FitchRatings

Banks

Asia-Pacific
Outlook Report

2011 Outlook: Asia-Pacific Banks

Rating Outlook

STABLE

Australia, China, Hong Kong, India, Indonesia, Japan, Malaysia, Mongolia, New Zealand, Philippines, Singapore, South Korea, Taiwan, Thailand

NEGATIVE

Vietnam

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Related Research

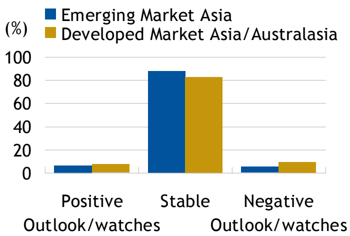
Applicable Criteria

- *Global Financial Institutions Rating Criteria (August 2010)*

Other Research

- *Chinese Banks: No Pause in Credit Growth, Still on Pace with 2009* (December 2010)
- *Singapore Banks Well – Positioned to Withstand Risks of a Modest Property Price Correction and Fragile External Conditions; Rating Outlook Stable* (December 2010)
- *Malaysian Banks: Annual Review and Outlook* (November 2010)
- *Major Japanese Banks: H1FYE11 Review* (December 2010)
- *Major Australian Banks' Semi - Annual Review and Outlook* (August 2010)
- *Philippine Banks' Annual Review and Outlook for H210-2011* (September 2010)

Outlooks and Watches for Asia-Pacific Banks



Source: Fitch

Rating Outlook

Good Defensive Qualities: The Stable Outlook on most rated Asia-Pacific (APAC) banks' ratings is underpinned by their reasonable capacities to cope with the threat of a still uncertain global economic environment. However, Fitch Ratings has a cautious outlook on banks in Vietnam and China. This is because their moderating profitability and relentless loan growth are pressuring capital, thereby weakening their credit profiles; a challenge which is reflected in their low Individual Ratings.

Healthy but Slightly Lower Economic Growth in 2011: Fitch expects APAC growth to be healthy in 2011, albeit slightly lower than in 2010. While the region's sharp recovery since H209 has supported banks' credit profiles, it has also raised the risks of inflation and asset bubbles. Some central banks around the region have already begun tightening monetary and credit conditions in the face of mounting inflationary pressure. However, a worse-than-expected commodities-inflation shock, and/or policy mis-steps that see monetary authorities fall "behind the curve" of local inflation expectations, could lead to sharper monetary tightening and a downside risk for Fitch's growth forecasts.

Loan Growth and Steady Asset Quality to Support Profitability: Steady loan growth, due to the level of optimism in most of APAC, and largely stable credit costs should underpin banks' profitability, although competition would likely limit margin upside.

Capital Satisfactory, but High Growth Systems may Need More Capital: Barring any large losses, APAC banks' capitalisation should remain satisfactory on average, given their stable earnings and level of loan loss reserves. Indeed, these served as effective lines of defence during the 2008/2009 global crisis, enabling them to emerge with their capital largely intact to pursue growth. However, some banks in China, India, Indonesia and Vietnam could need new capital to sustain their growth.

Generally Healthy Funding Profiles: Funding is not a concern for most APAC banks, since they are largely deposit-funded and do not have excessive loan-to-deposit ratios. However, banks with weaker deposit franchises in high growth systems may face some pressure. Wholesale-funded banks in Australia, New Zealand and South Korea are strengthening their liquidity positions, although lower liquidity in global markets, possibly due to European sovereign debt concerns, remains a threat.

Basel III Unlikely to be a Major Issue in APAC: Basel III is unlikely to be too onerous for most APAC banks due to their generally higher core capital buffers, modest reliance on hybrid capital and generally healthy liquidity. Still, bigger margins above minimum requirements may be desirable as they support flexibility for growth and instil investor confidence for future access to capital and liquidity.

What Could Change the Outlook

Key risks common to APAC banks' ratings and performance are a relapse in the global recovery, and/or a sharp slowdown in China. In addition to hurting trade, these events would likely weaken the sentiment-sensitive property sector, and in turn challenge banks, given their real estate loan exposures. Such risks appear highest in Australia, China, Hong Kong and Singapore, where home prices have risen appreciably in recent years. Fitch does not expect widespread negative rating actions to ensue across the APAC banks, in light of their satisfactory earnings trajectory, provision coverage and capital, although worse-than-expected asset quality deterioration which materially threatens solvency could exert downward pressure on ratings.

Australia

- Healthy domestic economic conditions in Australia are likely to moderate the effects of the volatile global environment and underpin bank performance in 2011
- Conservative loan growth and less scope for further reductions in impairment charges, given banks' already good asset quality, are likely to limit significant upside in profitability
- Steps have been taken to strengthen liquidity by lengthening the funding duration and collecting deposits, although wholesale funding is likely to remain a prominent funding source making Australian banks vulnerable to future disruption in global markets

Although the global operating environment remains volatile, a healthy domestic economy is likely to underpin stable bank performance in 2011. Fitch forecasts the Australian economy to grow at 3.2% yoy in 2011, picking up from an estimated 2.7% in 2010 (although the Queensland floods pose a downside risk to 2011 growth), and expects the unemployment rate to remain steady at around 5%.

As a further indication of economic health, the Reserve Bank of Australia (RBA) raised the policy rate for the seventh time in November 2010 to 4.75% after keeping rates on hold from May to October 2010 following six successive policy rate hikes after Q409. The central bank targets inflation within a 2% to 3% band and will likely tighten monetary policy further if inflationary pressures persist.

Of some concern is the emergence of a two-speed economy. Australia's mining sector and those sectors closely associated appear set to continue performing strongly, while conditions are likely to remain soft in sectors more reliant on discretionary spending (eg, retail).

An air of conservatism surrounds the outlook for credit growth in 2011, with both households and corporates adopting a wait-and-see approach. Against this backdrop of subdued credit growth, earnings improvements are likely to be modest.

Against the backdrop of steady economic growth, asset quality and profitability across the Australian banking sector should remain robust in 2011 underpinning stable bank ratings. External factors pose the most obvious threat, particularly a material slowdown in China. Reduced liquidity in global wholesale funding markets, possibly the result of a European sovereign debt crisis, is also a threat.

Improvements in profitability in 2010 have been heavily influenced by lower impairment charges, with asset quality stabilising. There is less scope for reductions in these charges in 2011, which together with modest top-line growth suggests that returns on equity and assets will not improve significantly. Potential exists for growth in non-interest income from the banks' wealth management operations, although this is subject to a return to more buoyant investment markets.

Australian banks' asset quality ratios are very good by international standards and are likely to remain so throughout 2011. Outside of commercial real estate, which includes residential property development and investment, no one sector has presented material concerns, while more broadly, Australian corporate balance sheets are likely to remain healthy after sizeable equity raisings during the financial crisis.

Moreover, a healthy corporate sector should be reflected in low unemployment and with Australia's household sector among the more highly indebted in the world, corporate health and low unemployment are key factors that will support sound mortgage asset quality. In addition to this, mortgage underwriting standards have remained prudent in Australia and were tightened further in 2008 in response to the expected deterioration due to the financial crisis. This deterioration did not eventuate and the prospect of material losses emanating out of the banks' mortgage loan portfolios in 2011 is slim.

Australian bank capital ratios have risen considerably since the onset of the financial crisis. While regulatory changes are under consideration, it is unlikely that these ratios will move noticeably lower in the foreseeable future, but at the same there appears to be some capacity to absorb regulatory changes. This in part reflects a level of conservatism that already exists within the Australian regulatory capital framework compared with a number of other systems in the world. By way of example, when risk-weighting assets Australian banks using the advanced approaches under Basel II must assume a relatively high minimum loss-given-default of 20% for residential mortgages.

Banking Systemic Risk Indicator

Australia	B2

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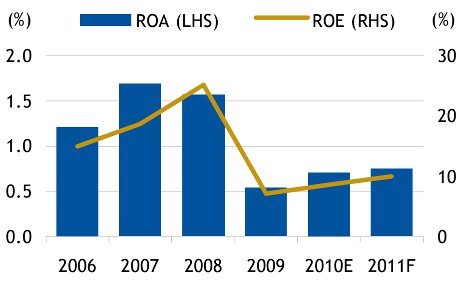
Australian banks have a relatively high reliance on wholesale funding. Steps taken to address this issue include lengthening the duration of long- and short-term funding, gathering more deposits and boosting liquidity. Despite these initiatives, offshore wholesale funding is likely to remain a prominent funding feature making Australian banks vulnerable to future disruption in global markets.

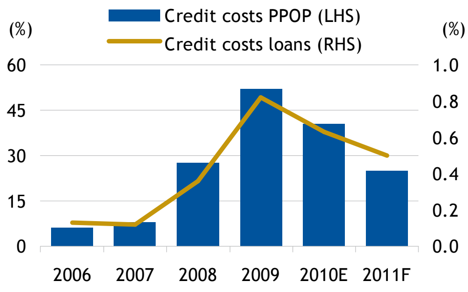
Meanwhile, competition is an issue being hotly debated in the Australian political arena. Regulatory change is likely to be a by-product of this debate, but possibly beyond 2011. While Fitch expects any changes will not pose a threat to system stability, they may provide a platform for smaller financial institutions to compete more effectively with the larger institutions, particularly on price.

Australia: Key Performance Trends
Return on assets & return on equity



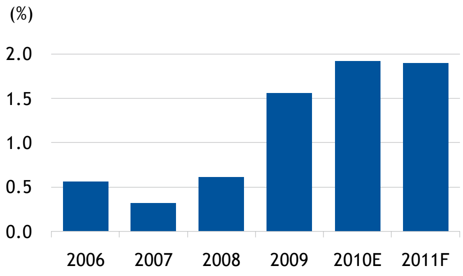
Source: Fitch

Australia: Key Performance Trends
Credit costs % PPOP and loans



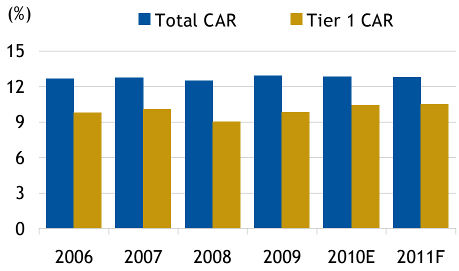
Source: Fitch

Australia: Key Performance Trends
Asset quality - NPL ratio



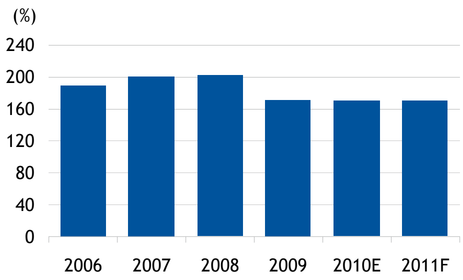
Source: Fitch

Australia: Key Performance Trends
Capital ratio



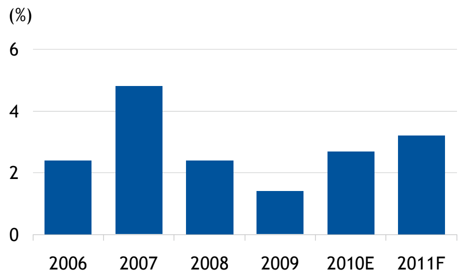
Source: Fitch

Australia: Key Performance Trends
Loan-to-deposit ratio



Source: Fitch

Australia: Key Performance Trends
Real GDP growth



Source: Fitch

- GDP forecast to slow to 9%, but could decelerate further if inflation intensifies or the global recovery falters
- An increase in lending rates of another 150bp could begin to materially strain corporate balance sheets, sparking a rise in delinquencies
- Absent these downside risks, credit conditions are likely to remain loose in 2011, with total credit growth on the order of 20%+ or CNY10trn-11trn, including upwards of CNY8trn in new CNY and FX loans from banks
- Financial performance of banks should hold up well as long as monetary tightening remains modest
- Asset quality, earnings, and capital will face pressure from tightened loan classification and provisioning, increased deposit reserve requirements, and higher regulatory capital thresholds

Banking Systemic Risk Indicator

China	D3

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China

Fitch's sovereign team forecasts China's economic growth will slow to 9% in 2011 from 10.3% in 2010 amid tightened monetary policy in the wake of rising inflation and accelerating capital inflows. However, compared with previous years, there is a greater risk that growth could disappoint on the downside should inflation intensify.

The agency's base case forecast assumes that inflation can be held in check throughout 2011 with only modest tightening. Inflation is expected to average 4.2% (2010: 3.5%), while the average one-year base lending rate is expected to rise to 6.4% (2010: 5.4%). In the event that inflation proves more persistent and broad-based, more aggressive tightening — particularly with respect to interest rates and credit extension — may be required, in turn weighing more heavily on growth. The global economic backdrop poses additional downside risk to Chinese export demand.

How China's banking system will fare in 2011 largely rests on what happens with inflation and the magnitude of policy tightening. If inflation can be controlled with only modest interest rate increases and a marginal tightening in credit, the impact on the corporate and banking sectors will likely be limited. If more aggressive policy moves are required, heightened borrowing costs and more limited access to credit could begin to erode the performance of Chinese corporates, in turn sparking a rise in corporate loan delinquencies and a deterioration in bank financials.

Fitch believes that Chinese corporates' repayment capacity could begin to come under material strain with an increase in base lending rates of another 150bp or more from January 2011 levels (currently 5.8% for one-year base lending rates). Tightening of this magnitude would place base lending rates near their historical peak over the past decade (7.5% in H108). However, unlike previously, Chinese corporates are contending with a much weaker external climate, as well as rising wages and input costs. Meanwhile, a larger share of loans is sitting with entities such as local governments that are less able to absorb higher borrowing costs.

These downside risks aside, the agency's current base case expectation is for credit conditions to remain relatively loose in 2011 reflecting the strong demand for credit. Fitch estimates total credit growth on the order of 20%+ in 2011, or CNY10trn-11trn, compared with CNY11trn-12trn in 2009 and 2010. However, as in 2010, central bank-set quotas/targets for bank lending are likely to limit explicit growth of CNY and FX loans from banks to upwards of CNY8trn (2010: CNY8.4trn).

The remaining gap will be filled by China's rapidly growing non-bank financial sector, as well as further product and accounting "innovations" that free space on bank balance sheets to extend credit above that allowed by official targets. Recent examples include the informal securitisation of loans into wealth management and trust products, and sales and repos of discounted bills. Informal securitisation could be a pressure point in 2011 as large amounts of products mature and/or are brought on-balance-sheet. In the past, such products have not been labelled as loans when recorded on-balance-sheet, and the CNY8trn forecast above excludes these items.

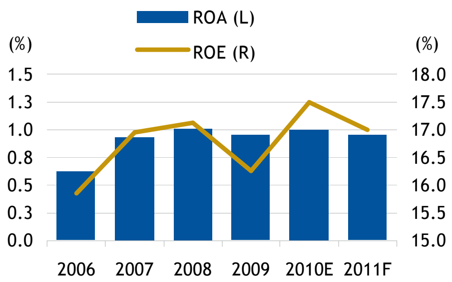
Under Fitch's base case, Chinese banks' performance should continue to hold up well in 2011, supported by ongoing robust GDP growth. Asset quality may demonstrate some deterioration, reflecting tightened classification standards for local government loans, but is unlikely to become a serious issue in the near term absent a significant tightening in corporate sector access to credit. However, the medium-term outlook for asset quality is a concern given the large rise in credit since 2008, which has far outpaced growth of GDP and corporate earnings, and banks' rising exposure to a frothy property market and local government borrowers.

Profitability will come under pressure from higher credit costs associated with a rise in delinquencies and higher loan loss provisioning requirements, increased deposit reserves, and intensifying deposit competition. In addition to tying up more funds in low-yielding assets, increased deposit reserves will raise funding costs for entities more reliant on money market funding, in particular smaller banks. Despite upwards of CNY500bn in equity raising in 2010, capitalisation will remain under strain in 2011 from increased regulatory requirements, higher risk weightings for local government loans, and growth continuing to outpace earnings. Hence, more banks may return to the market to raise further Tier 1 and Tier 2 capital.

The Long-Term IDRs of China's major banks are underpinned by strong expectations of state support, and any revisions will be directly tied to shifts in the sovereign's ability to provide support. The outlook is generally stable, but downward revisions of Long-Term IDRs and Individual Ratings are possible if credit growth remains elevated, asset quality or earnings weaken to levels that threaten solvency, or funding becomes strained (the system loan-to-deposit ratio has held steady between 69% and 72% for the last five years). In June 2010, China's Macroprudential Indicator was revised to '3' (high potential for bank systemic stress) from '1' (low potential), reflecting the acceleration in credit and strong increases in asset prices.

China: Key Performance Trends

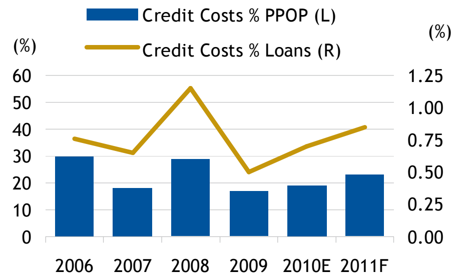
Return on Assets & Return on Equity



Source: Fitch, 16 major banks 2006, CBRC 2007+

China: Key Performance Trends

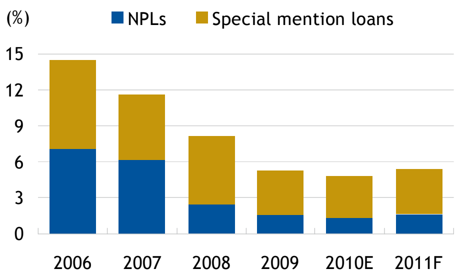
Credit costs % PPOP and loans



Source: Fitch, 16 major banks

China: Key Performance Trends

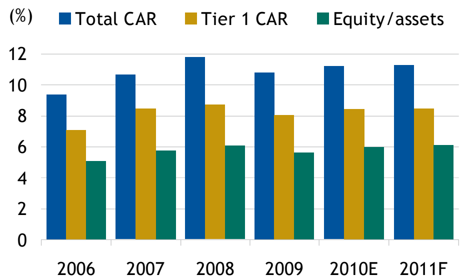
Classified loans % total loans



Source: Fitch, CBRC NPLs, 16 major banks SM loans

China: Key Performance Trends

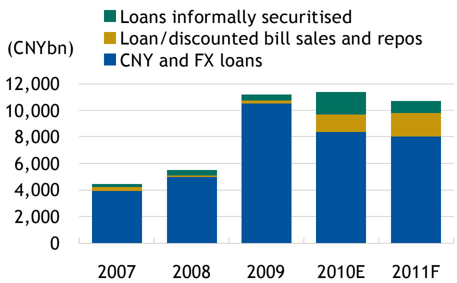
Capital ratios



Source: Fitch, 16 major banks

China: Key Performance Trends

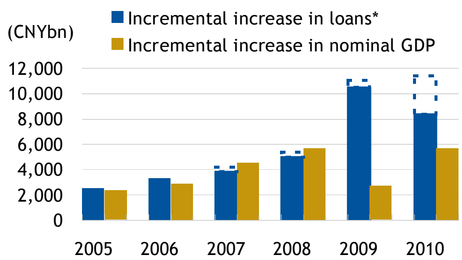
Net new credit flows



Source: Wind, Fitch

China: Key Performance Trends

Loan growth vs. GDP growth



* Dashed line includes loans moved off-balance-sheet

Source: IMF, PBOC, Fitch

- The Hong Kong banking system maintains sound capitalisation, considerable liquidity and adequate provisioning to withstand economic shocks
- The economic recovery and buoyant property market sustained strong loan demands while banks' credit profiles become more closely tied to China's health
- A meaningful deterioration in the property market and/or China's operating environment would likely be negative for Hong Kong banks generally

Banking Systemic Risk Indicator

Hong Kong	B3

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Hong Kong

The Hong Kong banking system is stable, underpinned by solid capitalisation, strong liquidity and adequate provisioning to weather any unexpected slowdown/reversal in economic momentum. Although competition and low interest rates have dented bank profitability, their performance compares well with developed market peers.

Pressured margin levels raise the risk of banks expanding faster into China. As such, stability in Hong Kong will increasingly hinge on China's health, particularly in its corporate and banking sectors and property market, where Hong Kong banks have been actively involved. More meaningful exposure to mainland credit risk could see banks' Outlooks revised to Negative, while any meaningful deterioration in the property market and/or China's operating environment would likely also have negative rating implications for Hong Kong banks generally.

Rising trade flow, economic cooperation with China and a hot property sector resulted in strong demand for credit in 2010, with property-related loans the major contributor. The trend of rising China exposures (particularly interbank) persists, although the share of mainland-related claims to total assets currently remains modest at about 9%.

Fitch expects loan growth to ease slightly in 2011 as economic growth is unlikely to be meaningfully higher than in 2010. This is because of local authorities' moves to damp property speculation and potentially lower demand from mainland China amid cooling measures for its economy. However, the buoyancy of the housing market and low interest rates give rise to risks and incentives to take on further leverage. That said, a series of prudential measures imposed by the Hong Kong government could help contain risks associated with rising property prices.

The sound aggregate operating ROA of about 1% in Q110-Q310 was aided by lower impairment charges and lower Lehman Brothers minibond provisions, and by a growth in fee income and improvements in operating cost control. However, net-interest income remains constrained by narrowing net interest margins, partially offset by a significant expansion of interest-bearing assets. Low interest rates, pressure on deposits and competition in the loan market make it less likely that there will be any meaningful improvement in profitability in 2011.

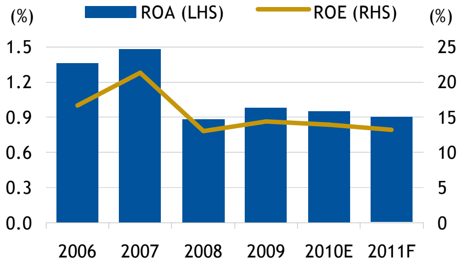
Relative to other markets, asset quality is good, and has improved recently due to loan growth, rising asset prices and greater economic optimism. But some new mortgages may have been underwritten with higher risks due to surging property prices and lower mortgage rates, while banks' mainland credit and counterparty exposures also warrant close monitoring.

Fitch anticipates some asset quality deterioration in the event of a meaningful correction in the property market and should growth in China ease, but the system is nevertheless well placed to manage such pressures.

Hong Kong is a well-capitalised system; its consolidated Tier 1 ratio was 12.6% and its total CAR was 16.2% at end-H110. Given internal capital generation prospects, the banking system is expected to remain easily compliant with Basel III guidelines even in the event of economic adjustment and rising impairment charges.

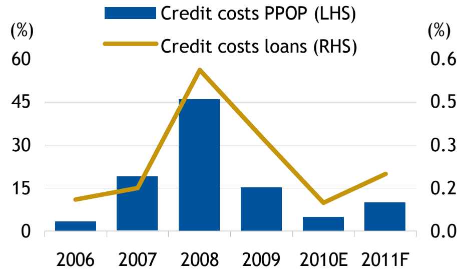
The system boasts solid liquidity as evidenced by an aggregate loan-to-deposit ratio of 61% and loans accounting for just 35% of total assets for all licensed banks at end-Q310. A significant deposit base and less reliance on wholesale funding support the banks' greater stability during volatile times relative to other developed markets. That said, the banks' interbank portfolios, which currently account for one-third of total assets, are beginning to take on greater liquidity and credit risk as mainland counterparty exposures rise. Meanwhile, part of the system's current strong liquidity position is partly attributable to strong capital inflows. Were they to reverse, the system's liquidity could be pressured, particularly for banks with weaker retail deposit-taking franchises.

Hong Kong: Key Performance Trends
Return on assets & return on equity



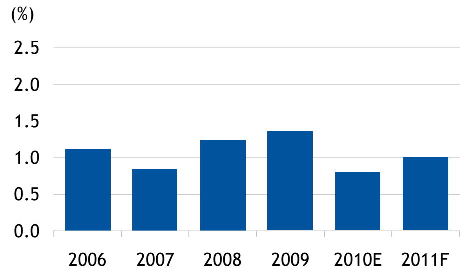
Source: Fitch, HKMA

Hong Kong: Key Performance Trends
Credit costs % PPOP and loans



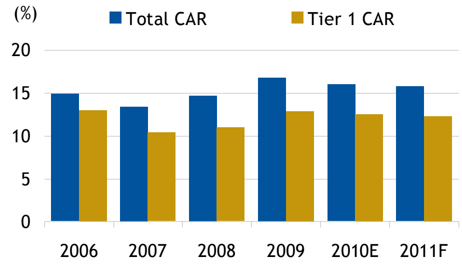
Source: Fitch

Hong Kong: Key Performance Trends
Asset quality - Impaired loan ratio



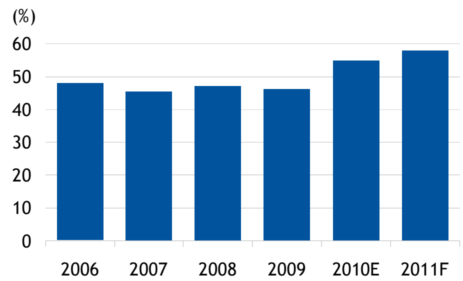
Source: Fitch, HKMA

Hong Kong: Key Performance Trends
Capital ratio



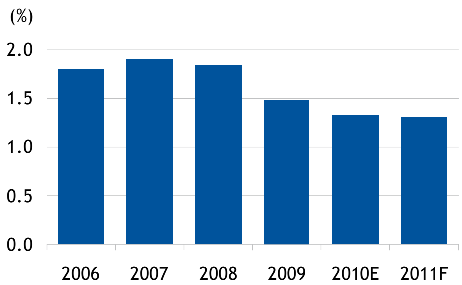
Source: Fitch, HKMA

Hong Kong: Key Performance Trends
Loan-to-deposit ratio



Source: Fitch, HKMA

Hong Kong: Key Performance Trends
Net interest margin



Source: Fitch, HKMA

- The Indian economy's strong growth momentum should underpin banks' performance and credit profiles in 2011
- Profitability trends range from neutral to negative; higher funding costs are likely to pressure NIM, balanced by potentially lower credit costs as NPL accretions ease
- In view of tight market liquidity, Fitch expects banks' funding profile to deteriorate slightly as they increase dependence on wholesale corporate deposits to support robust loan growth

India

A strong growth momentum in the Indian economy sets the background for a Stable Outlook on most Indian bank ratings through 2011. GDP growth estimates of 8.5% in 2011 and 8.2% in 2012 (2010: 8.7%) are expected to drive credit demand from both the industrial and consumer segments, notwithstanding the tight monetary stance of the central bank to fight inflation.

Fitch expects profitability to exhibit neutral to negative trends. Loan growth of 20%-22% during 2011 is expected to drive net interest income, which is expected to continue to be the dominant (60%-65%) part of operating income. Narrowing NIM in a rising interest rate regime will likely moderate profit growth, balanced by a possible reduction in credit costs as non-performing loan (NPL) accretions begin to ease.

Higher pension provisions could hypothetically be a drag on government banks' profitability, although the quantum and the accounting treatment are yet to be announced. The growth momentum in fee income will likely be sustained for the larger government banks, particularly from consumer and transaction banking, by leveraging on the investments made to update technology during the last five years.

NPL ratios could peak around March 2011 when most of the restructured loans are due for redemption, some of which could turn non-performing. The strong growth environment and the improved corporate credit profile is likely to ease asset quality concerns for a large part of banks' loan portfolio, although a few vulnerable sectors including commercial real estate and some of the export-oriented sectors may see rising delinquencies.

Asset quality resilience derives from the relatively diversified loan portfolio, which is divided between industry (30%), infrastructure (15%), residential mortgage (10%), other consumer loans (9%), trade and services (24%) and agriculture (12%). Of these, infrastructure will likely remain the fastest growing until it hits the sector cap of 20%, possibly in 2012-2013. While there has been only a low level of NPLs in the infrastructure exposure so far, there are occasional delays and cost overruns, particularly in road projects, that may require a part of the portfolio to be restructured.

The requirement to raise specific loan loss provisions to 70% on incremental NPLs should strengthen the banks' historically low reserves position. This will also be timely if NPL recoveries dip in the event property prices fall. That said, on balance, any sharp correction in property or equity prices is unlikely to have any material impact on banks' overall asset quality, given their banks' low exposure to commercial real estate and capital market lending (less than 5% of loans).

With loan growth likely to remain above the internal capital generation rate for banks (around 10%), banks will need to infuse common equity to maintain the core Tier 1 ratio at 9%. Most of the fresh infusion will likely be from the government, given its commitment to help government banks maintain a minimum Tier 1 ratio of 8%, together with its reported plan to raise the minimum shareholding considerably above the current regulatory minimum of 51% in these banks.

Fitch expects the banks' funding profile to deteriorate slightly amid tight liquidity in the market. Inflationary pressures are likely to persist globally, and in India the current tight liquidity scenario in the system is unlikely to ease significantly. Banks are therefore likely to focus on mobilising retail deposits, although these may not be sufficient to fund loan growth, thereby increasing the proportion of wholesale corporate deposits. Retail deposits and customer current accounts will, however, remain the dominant funding sources, together accounting for about 65% of total deposits. Some comfort on short-term liquidity stems from banks' holdings in government securities (about 24% of assets) and cash (6% of assets) that Indian banks are statutorily required to maintain.

Banking Systemic Risk Indicator

India	C1

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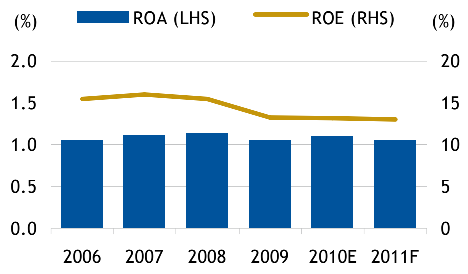
Overall, the Stable Outlook on the Long-Term Ratings of Indian banks reflects expectations of easing asset quality concerns, together with a strengthened loan loss reserves position and timely infusions of common equity.

India: Key Performance Trends

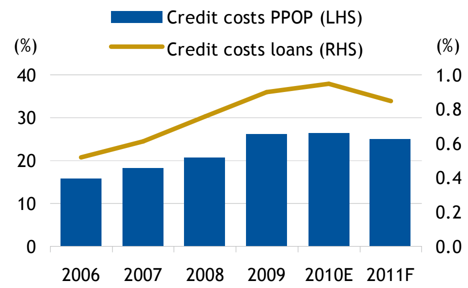
Return on assets & return on equity



Source: Fitch, banks

India: Key Performance Trends

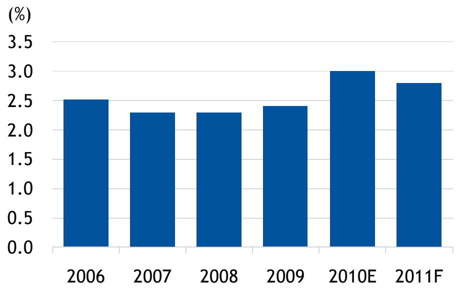
Credit costs % PPOP and loans



Source: Fitch, banks

India: Key Performance Trends

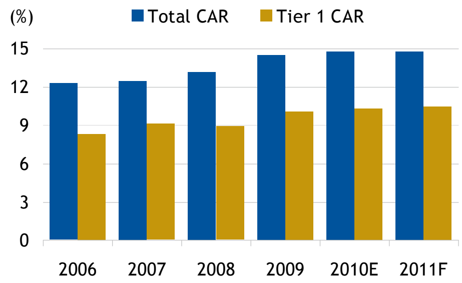
Asset quality - NPL ratio



Source: Fitch, RBI

India: Key Performance Trends

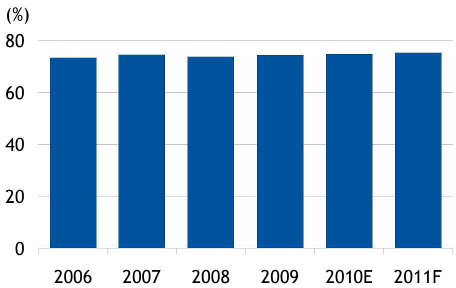
Capital ratio



Source: Fitch, RBI

India: Key Performance Trends

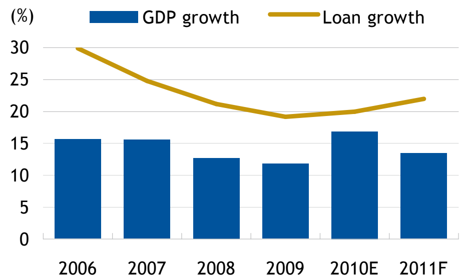
Loan-to-deposit ratio



Source: Fitch, RBI

India: Key Performance Trends

Loan growth vs. nominal GDP growth



Source: Fitch, RBI

- Strong loan growth and healthy economy to moderate impact of competition and underpin sound profitability in Indonesia in 2011
- Favourable economic conditions support asset quality, although further improvement would likely be at a more moderate pace than before, due to the seasoning of the portfolio
- Capitalisation to remain satisfactory in 2011, albeit lower due to growth and the phasing in of Basel II operational risk charges
- Of the 10 major banks, four have yet to meet the 78%-100% LDR range introduced by the regulator as they balance between the cost of non-compliance (0.1% of deposits for every 1% that the LDR is below the regulatory floor) with that of the potential credit risk associated with fast loan growth

Banking Systemic Risk Indicator

Indonesia	D2

Analysts

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Indonesia

Fitch believes that the Indonesian banks' strong profitability and improved provision cover provide a reasonable buffer if economic conditions become more challenging, such as in the event of a renewed global slowdown.

At the same time, the Outlook for the Long-Term IDRs of all the major Indonesian banks is Stable, reflecting that of the Indonesian sovereign. However, any notable pressure on earnings and/or asset quality resulting in a rise in impairment risk on capital may exert pressure on the banks' ratings.

With strong domestic demand and positive economic sentiment, the agency expects Indonesia's full-year real GDP to grow by 6% in 2010 and 2011. Against this backdrop, Fitch expects Indonesian banks to maintain their sound profitability in 2011 because stronger loan growth and manageable credit costs in light of generally healthy economic conditions should offset the pressure from increased competition and disintermediation. Indonesia's relatively low loan penetration should support lending yields despite the prospect of higher funding costs as interest rates gradually rise over the course of 2011 from their currently low levels.

The banks' NPL ratio and credit costs are expected to remain manageable in 2011 amid moderate interest rates and favourable economic conditions. However, significant improvements in asset quality could be less likely due to the low seasoning of the loan portfolio, which has grown rapidly since Q409.

The gross NPL ratio fell to 3.1% in Q310 after peaking at 3.9% in Q309 while provision cover was higher at about 153% of NPLs. The average credit costs of 10 Indonesian major banks rated by Fitch — which account for 65% of system assets — moderated to 1.5% of total loans in 9M10 from 2.3% in 2009. Fitch estimates that on average, the Indonesian banks' earnings can absorb up to 4% of annualised credit costs in a stressed scenario (see Fitch's "*Stress Test on Indonesian Banks*" report, dated 25 August 2009, for details).

Capital ratios remain satisfactory but have generally been on the decline due to rapid loan expansion and the gradual implementation of Basel II operational risk charges since H110. Some banks' average Tier 1 CAR fell to 13% at end-September 2010 from 13.5% in 2009. Fitch expects capital ratios could ease further in 2011 with continued loan expansion and the full implementation of operational risk under Basel II in the beginning of 2011.

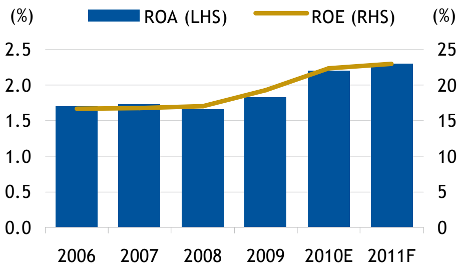
Fitch notes that some banks have made efforts to conserve capital through slower loan growth, lower dividend payouts and equity injections. Compared with other regional banks, Indonesian banks have higher capitalisation, which Fitch believes is desirable to support their fast growth as well as provide a buffer against Indonesia's generally volatile operating conditions.

The banking system's loan/deposit ratio (LDR) increased to 78.5% at end-September 2010 (2009: 75.6%) as loan growth outpaced deposit growth, reflecting positive sentiment but also the regulator's 78%-100% LDR requirement implemented in Q110 to support lending. Fitch understands that there is a regulatory cost for not meeting the requirement (0.1% of deposits for every 1% that the LDR is below the regulatory floor). Of the 10 major banks, the agency notes that four have yet to comply, possibly because they remain cautious of the potential credit risk associated with expanding their loans too quickly to meet the requirement.

The system's foreign-currency LDR has also risen in tandem to 69.1% at end-September 2010 (end 2009: 66.7%) due to higher demand for such loans on the back of a more stable exchange rate. However, the system's foreign-currency LDR remains lower than the local-currency LDR, possibly reflecting the banks' generally cautious stance on foreign-currency lending, following experiences from past crises.

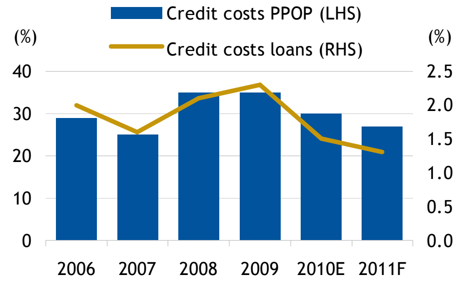
To moderate foreign-currency liquidity risk, the regulator intends to raise reserve requirements against foreign-currency deposits to 5% by 1 March 2011 and to 8% by 1 June 2011 from 1% currently.

Indonesia: Key Performance Trends
Return on assets & return on equity



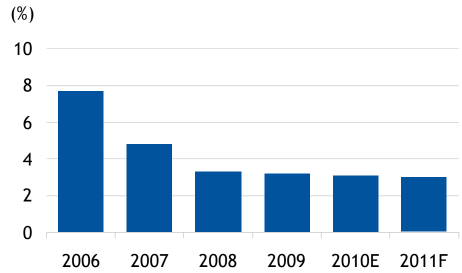
Source: Fitch, 10 major banks

Indonesia: Key Performance Trends
Credit costs % PPOP and loans



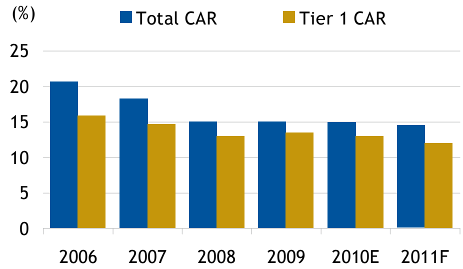
Source: Fitch, 10 major banks

Indonesia: Key Performance Trends
Asset quality - NPL ratio



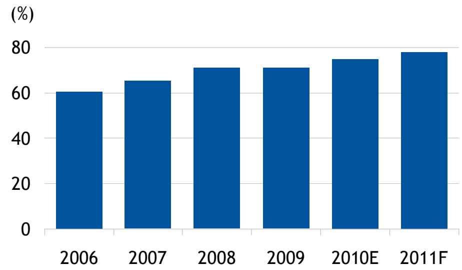
Source: Fitch, 10 major banks

Indonesia: Key Performance Trends
Capital ratio



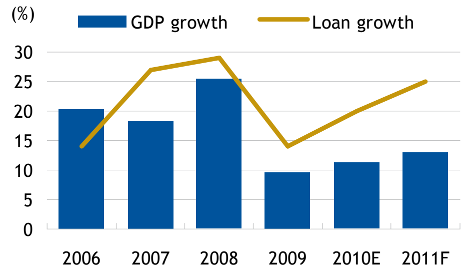
Source: Fitch, Bank Indonesia (BI)

Indonesia: Key Performance Trends
Loan-to-deposit ratio



Source: Fitch, 10 major banks

Indonesia: Key Performance Trends
Loan growth vs. nominal GDP growth



Source: Fitch, Bank Indonesia (BI)

Japan

- Fitch's sovereign group expects Japan's economic outlook to be fair with an estimated 1.5% GDP growth in 2011, and an end to deflation by 2012; a convincing economic recovery would be key in improving banks' financial strength and Individual Ratings
- Meanwhile, core profitability will remain low, with comfortable liquidity to support higher loan demand
- M&A activities may increase among mega banks to improve their overseas representation, but capital considerations could limit the size of transactions

Banking Systemic Risk Indicator

Japan	C1

Analysts

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The Stable Outlook on Japanese banks' IDRs reflects either their own adequate financial strength for the respective IDRs or likely support from the Japanese government, if needed. A sustainable economic turnaround will be the key factor driving the banks' future ratings prospects, since one of the primary constraints at present is limited organic growth opportunities, which continues to suppress profitability and internal capital generation.

The banks' operating performance began to recover in 2010, attributable mostly to capital gains from bond investment and a reduction in loan loss charges rather than to an improvement in recurring banking operations. Indeed, the deflationary economic environment constrains operating profitability and undermines internal capital generation. To address this, Japan's "mega" banks — Mitsubishi-Tokyo Financial Group ('A'/Stable for its operating banks — Bank of Tokyo - Mitsubishi UFJ and Mitsubishi UFJ Trust and Banking Corporation), Mizuho Financial Group ('A'/Stable) and Sumitomo Mitsui Financial Group ('A'/Stable) — raised common equity in 2009 and 2010 to increase their average core capitalisation to more satisfactory levels. Separately, regional banks' core capitalisation varies from weak to strong. Instead of raising new Tier 1 capital, banks with strong capitalisation have exercised buy-back of their treasury stocks.

Japan's economic outlook is fairly stable: Fitch's sovereign group estimates real GDP growth will be 1.5% in 2011. Despite the positive forecast, low loan demand, fierce price competition and ultra-low yen interest rates are likely to pressure net interest income. Banks will continue to face this challenge as long as deflationary conditions persist, which Fitch's sovereign group believes could end in 2012. In the meantime, the government has announced as part of an economic stimulus package a 5% point reduction in corporate tax from the fiscal year starting April 2011. Whether the stimulus measures are adequate and effective remain to be seen.

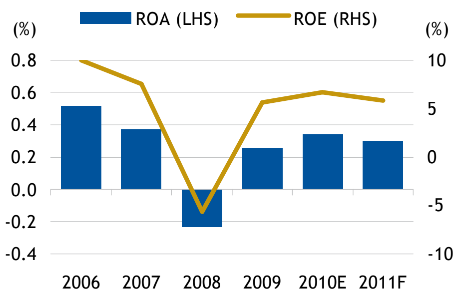
Non-performing loans are at a historically low level, and should contain loan loss charges in 2011. This is because the government's forbearance policy — which was instituted in 2008 — will continue for another year to help SMEs' cash flow. However, the strong yen as well as soft economic sentiments in Japan are factors which slow down organic growth in the economy, and will continue to cast shadows on asset quality unless the government is successful at stimulating the economy.

Although a higher interest rate will eventually improve the margins earned on the banks' abundant low-cost deposits, the immediate impact would be impairment losses on fixed interest rate investments, most notably Japanese government bonds. The degree of the impact is sensitive to the magnitude of interest rate changes and banks' prevailing asset-liability positions. Fitch's profitability forecast is based on a flat to moderate rise in long-term interest rates.

Liquidity will remain adequate, given the limited lending opportunities and retail depositors' preference for savings deposits over non-deposit financial instruments. These factors underpin the fairly low loan to deposit ratio (around 80%), with the latter reason also explaining why fee income prospects are likely to remain modest in 2011, especially at the regional banks.

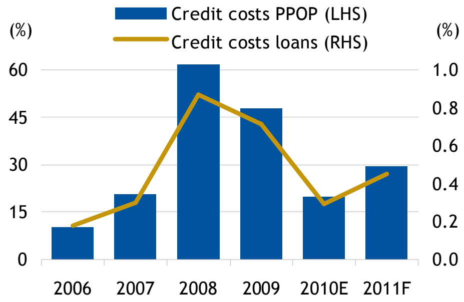
Fitch expects the mega banks will continue to seek M&A opportunities in 2011. As banking business in Japan is limited, the mega banks may attempt to increase their presence overseas either via joint ventures with local partners or M&A. However, transaction size should be limited considering the negative impact on the capital ratio. While the likelihood of mergers among regional banks is low in 2011, it is likely to happen at some point in the future as a means to lower overhead costs.

Japan: Key Performance Trends
Return on assets & return on equity



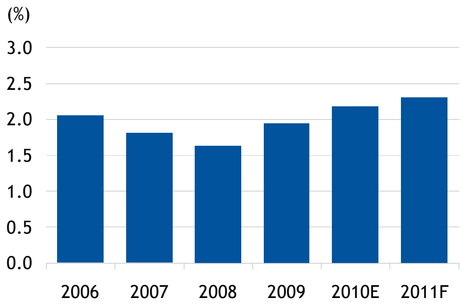
Note: The years represent fiscal years ending March each year
Source: Fitch, Japan's 3 'Mega' Banks

Japan: Key Performance Trends
Credit costs % PPOP and loans



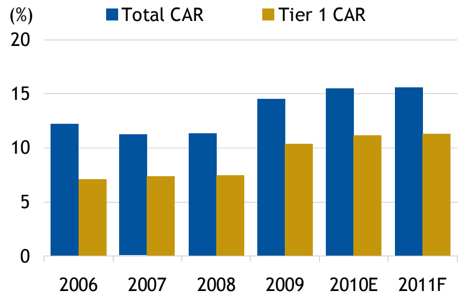
Note: The years represent fiscal years ending March each year
Source: Fitch, Japan's 3 'Mega' Banks

Japan: Key Performance Trends
Asset quality - NPL ratio



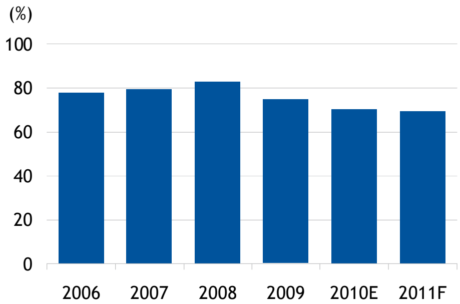
Note: The years represent fiscal years ending March each year
Source: Fitch, Japan's 3 'Mega' Banks

Japan: Key Performance Trends
Capital ratio



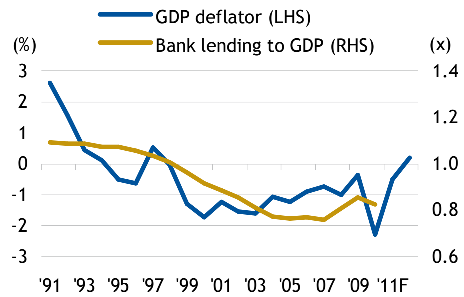
Note: The years represent fiscal years ending March each year
Source: Fitch, Japan's 3 'Mega' Banks

Japan: Key Performance Trends
Loan-to-deposit ratio



Note: The years represent fiscal years ending March each year
Source: Fitch, Japan's 3 'Mega' Banks

Change in GDP Deflator vs. the Gap Between Bank Lending & GDP (Nominal)



Note: The represent year is calendar years
Source: Cabinet Office, Bank of Japan, Fitch

- Malaysian banks have good loss absorption capacities and satisfactory liquidity, enabling them to operate favourably even against a backdrop of somewhat uncertain external conditions
- Fitch expects steady profitability as higher fee revenues and lower credit costs offset competitive pressure on margins
- Possibility of capital raising over the near to medium term for organic as well as inorganic growth opportunities

Malaysia

The Stable Outlook on most Malaysian banks' ratings reflects Fitch's view that banks' credit profiles will remain satisfactory, supported by the country's healthy economic environment. The agency's 2011 GDP growth forecast is 5% for Malaysia. Fitch also recognises the local banks' good loss-absorption capacities in coping with renewed challenges, possibly arising from the somewhat weak external environment, which could have a knock-on impact on Malaysia as it is a fairly open economy.

Amid expectations of an expansionary economic backdrop in 2011, the agency anticipates that the Malaysian banks' ROA will remain steady at around 1.2%, with narrowing margins due to competition offset by higher fee-based revenues and lower credit costs. Regional operations, particularly in less developed markets, are likely to provide better earnings upside than in Malaysia, which has in comparison a fairly saturated banking system.

The system-wide NPL ratio could decline to 2.5% by end-2011 due to ongoing recovery and write-off measures, supported by the generally stable credit environment. This, together with NPL reserve coverage already at almost 100%, also suggests low NPL provisioning risks. As such, impairment charges in 2011 may ease further.

Fitch believes that the consumer loans in Malaysia, which represent 55% of banking sector loans, are of reasonable quality and well-seasoned, having withstood the recent recession in 2008/2009 quite well thanks to low interest rates and well-contained job losses. The local banks' pre-provision profits, as the first line of defence, should be capable of absorbing credit costs of up to 2.4% of loans on average under Fitch's own "simulated-stressed" scenarios (see Fitch's "*Stress Test on Malaysian Banks*" report, dated 6 August 2009, for details). Banks' actual credit costs did not exceed 1% in 2008-2009 despite recessionary conditions.

These factors, together with the government's pre-emptive regulations, including on credit cards and home loans, underpin the agency's expectations of low capital impairment risks for the rated-Malaysian banks, even in a fresh downturn scenario (see the agency's "*Malaysian Banks: Annual Review and Outlook*" Special Report, dated 9 November 2010, for details).

Over the near to medium term, Fitch believes the Malaysian banks are more likely to further strengthen their capitalisation so that they are better positioned to grow by organic means or by participating in mergers and acquisitions (M&A), particularly in less developed markets with greater operating environment challenges.

Fitch believes that maintaining a bigger margin above Basel III's minimum capital requirements is desirable as it underpins banks' financial flexibility in terms of growth without unduly compromising dividend payments to shareholders. Indeed, shareholder friendly practices are important for maintaining access to new capital should the need arise. At end-September 2010, the average core Tier 1 CAR of the rated local banks was 9%, slightly higher than Basel III's proposed minimum of 7%.

The Malaysian banks continue to have satisfactory funding and liquidity profiles. They do not rely much on wholesale borrowings as their loans are comfortably funded by customer deposits, with the loans/deposits ratio not exceeding 80% over the past five years.

Banking Systemic Risk Indicator

Malaysia	C1

Analysts

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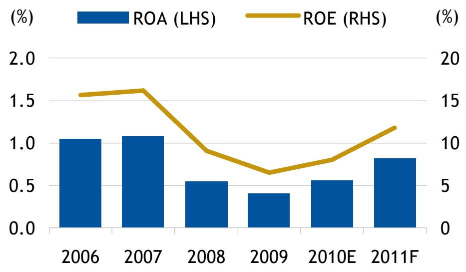
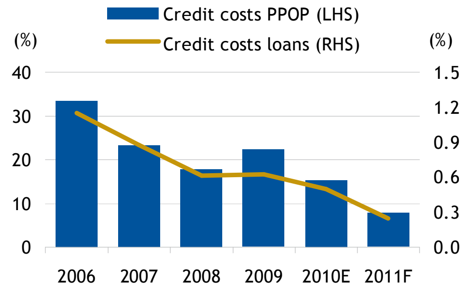
Malaysia: Key Performance Trends
Return on assets & return on equity



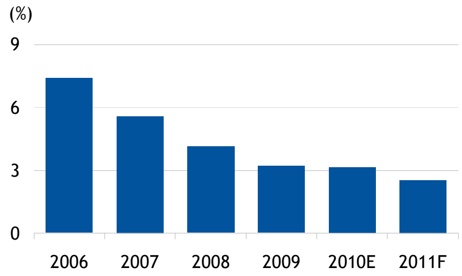
Source: Fitch, banks

Malaysia: Key Performance Trends
Credit costs % PPOP and loans



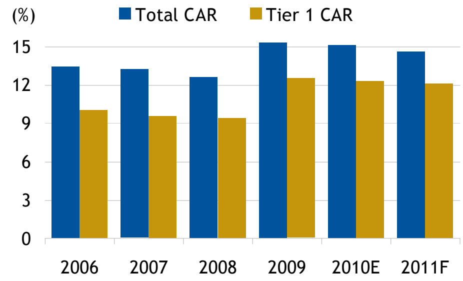
Source: Fitch, banks

Malaysia: Key Performance Trends
Asset quality - NPL ratio



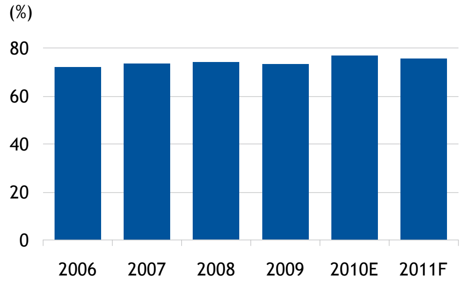
Source: Fitch, BNM

Malaysia: Key Performance Trends
Capital ratio



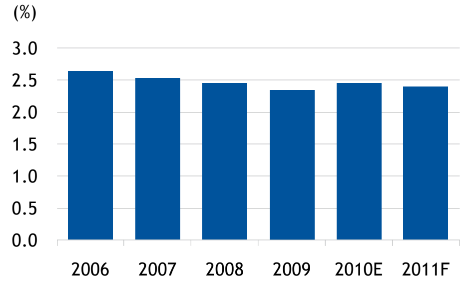
Source: Fitch, BNM

Malaysia: Key Performance Trends
Loan-to-deposit ratio



Source: Fitch, BNM

Malaysia: Key Performance Trends
Net interest margin



Source: Fitch, BNM

Mongolia

- Fitch expects further improvement in loan quality and profitability on back of the economic recovery
- The buoyant mining sector is likely to benefit Mongolia's economy and banking system
- The volatile operating environment remains the major risk factor
- More stringent risk management and higher capital needed to cope with the volatility

Fitch expects the Mongolian banking system to further recover in 2011, supported by healthy domestic economic growth. However, the volatile operating environment — characterised by less predictable economic conditions, weather and commodity prices — remains a key risk.

Consequently, more stringent risk management and higher capital levels are needed to strengthen the banks against unexpected losses, given still favourable credit growth prospects. Excessive credit growth, if any, which erodes capital and further pressures liquidity would likely have negative implications for the banks.

The main impetus for economic growth is large mining projects such as Oyu Tolgoy. These will benefit the banking sector through a pick-up in economic activity and greater loan demand. The local banks are unlikely to have capacity to finance the largest projects, but medium to smaller size projects and other business that will stem from the sector should provide ample lending opportunities for them.

This loan growth augurs well for profitability in 2011. Fitch believes the volume effect from a larger loan book would offset the pressure on lending spreads arising from higher funding costs (due to the banks' need for more funding). Also, loan loss charges are likely to decline further along with an improvement in asset quality, which should support profitability.

As the economy is stabilising, Fitch expects NPLs to decline faster in 2011 relative to 2010. This assumes banks grow their loan books responsibly as they work on strengthening risk management. In the meantime, their relatively cautious stance toward loan growth offers some comfort. The risk of NPL losses due to related-party lending is somewhat mitigated by the government's new regulations limiting such lending, although whether enforcement will be effective remains to be seen.

Fitch expects no significant change in NPL reserve coverage in 2011, as it is fixed by central bank regulation. The agency believes there is significant scope for the current reserve coverage to be improved considering the volatile environment and the large gap between IFRS and local NPL classification standards.

While the system's total CAR of 16% in 2010 compares well with the region, Fitch believes some banks may need additional capital in 2011 to support strong loan growth amid still volatile conditions.

Such growth could also exert renewed pressure on funding. While the system's loan-to-deposit ratio has declined from the peak of 176% in 2008, it is likely to remain well over 100%, suggesting reliance on wholesale funding. This poses risks if market conditions deteriorate as they did during the global crisis.

While, the government's Empowering the Banking Sector and Capital Support Programme should establish a framework to allow it to inject capital in troubled banks, it remains uncertain when parliament will approve it. Regulatory support for banks has not always been forthcoming in Mongolia. For example, Anod Bank was allowed to fail in 2008 when a surge in NPLs eroded its capital. Approval of the framework could benefit the banks' Support Ratings, and show the government's commitment to support the banking sector in case of need.

Banking Systemic Risk Indicator

Mongolia	-

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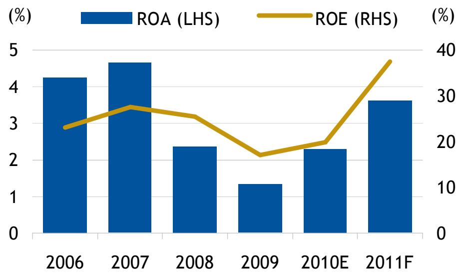
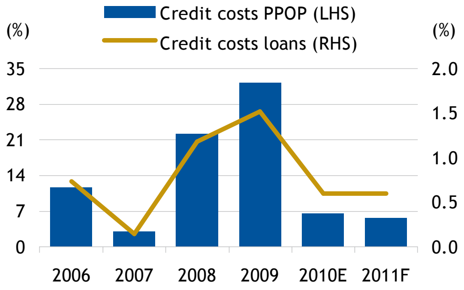
Mongolia: Key Performance Trends
Return on assets & return on equity



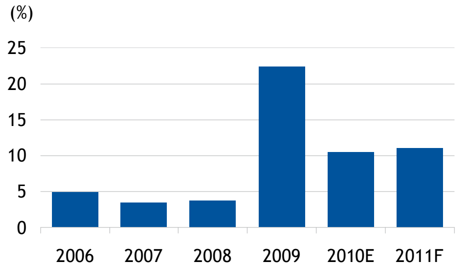
Source: Fitch, Bank of Mongolia, Banks

Mongolia: Key Performance Trends
Credit costs % PPOP and loans



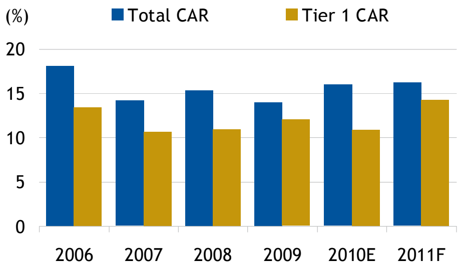
Source: Fitch, Banks

Mongolia: Key Performance Trends
Asset quality - NPL ratio



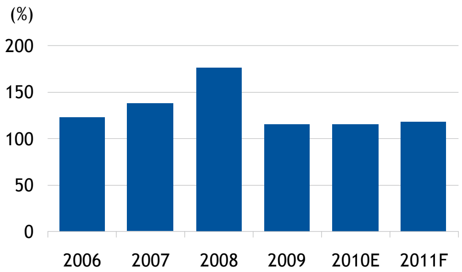
Source: Fitch, Bank of Mongolia

Mongolia: Key Performance Trends
Capital ratio



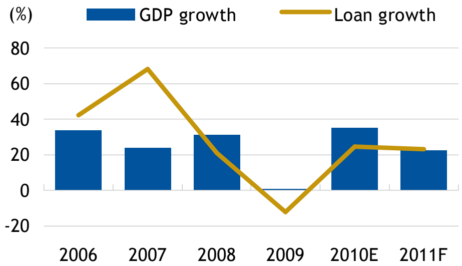
Source: Fitch, Bank of Mongolia, Banks, IMF

Mongolia: Key Performance Trends
Loan-to-deposit ratio



Source: Fitch, Bank of Mongolia

Mongolia: Key Performance Trends
Loan growth vs. nominal GDP growth



Source: Fitch, Bank of Mongolia

New Zealand

- A rather subdued economic outlook for New Zealand in 2011 suggests that earnings are likely to be flat at best
- Strong trade ties with Australia and Asia underpin a reasonable level of business activity, which augurs well for asset quality stabilisation
- The four major banks are addressing the potential vulnerability associated with meaningful dependence on offshore wholesale funding by lengthening the duration of funding and collecting deposits; a strategy also adopted by their Australian parents

A sustained recovery in New Zealand hinges somewhat on recovery in the global environment, with continued strong demand for soft commodities being a key factor.

Accounting for around 90% of the market, the subsidiaries of Australia's four major banks dominate the New Zealand banking sector. Within an overall stable outlook for the financial sector, smaller institutions are likely to face the greatest pressure from subdued economic conditions and their impact on asset quality and profitability. The four major banks, by virtue of their size and scale advantages, are on a more stable footing. However, should Asian demand for commodities be materially eroded by a regional or global economic downturn this could lead to downward pressure on ratings.

After absorbing significant tax and loan loss provisions in 2009, bank profitability rebounded in 2010. However, a rather subdued economic outlook for 2011 suggests that earnings are likely to be flat at best. More specifically, modest credit growth appears set to constrain net- and non-interest income, but at the same time impairment charges are likely to remain relatively stable.

Despite a rather severe economic downturn, asset quality at New Zealand's banks and building societies has remained very good by international standards. However, finance companies have been particularly hard hit largely due to their disproportionately large exposure to commercial real estate. With signs that impaired loan levels may have peaked, New Zealand's strong trade ties with Australia and Asia look set to underpin a reasonable level of activity in 2011, which bodes well for a stabilisation of asset quality.

Like many other banks around the world, New Zealand banks have steadily increased capital levels since the onset of the financial crisis. Most appear well placed to manage any increase in minimum regulatory capital requirements, and in the interim they are likely to preserve high ratios until more certainty around the rules emerges.

New Zealand banks rely heavily on offshore wholesale markets for funding and this is likely to remain a vulnerability of the system for the immediate future. Cognisant of this, the four major banks have followed in the footsteps of their Australian parents by lengthening the duration of long- and short-term funding, gathering more deposits and boosting liquidity.

Banking Systemic Risk Indicator

New Zealand	B2

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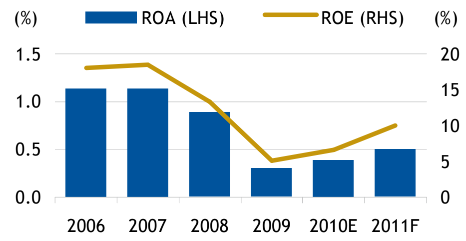
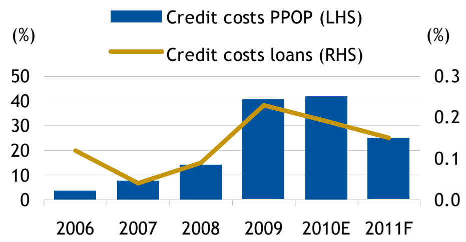
New Zealand: Key Performance Trends
Return on assets & return on equity



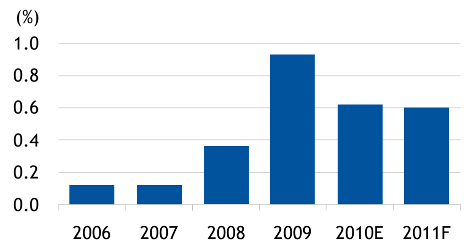
Source: Fitch

New Zealand: Key Performance Trends
Credit costs % PPOP and loans



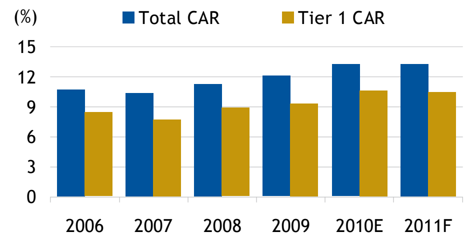
Source: Fitch

New Zealand: Key Performance Trends
Asset quality - NPL ratio



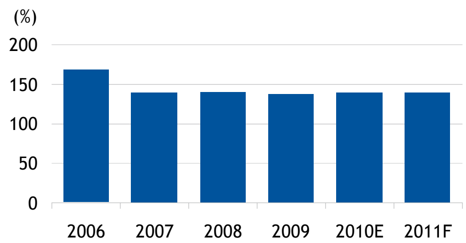
Source: Fitch

New Zealand: Key Performance Trends
Capital ratio



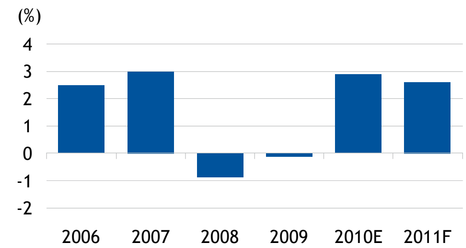
Source: Fitch

New Zealand: Key Performance Trends
Loan-to-deposit ratio



Source: Fitch

New Zealand: Key Performance Trends
Real GDP growth



Source: Fitch

- Philippine banks' earnings and capital offer reasonable protection should there be spill-over effects from renewed weaknesses in the global economy
- The deposit-funded and reasonably capitalised banks are well positioned to grow loans, but competition and potentially lower trading gains could limit improvement in profitability
- Corporate concentrations could pressure balance sheets if there are credit mishaps in the portfolio, given their size

Banking Systemic Risk Indicator

Philippines	D1

Analysts

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Philippines

The Stable Outlook on the Philippine banks' ratings reflects Fitch's expectation that their credit fundamentals will remain intact amid generally sound domestic economic conditions. The agency also believes the levels of earnings and capital offer reasonable creditor protection should there be spill-over effects from weaknesses in certain western economies.

Fitch is forecasting real GDP growth of 5.5% in 2011, moderating nearer the longer-term trend from an estimated 7% for 2010, but still favourable compared with the 1.1% growth reported in 2009. Domestic consumption driven by strong overseas Filipino workers' (OFWs) remittances should offer some respite if export conditions wane. Indeed, in addition to multinational corporations' demand for space to set up service outsourcing centres, the growing trend in OFWs buying new homes for their families is injecting renewed vigour in the real estate market through genuine demand, albeit from a low base. This augurs well for property developers, and ultimately the banks via a gradual rise in loan demand. That said, inflationary pressure from rising commodity prices, although not a key risk in the short term, could lead to a more severe monetary policy tightening and a downside risk for growth.

Barring any severe negative economic shocks, the deposit-funded and reasonably capitalised banks are well positioned to support loan growth. Fitch expects gradually rising interest rates to support net interest margins since loans typically reprice faster than deposits in the Philippines. However, competitive pressure and potentially lower bond trading gains amid rising interest rates could limit upside in overall profitability.

Asset quality metrics remain steady, although modest compared with the region. A long-standing concern is possible impairment from foreclosed properties due to their low reserve coverage. For example, three medium-sized and lower rated banks would have reported weaker financial performance had they not been allowed regulatory relief to amortise over 10 years their losses from the disposal of non-performing assets. Fitch is also concerned that credit mishaps in the corporate segment may cause a notable rise in NPLs, given the concentration risk in their balance sheets. While there is growing focus on consumer borrowers, corporates still account for the bulk of total loans.

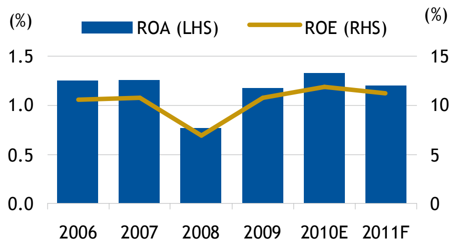
On a more optimistic note, Fitch estimates that the banks' core Tier 1 capital ratio would remain at a satisfactory level of about 9% on average assuming some hypothetical write-downs on foreclosed properties and deferred charges under stress conditions (see Fitch's "*Stress Test on Philippine Banks*" dated 18 August 2009, for details).

In Fitch's opinion, capitalisation should remain satisfactory because of earnings retention and some capital raising by selected banks. For example, the three largest banks have raised capital via rights issues over the course of 2010 to support growth as well as prepare for Basel III. Fitch's preliminary assessment of Basel's proposals suggests that the impact is unlikely to significantly affect most rated banks' capital as they have reasonable capital buffers, modest dependence on hybrid capital, and limited non-financial businesses.

The banks are unlikely to face any near-term funding pressure. The loan-to-deposit ratio has not exceeded 65% over the last five years. Deposits showed remarkable stability despite the global crisis. Unlike a number of systems in the region, the Philippines did not institute a blanket guarantee on deposits, although it did raise the deposit insurance coverage to PHP500,000 from PHP250,000 in June 2009.

Philippines: Key Performance Trends

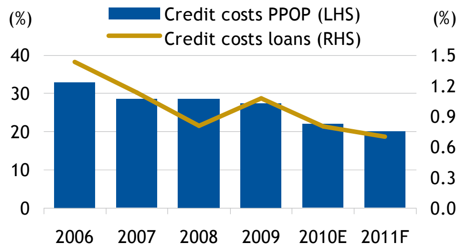
Return on assets & return on equity



Source: Fitch, BSP

Philippines: Key Performance Trends

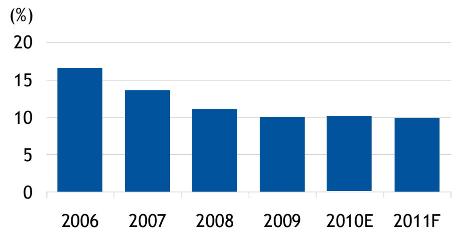
Credit costs % PPOP and loans



Source: Fitch, banks

Philippines: Key Performance Trends

Asset quality - NPA ratio[a]

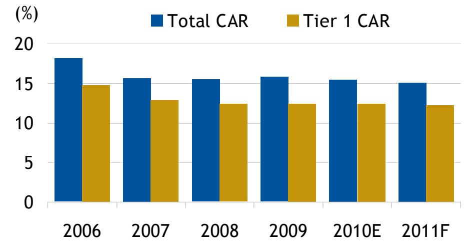


[a] NPA includes NPLs and foreclosed properties

Source: Fitch, BSP

Philippines: Key Performance Trends

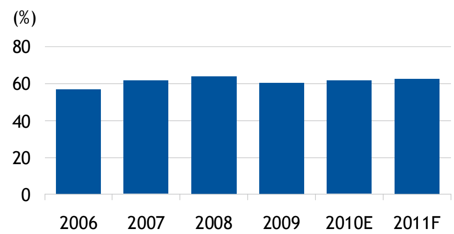
Capital ratio



Source: Fitch, BSP, banks

Philippines: Key Performance Trends

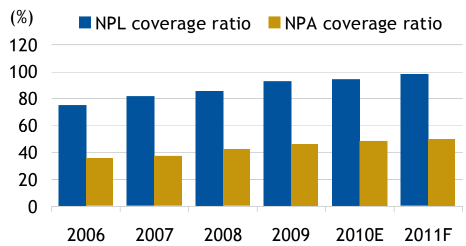
Loan-to-deposit ratio



Source: Fitch, BSP, banks

Philippines: Key Performance Trends

NPL & NPA coverage ratio



Source: Fitch, BSP, banks

Singapore

- Ongoing healthy economic environment in Singapore and the region to support local banks' credit profiles
- Key risks are a renewed global downturn and a sharp decline in property prices
- Satisfactory underlying profitability and well capitalised balance sheets to enable local banks to withstand a weakening in operating conditions

Barring any significant negative global events, Fitch forecasts Singapore's 2011 GDP growth to be 5%, which is satisfactory for the economy's level of development. This, together with Hong Kong, Indonesia, Malaysia and Thailand (where Singapore banks also have operations), which are also expected to register healthy GDP growth rates ranging from 4% to 6%, is supportive of the local banks' performance and credit profile in 2011.

The local banks' ROA in 2011 may, however, ease somewhat to about 1.0% from 1.2% in 2010 due to lower treasury gains and tighter margins. Even then, credit costs may stay low in view of broadly stable credit conditions in most of these countries and the local banks' improved reserve coverage on non-performing assets (NPAs) of 109% at end-September 2010. The agency forecasts that the banks' gross NPA ratio could ease further to 1.5% by end-2011 from 2.0% at end-September 2010.

The Stable Outlook on Singapore banks' ratings reflects Fitch's expectations of the banks' credit profile staying sound. This is even despite the somewhat weak external environment, which in a worst-case scenario could again threaten the growth prospects of many Asian economies, especially small and open countries like Singapore. Further, Singapore's private home prices, after having increased rapidly within one year or so, are facing renewed elevated risks of a correction. Such risks may arise if negative sentiment were to drive the strong foreign-fund inflows out of the country, and this may in turn adversely impact property-related loans, which represent almost half of the local banks' lending portfolio.

However, Fitch assesses any asset quality deterioration arising from such adverse scenarios, if manifested, to be manageable, and importantly it believes capital impairment risks will remain low for Singapore banks, as concluded in the agency's stress test review. Evidently, the local banks underwent extremely challenging operating conditions in H208/H109, yet their performance was resilient and their capital position was intact and strong; credit costs were easily covered by earnings, with impairment charges on average representing only 30% of the local banks' pre-provision profits in 2008/2009.

Fitch attributes the banks' better-than-expected performance in 2009 primarily to the unprecedented stimulus measures by the Singapore government (sovereign Long-Term IDR: 'AAA'/Stable), low interest rates and the banks' generally prudent risk management (see Fitch's "*Singapore Banks Well-Positioned to Withstand Risks of a Modest Property Price Correction and Fragile External Conditions; Rating Outlook Stable*" Comment, dated 15 December 2010, for details). Moreover, the difficult operating environment was relatively short-lived, with global trade having rebounded sharply and the operating environment becoming more stable since H209.

Fitch expects the three local banks to remain well-capitalised, with a core Tier 1 CAR (excluding hybrids and preference shares) of more than 11% at end-September 2010. Their strong and high-quality capitalisation has been a rating strength, with their 'AA–' IDRs among the highest for APAC banks. In view of the banks' healthy capital buffers, the agency does not anticipate Basel III to be a major issue for them.

The local banks have good funding and liquidity profiles, thanks to their strong deposit franchises in Singapore. Their loans/deposits ratio remained healthy, averaging 83% at end-September 2010, as there is ample liquidity in the domestic banking sector. For instance, stable non-bank deposits in Singapore expanded steadily by 13% in 2009 and 11% year-to-date in November 2010. In comparison, expanding deposits will continue to be an area of focus for the banks' regional operations where there are better loan growth opportunities.

Banking Systemic Risk Indicator

Singapore	B1

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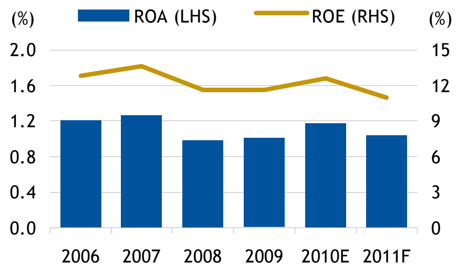
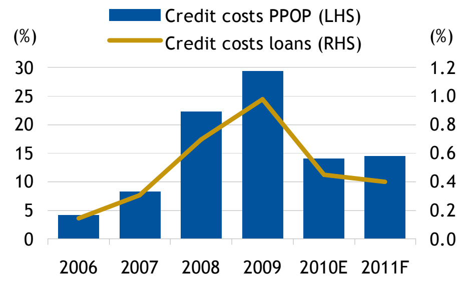
Singapore: Key Performance Trends
Return on assets & return on equity



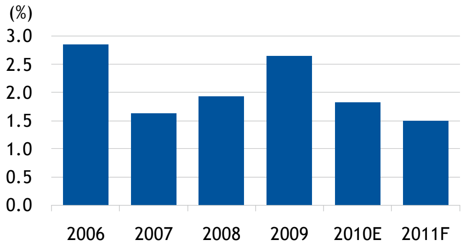
Source: Fitch, banks

Singapore: Key Performance Trends
Credit costs % PPOP and loans



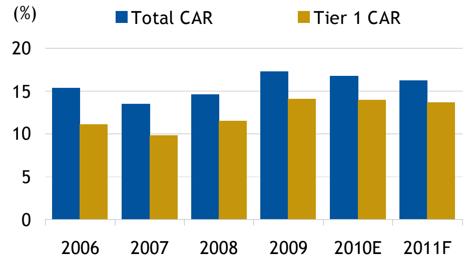
Source: Fitch, banks

Singapore: Key Performance Trends
Asset quality - NPA ratio[a]



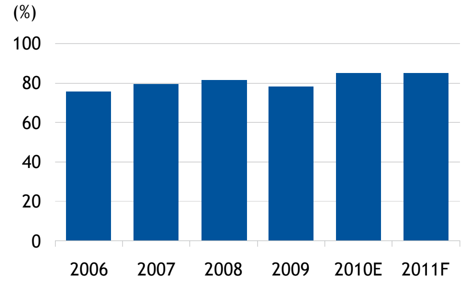
[a] NPAs include NPLs, debt securities + contingencies
Source: Fitch, banks

Singapore: Key Performance Trends
Capital ratio



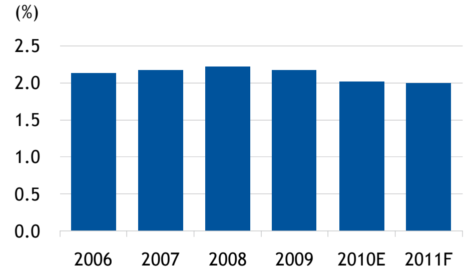
Source: Fitch, banks

Singapore: Key Performance Trends
Loan-to-deposit ratio



Source: Fitch, banks

Singapore: Key Performance Trends
Net interest margin



Source: Fitch, banks

South Korea

- Stabilising economic conditions should result in better top line profitability and lower credit costs at South Korean banks
- New NPL formation should bottom out by 2011, although withdrawal of support measures for weak property developers and SMEs could cause an uptick
- Capitalisation should moderate but remain reasonably strong, assuming moderate loan growth offsets the potential for higher dividend payouts
- An improvement in banks' liquidity would likely be limited, although the funding situation has improved since the global financial crisis due to the abundant liquidity in the markets

Banking Systemic Risk Indicator

South Korea	C2

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The Outlook for the South Korean banking system is Stable as most of the ratings assigned by Fitch are driven by expectations of support, if needed, from the government or their parent.

A significant improvement in the banks' loan quality and/or foreign-currency liquidity may benefit their ratings. However, losses that result in a meaningful weakening in capitalisation and/or sharply reduced access to wholesale market funding could have negative rating implications. In addition, any change in the Outlooks of South Korea's sovereign rating or their parents' ratings will have a direct impact on those banks with their ratings at their respective Support Rating Floors.

Fitch expects interest rates in South Korea to increase gradually over the next few years given the economy's strong recovery from the global credit crisis and rising inflation pressure. Assuming no excessive inflation, commercial banks' top-line profitability will improve, while their credit costs should fall somewhat due to the adoption of IFRS, which requires the banks to set provisions on an historical loss basis rather than the current, more forward-looking requirement. That said, it will still be too early for significant write-backs to take place in 2011.

Fitch forecasts the banks' NIM to remain at 2.4% in 2011. The expected interest rate increase and weakened competition in deposits, as observed in late 2010 in particular, would help the NIM to improve. However, that will be offset by the impact of the spin-off of the sizable credit card operation of Kookmin Bank (Kookmin, 'A'/Stable), which accounts for about 15bp of the banks' NIM.

Bottom-line profitability is expected to improve significantly, with a forecast ROA of 0.8% in 2011. Of that, about 20bp will be due to the sizable gains from selling their stakes in Hyundai Engineering and Construction. The impact of the sale of Kookmin's treasury shares (which it is required to sell in September 2011) remains to be seen.

The average quarterly new NPL formation rate of the banking system (inclusive of the policy/specialised banks) is expected to be about 65bp in 2011, compared with 72bp (estimated) in 2010 and 60bp in 2009. Fitch cautiously believes that corporate sectors' new NPL formation rate will level out in 2011 or might have peaked already in H210 given that the banks have gone through significant system-wide loan reviews in the past two years, resulting in sizable work-outs of corporate borrowers.

That said, ailing property developers and SMEs which are fundamentally weak but which have survived so far — mainly due to the banks' and authorities' support measures — will continue to affect the banks' loan quality as and when more of these measures are withdrawn. Meanwhile, household sector loans will continue to perform well, although delinquency rates will increase as and when interest rates increase. The agency notes that household sector credit has increased noticeably over the past six years, although the banks in general have been conservative by targeting their lending to individuals with a good credit profile.

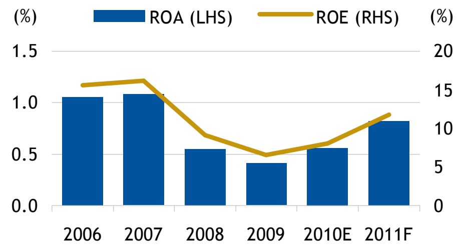
The banks' capitalisation will weaken slightly but remain strong with a forecast core Tier 1 ratio of 10.2% at end-2011. Hana Bank ('A–'/Stable) is expected to upstream a sizable special dividend (KRW1.9tn) to support its parent's acquisition of Korea Exchange Bank ('A–'/Stable). While the spin-off of Kookmin's credit card operation is also expected to reduce the bank's equity, the sale of its treasury shares will boost the bank's regulatory capital base.

The banks believe their capital adequacy ratios are too high in general and thus may be motivated to pay higher dividends than in the past two years. They are also much less inclined to refinance any maturing subordinated debts. Any increase in risk-weighted assets will be limited assuming that the banks would continue to focus on cleaning up their loan books rather than competing aggressively for loan growth.

Any improvement in the banks liquidity in 2011 will be limited. The regulatory requirement of a 100% loan-to-deposits ratio is just for local-currency loans and deposits, including that to and from financial institutions. Many of the banks have met the requirement already and may not be motivated to improve any further. However, the banks have a structural weakness with regard to foreign currency, which cannot be improved easily as they do not have reliable retail deposits in foreign currency. That said, Fitch notes that overall liquidity and funding have improved and may improve further due to the abundant liquidity in the markets, particularly in local currency, and the tightened prudential measures, such as the funding limitations on foreign exchange forwards/swaps contracts and the bank-tax on non-deposit foreign currency liabilities.

South Korea: Key Performance Trends

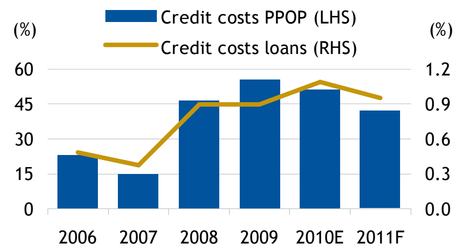
Return on assets & return on equity



Source: Fitch, banks

South Korea: Key Performance Trends

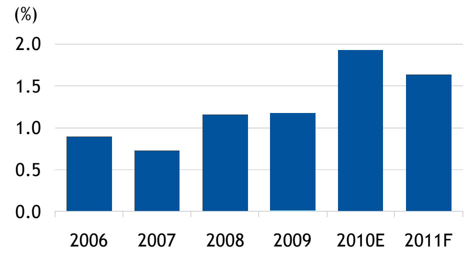
Credit costs % PPOP and loans



Source: Fitch, banks

South Korea: Key Performance Trends

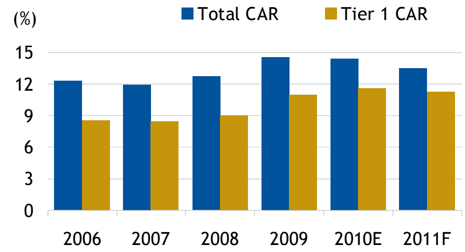
Asset quality - NPL ratio



Source: Fitch, FSS

South Korea: Key Performance Trends

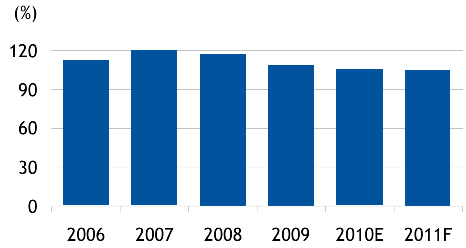
Capital ratio



Source: Fitch, FSS

South Korea: Key Performance Trends

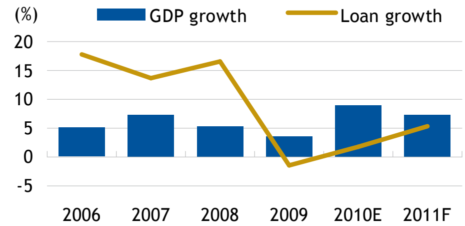
Loan-to-deposit ratio



Source: Fitch, FSS

South Korea: Key Performance Trends

Loan growth vs. nominal GDP growth



Source: Fitch, FSS

Taiwan

- The Taiwanese banks' record profitability and asset quality underpin their Stable Outlook with a slight positive bias, although caution should be exercised over whether the improved performance is due to cyclical rather than structural factors
- Key risks for the banks include a sharp domestic property market correction, weakness in the direct random access memory sector, prolonged weakness in the major economies, and/or a severe slowdown in China
- Ongoing liberalisation of cross-strait banking between Taiwan and China augurs well for banks' earnings prospects over the longer term, but is unlikely to be sufficient on its own to trigger a rating action by Fitch

Banking Systemic Risk Indicator

Taiwan	C1

Analysts

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Taiwanese banks as a whole are delivering their best results in terms of profitability and asset quality since 2004. The outlook for Taiwanese banks' credit profiles is stable with a slight positive bias. While Fitch continues to identify Taiwan as one of the most competitive banking markets in the region, as manifested by the market's infamous thin interest margins, Fitch is concerned that the improving financial performance — buoyed by a vibrant property market in 2009 and 2010 — may well be cyclical rather than structural.

Strong revenues from the recovery of impaired assets have helped reduce banks' net credit costs in 2010. Fitch believes that the prevailing housing rental yields of well below 2% or even lower in the Taipei metropolitan areas are not sustainable. This could potentially lead to an abrupt downturn in the property market resulting in a sharp deterioration in asset quality, as real-estate-related lending represents 35% of banks' total loans.

Considering that the Taiwanese economy is still a very much a small, export-driven economy, Fitch is mindful of potential external risks that include prolonged economic weakness in major developed markets in the US and Europe, as well as possible market hiccups due to any major mistakes in macroeconomic policy management by the Chinese government aimed at controlling an economic boom fuelled by excessive credit growth.

Fitch projects banks' profitability to remain favourable but to decrease modestly in 2011. ROA before tax is forecast at 0.45% versus an estimated 0.51% in 2010. The projection is based on extrapolation of the banks' performance in 2009-2010, factoring in mainly modestly improved interest margins but also an increase in loan provisioning by banks to meet tougher regulatory demand for general provisions (50bp of performing loans, effective from 2011 with a three-year grace period) as well as those to cover cyclical specific loan losses. The downside risks to the forecast would most likely come from a sharp property market correction, and/or a severe economic slowdown in China.

The system's ROA rose markedly to 0.58% in 9M10 (2009: 0.28%), driven by a substantial decline in credit cost to annualised 14bp (of total assets versus an already low 32bp in 2009), a recovery in interest margins riding on the ongoing economic recovery and interest rate hikes by the central bank in the wake of extraordinary margin compression seen in 2008-2009, as well as a rapid rebound in wealth management sales revenue.

Loans have grown faster, albeit still tepid at 4% ytd at end-September 2010, underpinned by an increased corporate demand in capital expenditures. Moral suasion with banks by the central bank to tighten credit standards on home mortgage and real estate development financing have somewhat slowed this type of lending, and have inadvertently helped boost margins for mortgages. Loans to corporates and for home mortgages grew by 6% and 4% ytd respectively at end-September 2010 (2009: −3% and 4% respectively).

Taiwanese banks reported in 2010 their best-ever asset quality since the last systemic crisis in the late 1990s, measured by new NPL formation, NPL ratios and provision coverage against loan losses. Banks together charged off TWD58bn in impaired assets in the first 10 months of 2010 (annualised, about 36bp of total loans or 22bp of assets), down sharply from TWD112bn in 2009 and TWD133bn in 2008.

NPL and loan-loss-provision-to-NPL ratios improved notably to 0.73% and 136% respectively at end-October 2010, compared with 1.15% and 96% respectively at end-2009. Restructured or rescheduled loans to troubled corporations (totalled less than 1% of total system loans) have benefited from the strong export recovery and are mostly performing on the restructured terms. Notwithstanding the improvement in 2009-2010, exposures to direct random access memory semiconductor makers remain vulnerable to any renewed cyclical weakness and pose a major risk to banks.

Banks' capitalisation generally kept steady between 2007 and 2010. The system's average Tier 1 and total CAR stood at 9% and 11.8% respectively at end-September 2010, based on the standardised approach for credit risks under Basel II. Fitch considers the capitalisation level to be adequate but not strong on account of the system's relatively low-risk nature, slow asset growth and banks' generally limited contingent liabilities.

Capital quality is generally good with very limited usage of equity-like hybrid securities. Issuances of hybrid securities that qualify for Tier 1 capital have so far been limited to large state-controlled banks. Fitch notes that market demand for rights issues by Taiwanese banks is weak, reflecting investors' disappointment about low total returns by Taiwanese banks in the past two decades. This negative perception appears to have taken hold and will continue to impede banks' ability to access new capital in equity capital market.

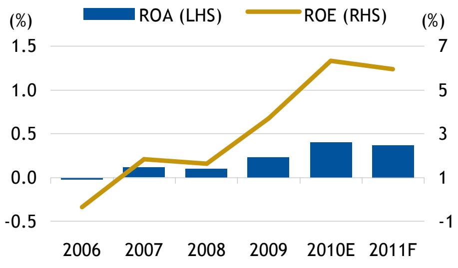
Funding with deposits remains very strong with 79.5% of banks' assets funded by customer deposits and the system's LDR standing at 75.9% at end-September 2010, with the foreign-currency LDR amounting to a mere 31%. Foreign-currency funding is particularly strong due to the economy's strong surplus position in balance of payments.

Notwithstanding the favourable funding profile, nearly all banks remain highly vigilant on liquidity management following the global financial crisis, which temporarily shook the confidence of depositors and aroused liquidity pressures among some private-sector banks. The system's liquidity reserve ratio was high at 27% at end-September 2010, markedly higher than 19% at end-2007. In view of the ongoing economic recovery and markedly improved financial performance by small private-sector banks, Fitch believes the withdrawal at end-2010 of the blanket deposit guarantee (initiated right after Lehman Brothers' collapse in late 2008) should be taken by the market with ease without disruptive runs on liquidity.

The ongoing liberalisation of cross-strait banking between Taiwan and China under the Taiwan-mainland China bilateral Economic Cooperation Framework Agreement, effective from 12 September 2010, has the potential to alter the competitive landscape of Taiwan's overly crowded banking market in the long term by opening up the massive mainland market to Taiwanese banks. However, in the short and medium term, the entry of Taiwanese banks to the mainland is unlikely to have a substantive economic impact on them, as there remain significant operational hurdles to overcome (including a lack of CNY funding, limited networks to tap retail markets a regulatory framework lacking in transparency and a largely undeveloped legal framework).

Taiwan: Key Performance Trends

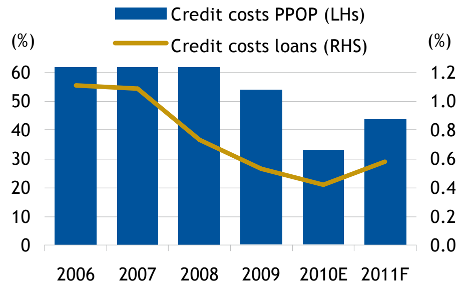
Return on assets & return on equity



Source: Fitch, CBC

Taiwan: Key Performance Trends

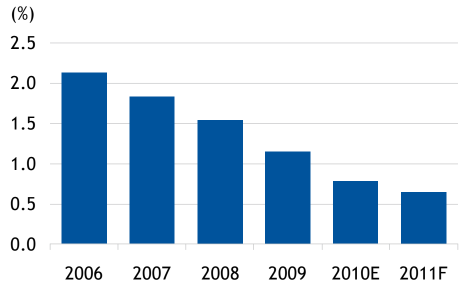
Credit costs % PPOP and loans



Source: Fitch, CBC

Taiwan: Key Performance Trends

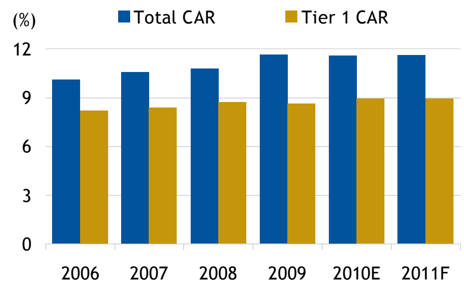
Asset quality - NPL ratio



Source: Fitch, CBC

Taiwan: Key Performance Trends

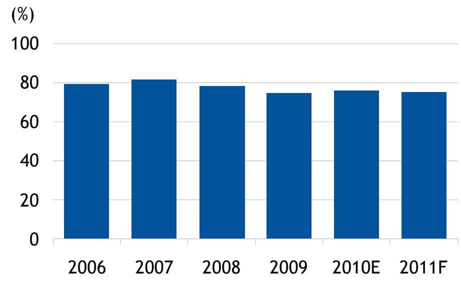
Capital ratio



Source: Fitch, CBC

Taiwan: Key Performance Trends

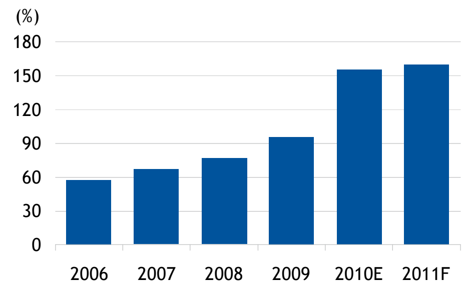
Loan-to-deposit ratio



Source: Fitch, CBC

Taiwan: Key Performance Trends

Asset quality - NPL coverage



Source: Fitch, CBC

- More moderate but still favourable economic growth in 2011 should underpin Thai banks' credit profiles in 2011
- Higher fee income and lower credit costs due to improving asset quality are supportive of profit growth momentum, although rising funding costs are likely to pressure net interest margins
- Level and quality of capital are satisfactory while the risk associated with rising loan-to-deposit ratios is partly addressed by reasonable holdings of liquid assets

Banking Systemic Risk Indicator

Thailand	C1

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Thailand

Fitch expects the Thai banks' outlook to remain stable in 2011, supported by strong profitability due to the generally favourable economic environment, increased operating efficiency and lower credit costs. Steady loan demand should moderate some of the pressure on net interest income arising from intense competition and rising funding costs. However, risks could arise from steep rate hikes, fuelled by stronger-than-expected inflation. This could impact loan demand and debt serviceability of borrowers, particularly those in the SME and housing sectors.

Thailand's economy has been resilient, with GDP growing 9.3% yoy in 9M10, despite the civil unrest in Q210, due to the base effect and strong export volume. Fitch expects steady export growth to support GDP growth of 4.3% in 2011, slightly lower than an estimated 7.6% in 2010, but still favourable compared with 2009's 2.2% contraction.

For the banking sector, credit growth has picked up since Q409, following the contraction of 1.7% yoy in 2009, driven mainly by strong demand for auto loans due to low interest rates, and the extraordinary growth in housing loans in H110 given the cessation of the government's property tax incentive programme at end-June 2010. Demand for housing loans has since declined and is likely to stabilise in 2011. Corporate loans have also seen stronger growth with demand for capacity expansion investments in key industrial and utilities sectors, increased working capital requirements and accumulation of inventory towards end-2010. However, loan growth was concentrated in a few sectors — financial intermediaries, manufacturing and the retail/wholesale trades.

Fitch expects economic growth in 2011 and ongoing revenue diversification from higher fee income to support banks' profit growth momentum; however, the rising funding costs are likely to pressure their NIM. The banks reported stronger net profit in 9M10 driven by moderate loan growth, lower funding costs, disciplined cost control and lower provisions as asset quality continued to improve. The seven largest banks' average ROA rose to 1.3% in 9M10 from 1.1% in 2009, while average NIM increased to 3.6% in 9M10 from 3.4% in 2009.

Fitch expects Thai banks' asset quality to improve further, with the seven largest banks' average NPL ratio estimated to fall below 5% in 2011 due to economic growth, although rising rates could pressure the asset quality of SMEs and the housing sector. Despite the business disruption in Q210, asset quality continued to improve from 2009 as a result of improved economic conditions and large NPL disposals by a few banks. The quality of loans to the property, construction and manufacturing sectors remained relatively weak, but this was balanced by the healthy asset quality of consumer loans. Meanwhile, the system's new NPLs in Q310 continued to decline from Q109.

Continuous improvement in asset quality and adequate NPL coverage at the major banks suggests that there is room for credit costs to decline further in 2011. The banks' NPL coverage continued to improve to about 85% at end-September 2010 from about 70% in 2009, despite the lower credit costs over the last few years as a result of steady declines in NPLs.

Fitch expects Thai banks' ongoing profit accretion to further improve their capital level. The quality of capital is reasonably high with modest dependence on hybrid instruments and preferred shares. The Tier 1 CAR and total CAR remained solid at 12.5% and 16.6% respectively at end-September 2010; excluding total outstanding hybrid Tier 1 instruments issued by Krung Thai Bank Public Company Limited ('BBB'/Stable) and TMB Bank Public Company Limited ('BBB–'/Stable), system Tier 1 CAR would still be high at 12.3%. However, the seven largest banks' Tier 1 CAR was lower at 11.7% at end-September 2010, given that smaller banks and foreign-owned banks tend to have higher Tier 1 levels.

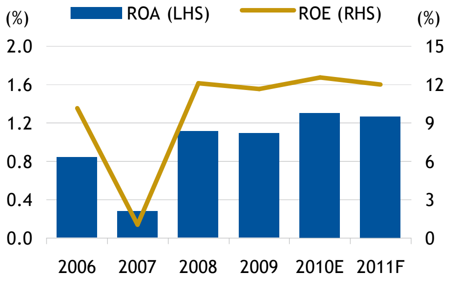
The banks' funding structure remains anchored by a large deposits base, of which about 40% are low-cost CASA deposits. While banks have gradually diversified their funding to include bills of exchange (B/Es), this still represents only 13% of total system deposits. The system's LDR, including B/Es, was relatively stable at 86% at end-September 2010 (94% including B/Es for the seven largest banks; although a few of them have above 100% LDR).

Fitch expects the system's LDR to rise as loans are likely to grow faster than deposits, even though rising interest rates could induce deposit growth in 2011. While some banks' LDRs appear somewhat higher than peers in the region, a factor mitigating some of this risk is their reasonable liquidity position. On average, liquid assets account for more than 30% of deposits and short-term liabilities. Fitch notes that major banks increasingly tapped local and offshore markets in 2010 to secure long-term low-cost funding to further enhance their liquidity.

The major developments of the Thai banking system's consolidation process in 2010 include Thanachart Bank Public Company Limited's ('A+(tha)'/Stable) acquisition of Siam City Bank Public Company Limited ('BBB−'/Stable), which created Thailand's sixth-largest bank, and Industrial and Commercial Bank of China's ('A'/Stable) acquisition of ACL Bank, an affiliate of Bangkok Bank Public Company Limited ('BBB+'/Stable). Apart from this, Thailand is removing the blanket guarantee on deposits. Starting from 11 August 2011 to 10 August 2012, Thailand's deposit protection will be capped at THB50m (about USD1.5m) per depositor per bank and reduced to THB1m (about USD30,000) from 11 August 2012 onwards.

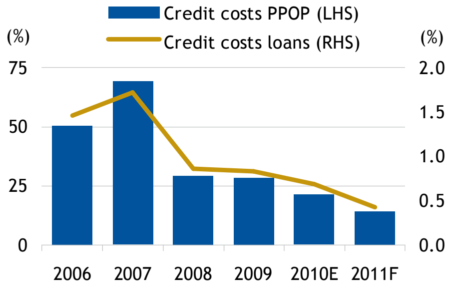
Fitch does not expect to see a material impact given that the majority of deposit accounts are less than THB1m, although over the longer term, major commercial banks and state banks could benefit from gradual deposit migration from smaller banks. Meanwhile, Thai banks have been developing the Internal Capital Adequacy Assessment Process (ICAAP) (part of Pillar 2 of Basel II), which would enable banks to assess capital impact from various types of risk not captured under Pillar 1. Banks are required to have a full system in place, including stress tests, by end-2010 and start submitting formal ICAAP reports to the Bank of Thailand within Q111.

Thailand: Key Performance Trends
Return on assets & return on equity



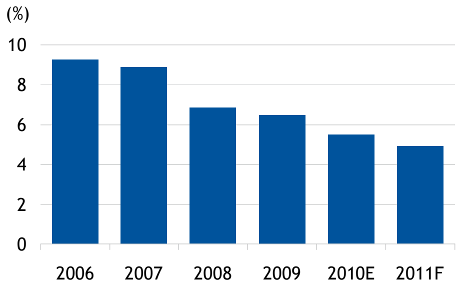
Source: Fitch, banks

Thailand: Key Performance Trends
Credit costs % PPOP and loans



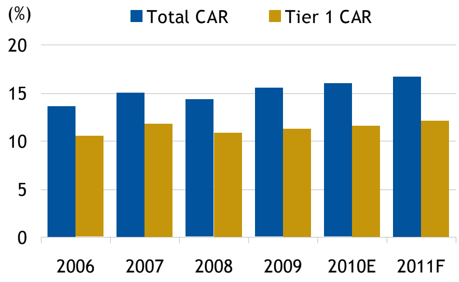
Source: Fitch, banks

Thailand: Key Performance Trends
Asset quality - NPL ratio



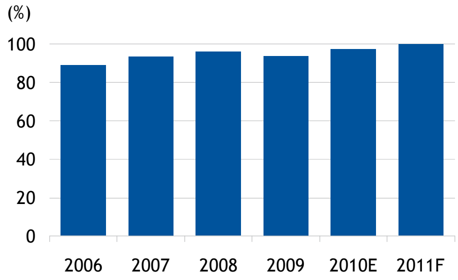
Source: Fitch, banks

Thailand: Key Performance Trends
Capital ratio



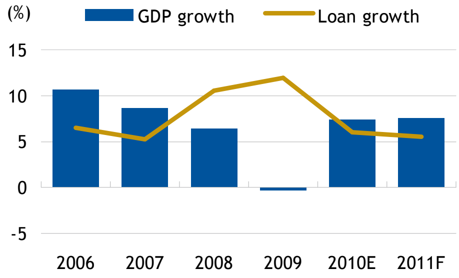
Source: Fitch, banks

Thailand: Key Performance Trends
Loan-to-deposit ratio



Source: Fitch, banks

Thailand: Key Performance Trends
Loan growth vs. nominal GDP growth



Source: Fitch, banks

Vietnam

- Challenging operating environment for Vietnamese banks arising from increasing inflationary pressure and repayment difficulties of a major state-owned enterprise
- Profitability under pressure due to rising cost of funds and higher provisions
- Ongoing weaknesses in underlying loan quality and capitalisation
- Increasing vulnerability of the system' liquidity to market volatility, in line with a tightening of market liquidity and weakening market confidence in the VND

Banking Systemic Risk Indicator

Vietnam	E3

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Fitch anticipates that Vietnam's economy will maintain its growth momentum, with forecasted real GDP growth of 6.4% for 2011, down from 6.8% in 2010. However, the agency expects the operating environment to become more challenging, particularly due to the increasing inflationary pressure and subsequent tightening liquidity (for both the USD and the VND) and ongoing repayment difficulties of major state-owned enterprise Vietnam Shipbuilding Industry Group.

As such, Fitch's outlook for the Vietnamese banking system is negative, given that these challenges would likely further pressure the banks' already weak credit profiles.

A substantial and sustainable improvement in the system's underlying loan quality, capital, underlying profitability and overall liquidity, as well as a more stable operating environment, could lead Fitch to revise its outlook for the system to stable, although it would be unlikely in near future.

Fitch expects loan growth to slow in 2011 from an estimated 28% yoy in 2010, which followed the 38% yoy growth in 2009 (3.4x higher than the nominal GDP growth rate). However, Fitch forecasts that the banking system's loan growth will exceed nominal GDP growth rates by at least 1.5x in 2010 and 2011 — which the agency considers excessively strong — as loan growth is still viewed by the government as a key pillar facilitating the country's economic growth.

Fitch expects margins to remain under pressure from competition for deposits given tightening liquidity and continued strong loan growth. This is despite the removal of interest rate caps for loans in H110, which has enabled the banks to pass higher funding costs onto borrowers. Together with expectations of credit costs rising in 2011, Fitch forecasts the system's average ROA to decline further in 2011 from around 1.1% in 2009 and an estimated 0.8% in 2010.

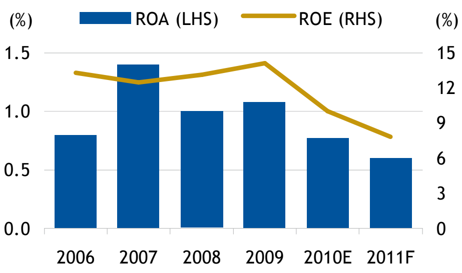
Fitch believes the system's weak underlying loan quality will be placed under further pressure by a tightening of liquidity, which will make it more difficult for borrowers to source financing/refinancing at a reasonable cost (particularly those whose leverage has significantly increased following the system's excessively strong loan growth over recent years).

The agency is particularly concerned about the quality of the banks' foreign-currency loans (more than 20% of total loans) — which grew at an exceptionally high rate of around 27% in H110 — as repayments would likely come under pressure from the increasing risk of VND devaluation against the USD. Fitch forecasts the system's NPL ratio to increase to above 4% at end-2010 and 2011 (versus around 2.4% at end-2009, 90% covered by reserves) under Vietnamese Accounting Standards, although loan forbearance would potentially lead to lower NPLs than currently anticipated by the agency. Fitch believes the banks' NPLs would be much higher (more than 3x) if classified under international standards.

The banks' capital is expected to remain barely adequate, even after capital raising exercises in 2010. How and when they will satisfactorily recapitalise remains uncertain, given Vietnam's small capital market size. Fitch believes the banks' capital will not be sufficient to adequately cushion against higher credit costs or support current loan growth rates, even after earnings retention. Also, Fitch estimates the CARs of some banks (even the larger banks) to remain around or below the new regulatory minimum of 9% at end-2010.

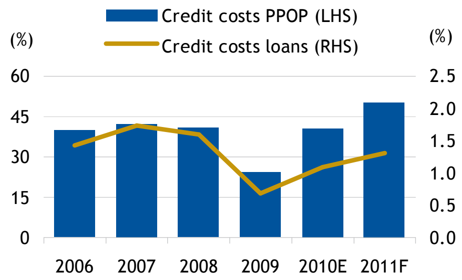
Fitch anticipates that banks' funding and liquidity profiles may further deteriorate in 2011, particularly in the event of a further tightening of liquidity and a weakening of confidence in the VND. Fitch expects deposits (the major funding source — above 70% of total liabilities), to become less sticky, given the deterioration in depositors' confidence in the VND, and Vietnamese banks to consequently fund loan growth increasingly through wholesale channels. As such, the banks' vulnerability to market volatility would remain high at least over 2011.

Vietnam: Key Performance Trends
Return on assets & return on equity



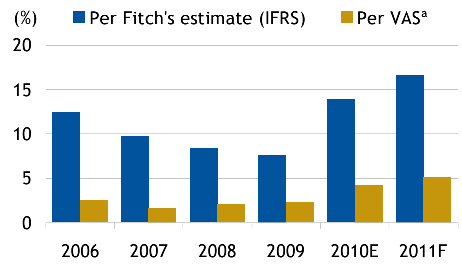
Source: Fitch, State Bank of Vietnam, IMF

Vietnam: Key Performance Trends
Credit costs % PPOP and loans



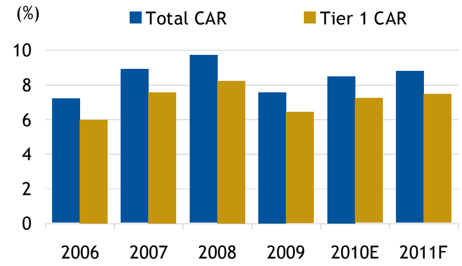
Source: Fitch, State Bank of Vietnam, IMF

Vietnam: Key Performance Trends
Asset quality - NPL ratio



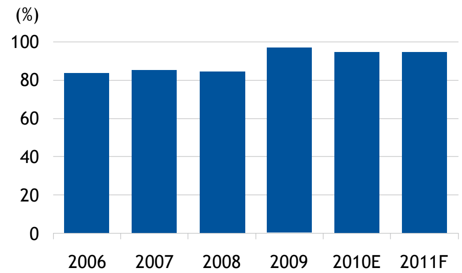
[a] Vietnamese accounting standards
Source: Fitch, State Bank of Vietnam, IMF

Vietnam: Key Performance Trends
Capital ratio



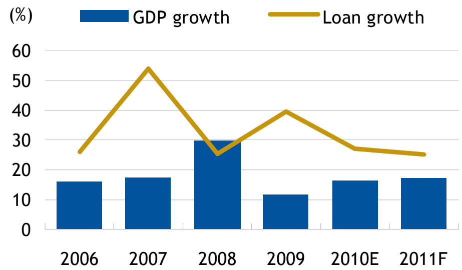
Source: Fitch, State Bank of Vietnam, IMF

Vietnam: Key Performance Trends
Loan-to-deposit ratio



Source: Fitch

Vietnam: Key Performance Trends
Loan growth vs. nominal GDP growth



Source: Fitch, State Bank of Vietnam, IMF