer rates as banks' repricing of deposits picks up steam, impacting profitability amidst a high maturity wall over the next 24 months**

The banking sector domiciled in South East Asia (ASEAN banks) has shown relative signs of resilience to the global worsening macroeconomic operating environment so far. On aggregate, the credit risk profile of ASEAN banks improves, as showcased by the NUS-CRI Aggregate (median) 1-year Probability of Default (Agg PD) in Figure 1a, in the first three quarters of 2023. Although the Agg PD for ASEAN banks does suggest that the sub-sectors' credit risk profile has worsened since the beginning of Q3 2023, with the aggregate PD close to the BBB- upper bound when referenced to PDiR2.0[1], a breakdown of the region's trends into its component economies suggests that not all ASEAN banks saw a homogenous improvement in their credit metrics. As seen in Figure 1b, Vietnam and Indonesia have seen a disproportionate improvement in their Agg PD YTD, compared to banks domiciled in the Philippines and Thailand, which saw their credit risk profiles worsen.

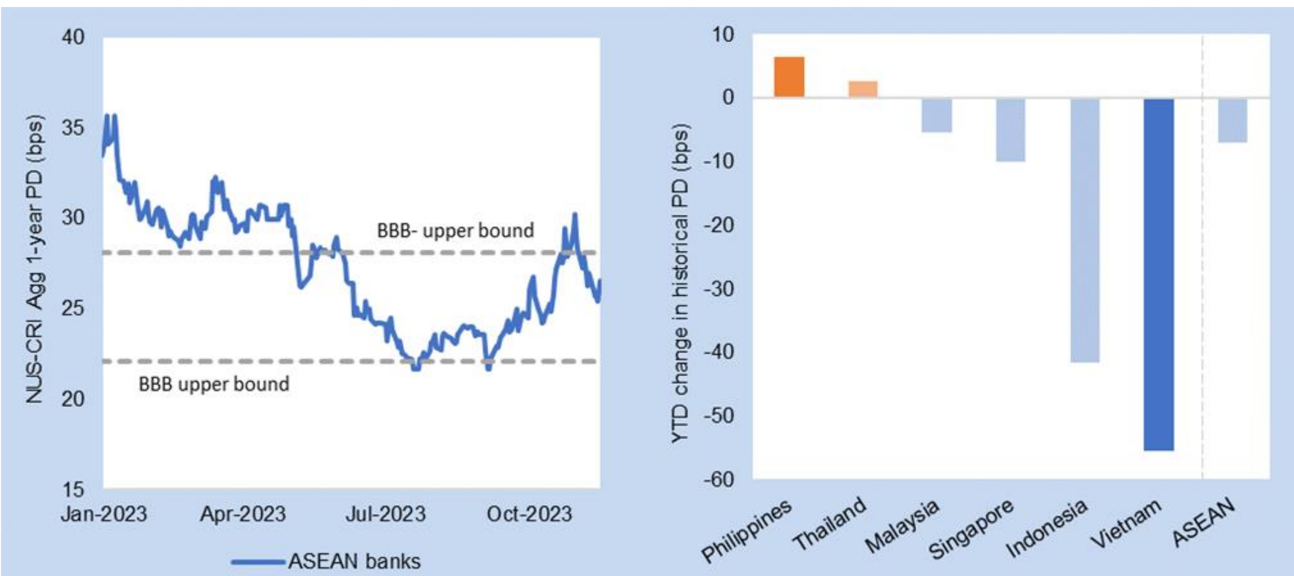

Figure 1a (LHS): NUS-CRI Aggregate (median) 1-year Probability of Default for ASEAN banks, with reference to PDiR2.0 bounds. Figure 1b (RHS): YTD change in NUS-CRI Aggregate (median) 1-year Probability of Default for banks in major ASEAN countries. *Source: NUS-CRI*

From a macroeconomic perspective, ASEAN banks have benefitted largely from the rising interest rate environment. With ASEAN central banks following their global counterparts' commitment to increasing policy rates, ASEAN banks' credit profiles have benefitted from the boost in NIMs. Major banks in the region were able to register record profits in 2023, with some major banks expecting to continue the streak into [2024](#). DBS, a major Singapore-domiciled bank, recently posted an [18%](#) jump in Q3 2023 net profit aided by higher interest margins and higher non-interest income. Unlike their US and developed market counterparts, ASEAN banks have fared relatively well during the regional banking crisis of Mar-2023. However, higher-for-longer interest rates have dampened the region's growth prospects, with expectations of GDP growth dropping 1.2 percentage

[1] The Probability of Default implied Rating version 2.0 (PDiR2.0) provides a more familiar interpretation by mapping the NUS-CRI 1-year PDs to the S&P letter grades. The method targets S&P's historical credit rating migration experience exhibited by its global corporate rating pool instead of relying solely on the reported default rates.

points in 2023 compared to 2022 levels. Weaker demand for credit amidst the tightened monetary environment has also led to a decrease in credit growth across major banks in the region.

From an asset quality perspective, banks in the ASEAN region have managed to prevent a major deterioration as exhibited by their stable NPL ratios, seen in Table 1. Although the initial asset quality of banks due to the pandemic benefited from increased credit growth and loan moratoriums that mitigated widespread delinquencies, in 2023, banks are likely to see negative moderation in their asset quality due to an uptick in bad debt. Vietnamese banks have seen their asset quality deteriorate as the domestic business environment remains challenging. However, despite the hurdles faced, Vietnamese banks have managed to achieve positive profit growth in 2023. Similarly, Thai banks have also seen an uptick in bad loans in Q3 2023, with distress emanating from consumer loans. An increase in Thailand's household debt has raised questions regarding the serviceability of personal loans and mortgages. It won't be surprising in countries such as Thailand which relied heavily on forbearance measures, to see banks pursue active NPL management to strengthen their balance sheets. However, banks in the ASEAN region remain supported by their robust capital buffers which may prevent a sharp deterioration in credit health. (see Table 1)

	Asset quality (%)			Capital adequacy (%)		
	Q4 2022	Q1 2023	Q2 2023	Q4 2022	Q1 2023	Q2 2023
Indonesia banks	2.44	2.49	2.44	26.28	26.01	25.35
Malaysia banks	1.72	1.74	1.76	18.99	18.63	18.79
Philippines banks	3.16	3.33	3.43	15.66	15.98	NA
Singapore banks	1.84	1.79	1.7	17.13	17.53	16.97
Thailand banks	2.88	2.84	2.82	18.89	18.98	19.02
Vietnam banks	2.03	2.82	3.36	11.68	11.51	11.47

Table 1: Select fundamental ratios of ASEAN banks *Source: Bloomberg, CEIC*

With the global landscape witnessing historically significant interest rates, marked by a deceleration in rate hikes and a prevailing market sentiment anticipating the conclusion of the rate hike cycle, ASEAN banks are likely to see the impact on their profitability prospects moving forward as their once-widened net interest margins are expected to contract. Compounding this issue, bank loan rates, known for their swifter and more proactive response to rate hikes compared to interest paid on deposits, have remained elevated for an extended period. As signs of an impending recession emerge, the possibility of protracted and heightened financial distress looms over numerous corporations, potentially leading to an increase in bank loan souring and widespread defaults. Consequently, the NPL ratio for ASEAN banks may experience a surge in the earlier quarters of 2024.

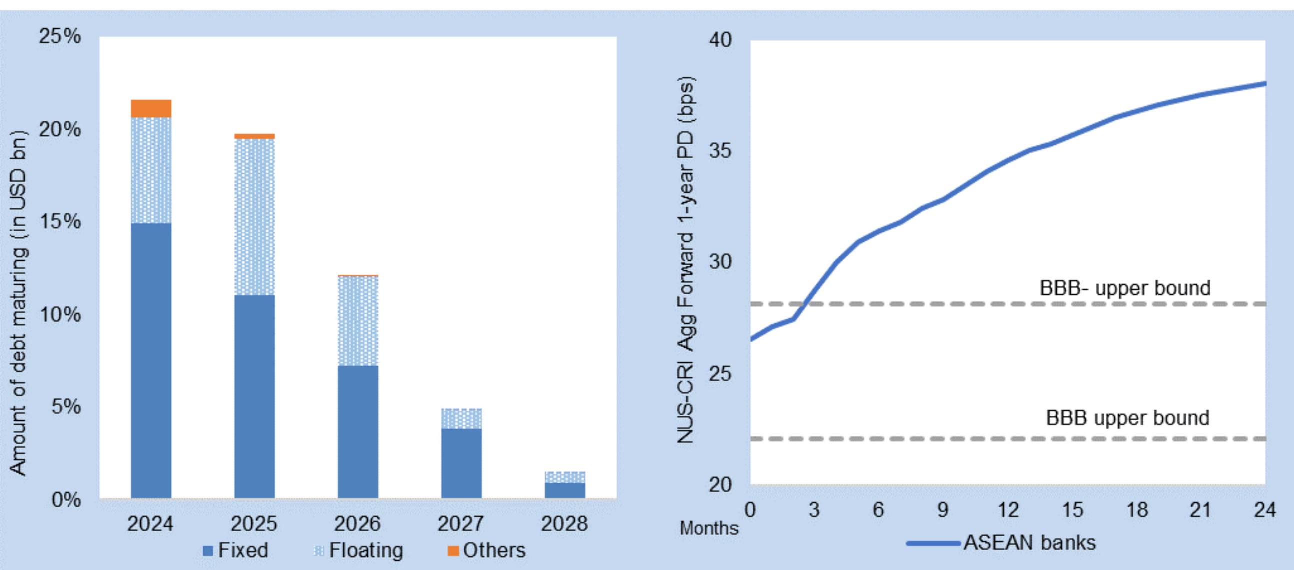

Figure 2a (LHS): Maturity distribution of outstanding debt of ASEAN banks Figure 2b (RHS): NUS-CRI Agg (median) Forward 1-year PD for ASEAN banks as of Nov-2023, with reference to PDiR2.0 bounds. *Source: Bloomberg, NUS-CRI*

In addition, as seen in Figure 2a, the ASEAN banks are faced with heavier debt repayment pressure in the coming two years with over USD 35bn debt (comprising close to 45% of total debt outstanding) set to mature, which necessitates a delicate balancing and refinancing act for banks. The NUS-CRI Aggregate (median)

Forward 1-year PD (Forward PD[2]) for the ASEAN banks shown in Figure 2b exhibits a gradual upward trend over the next 12 months, signaling the potential for stressed credit profiles within the region. However, a potential source of relief for ASEAN banks is the fact that nearly 70% of the debt maturing next year has been priced with fixed interest rates, affording a degree of manageability and predictability in interest repayment pressures, as depicted in Figure 2a.

Another potential tailwind for ASEAN banks is their relatively robust capital positions. Although refinancing bonds, especially outstanding AT1 bonds that are used for reserve capital, is likely to remain expensive, enhanced earnings over the past year could provide buffers that make refinancing AT1 bonds unnecessary. The impact of a reduced refinancing burden is likely to be beneficial only in the short term as NIMs are expected to contract going forward, possibly suggesting why the Forward PD term structure in Figure 2b increases, potentially signaling a reversal in the recovery witnessed by the sub-sector year-to-date.

[2] The Forward PD estimates the credit risk of a company in a future period, which can be interpreted similar to a forward interest rate. For example, the 6-month Forward 1-year PD is the probability that the firm defaults during the period from 6 months onwards to 18 months,conditional on the firm's survival in the next 6 months.

Credit News

Bonds' best month since March faces 'sanity check' in auction

Nov 20. Recently, traders and investors have been heavily investing in US government debt due to decreasing inflation and signs of economic slowdown. This shift in investment behavior stems from the belief that the Federal Reserve will stop increasing interest rates and might start reducing them by mid-next year. This change in trend ended a six-month period of losses for Treasuries, leading to a 2.6% market gain in November, the largest since March, which was marked by fears of an economic downturn caused by a banking crisis. However, this increased interest in Treasuries has reduced yields to their lowest since September. (Bloomberg)

Lasting recovery in small caps still elusive as debt costs bite

Nov 19. The Russell 2000 Index, a key indicator of smaller companies' performance, saw a significant rise of over 5% last week, driven by softer US inflation data and growing expectations that interest rates have reached their peak. Despite this uptick, the index still faces the likelihood of recording its worst performance since 1998 compared to larger company benchmarks. This situation is partly due to its vulnerability to high debt costs and the risk of an economic downturn. The broader issue of rising debt costs affects many companies. Bloomberg Intelligence predicts that corporates borrowing in dollars might face an additional USD 27 bn in interest costs when refinancing debts due between 2024 and 2026. (Bloomberg)

India's move on risky loans to hit banks more than economy

Nov 17. The Reserve Bank of India (RBI) is taking measures to mitigate risks in consumer lending amidst India's booming economy. This approach primarily targets unsecured consumer loans, such as credit cards and small personal loans. The RBI's directive requires lenders to allocate more capital for these types of loans. As a result, S&P Global Ratings anticipates an increase in lending rates, a decrease in capital adequacy ratios for some banks, and a potential impact on their profits. The RBI's new regulations are particularly impactful for India's shadow banks and financial technology firms, which are typically less stringently regulated compared to traditional banks. This regulatory tightening might slightly affect economic growth, but its primary consequence will be on the banking sector, especially in areas of profitability and risk management. (Bloomberg)

Foreigners hold more JGBs than Japan banks for first time

Nov 15. Foreign investors now hold a greater share (14.5%) of Japanese government bonds (JGBs) than domestic banks (13.1%), marking a historic shift. This change is attributed to the Bank of Japan's substantial JGB purchases, causing Japanese banks to sell bonds. Over 15 years, foreign investors' JGB share doubled, fueled by low interest rates and a weak yen. The Finance Ministry is concerned about market stability, given Japan's high debt-to-GDP ratio. Despite worries, some see potential benefits, anticipating increased liquidity with foreign investors. The Finance Ministry is actively engaging with international investors to diversify the JGB market. (Nikkei Asia)

Vanke bonds volatility underscores China property debt contagion

Nov 14. China's Vanke, a major property developer, faced a bond sell-off in October, making it Asia's worst investment-grade performer. Despite reassurances from the state-owned controlling company, concerns about liquidity and a slow real estate market linger. The recovery of bond prices followed official support, but negative market sentiment persists after defaults by other large developers. Vanke, China's second-largest developer by sales, diversified its business due to industry debt concerns. Analysts hold mixed views on its financial health, highlighting the need for sales recovery and improved funding access. Bond repayments before year-end will be closely monitored as an early indicator for 2024 obligations. (Bloomberg)

Squeezed property owners put their faith in the Fed (WSJ)

Moody's lifts Italy's debt outlook to stable in boost for Meloni govt (Reuters)

Oil and gas firms face virtually no extra borrowing costs, S&P finds (FT)

Regulatory Updates

ECB hawks push back on early rate cut bets

Nov 17. Key conservatives within the European Central Bank (ECB) are urging caution against early interest rate cuts, emphasizing that inflation remains high, and the impact on growth is still relatively mild. Bundesbank President Joachim Nagel stated that it would be unwise to start cutting interest rates too soon and emphasized the need to ensure a lasting return to price stability before loosening policy. Austria's Robert Holzmann also expressed that the second quarter is too soon for a rate cut, urging markets not to assume the end of rate hikes. Belgian central bank chief Pierre Wunsch highlighted the risks of being too hasty, suggesting that the ECB should be comfortable reaching a 2% inflation target before considering rate cuts. Wunsch proposed tightening policy further by ending the Pandemic Emergency Purchase Programme's bond purchases earlier than planned (Reuters)

Officials seek more transparency for US Treasury market

Nov 17. Officials from the Federal Reserve and the Treasury Department are advocating for increased transparency in the USD 26tn Treasury bond market. While the market is the largest and most liquid globally, publicly available data on transactions is limited. There has been a recent push to bring more transparency to the market, with Treasury under-secretary Nellie Liang noting "important progress" in implementing proposals for reporting transaction data on widely traded Treasury bonds. The call for more transparency extends to the less liquid segments of the market as well, such as the off-the-run market, where limited transparency poses challenges during events like the Mar-2020 market crisis. The structural changes and increased participation from less-regulated entities in the Treasury market have raised concerns, prompting the need for greater clarity in data availability. (FT)

China keeps lending benchmark rates unchanged, as expected (Reuters)

Global rate-hike marathon may keep going in Nordics (Bloomberg)

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