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FitchRatings

EM Banks: Managing the Credit Build-Up

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Agenda

EM Banks: Managing the Credit Build-Up

LATAM & Developed Markets Banks: Is the gap closing?

Brazil: Fast Growth, But Sound Metrics

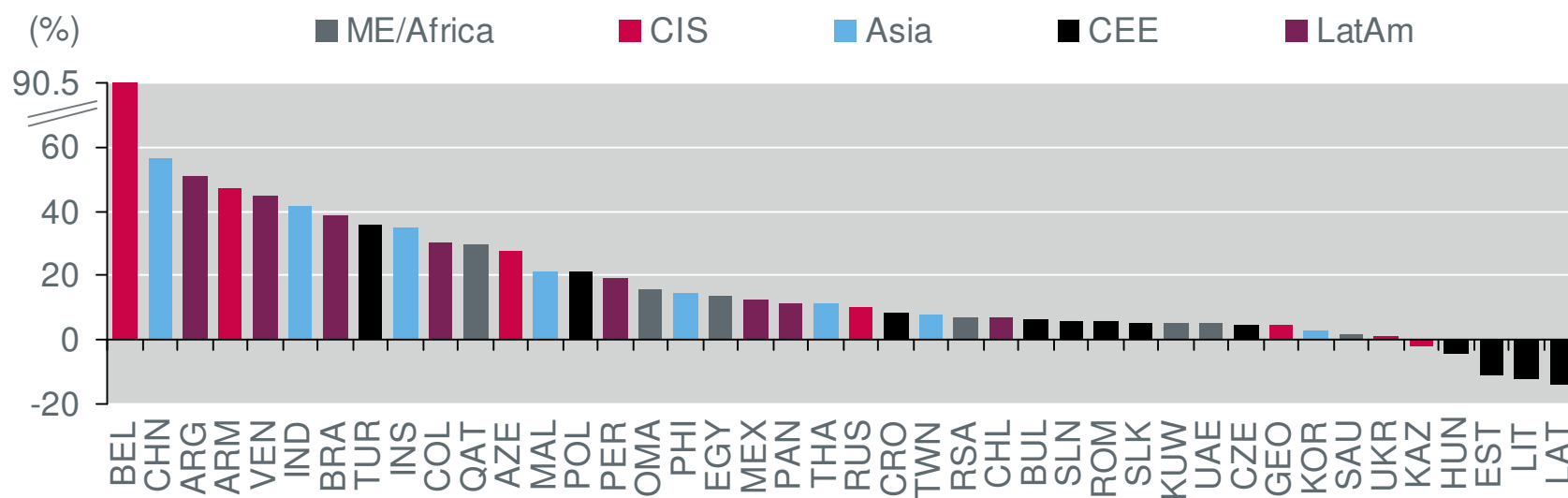
Peru: Rapid Expansion from Low Base

Colombia: Capital Needed for Growth

Many EMs Quick to Return to Loan Growth Post-Crisis

- Rapid loan growth in China even higher if off-balance sheet activity included
- Significant credit expansion in other major EMs, notably India, Brazil, and Colombia
- Deleveraging in worst hit Kazakhstan and Baltics; subdued growth in most of CEE/CIS

Cumulative Loan Growth 2009-2010

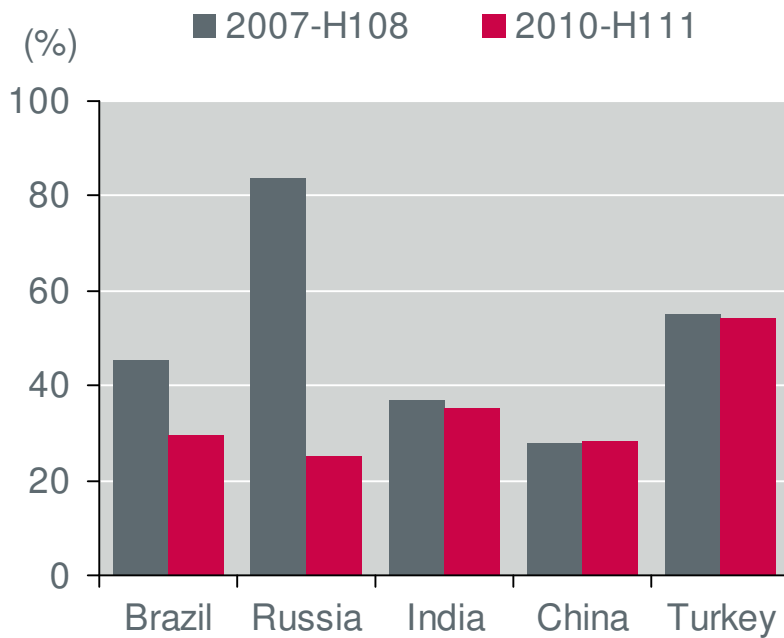


Source: National banks and bank regulators, Fitch Ratings calculations and estimates

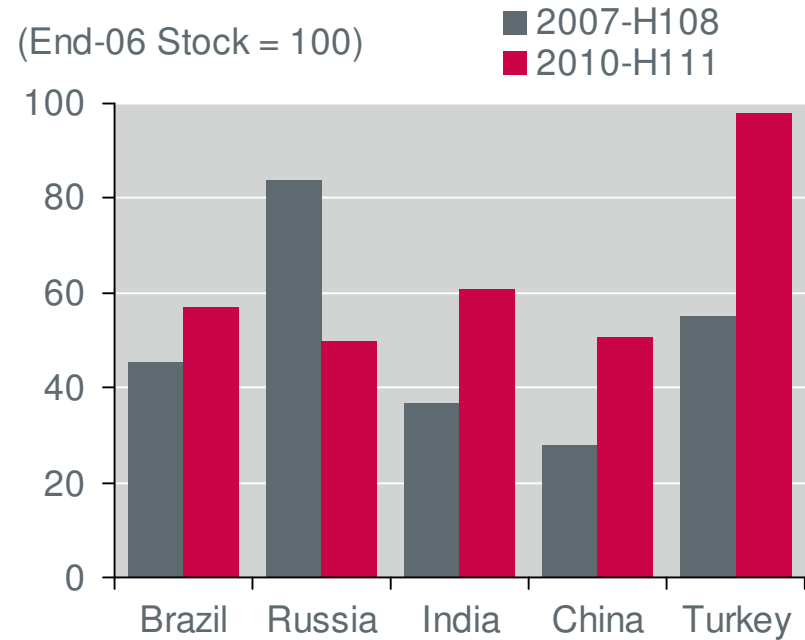
Rapid Growth, Even Compared to Pre-Crisis

- Marked deceleration in credit expansion evident only in Russia

Percentage Loan Growth



Loan Growth in Absolute Terms



Sources: Central banks, Fitch Ratings

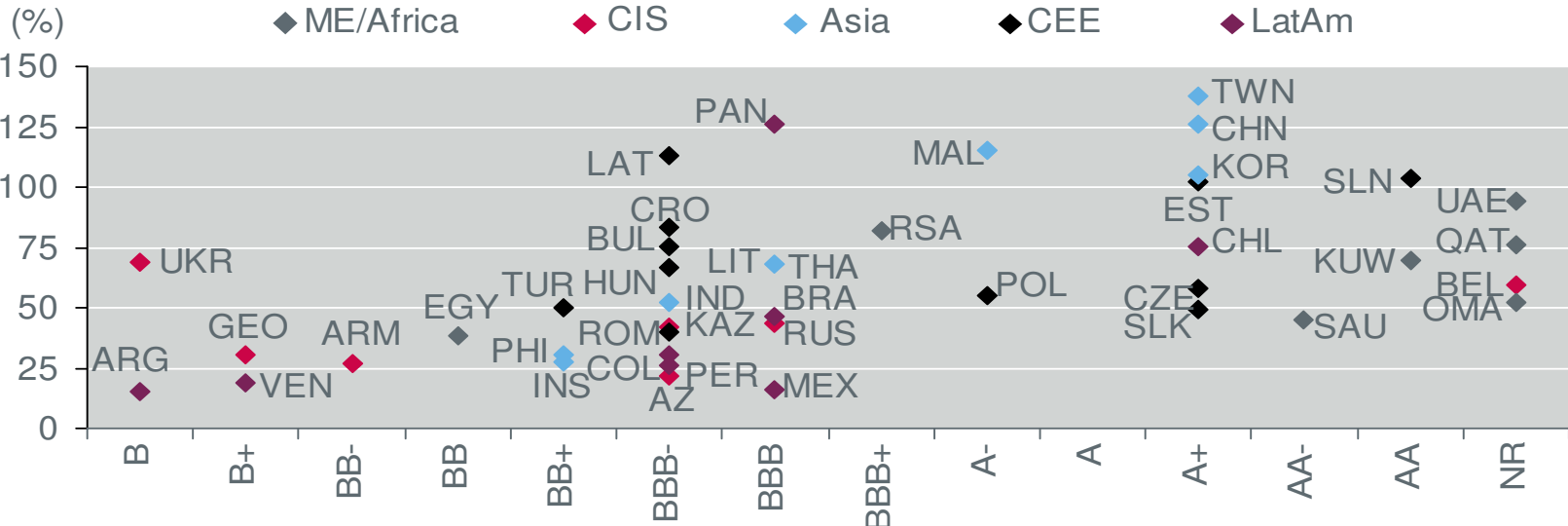
But (Ex-China) Only Moderate Risk of Credit Bubbles

- Considerable risk of asset quality deterioration in China
- Slowing global growth outlook may help balance inflationary and monetary policy challenges in many EM markets
- However, higher-growth EMs (ex-China) have mostly still moderately-leveraged economies, reducing the risk of sharp asset quality downturns...
- ...and most of these markets have relatively sound banking system balance sheets, indicating an ability to absorb moderate credit deterioration:
 - starting points of low loan impairment
 - significant loss absorption capacity offered by pre-impairment profit and capital
 - mainly deposit funded systems, with moderate dependence on foreign borrowing and balance sheets denominated in local currency
- Greatest risks on 'margins' of larger banking systems, e.g. question marks over long-term sustainability of mid-sized banks in Russia, Brazil and Turkey

Most EM Economies Not Highly Leveraged

- Loans/GDP ratios exceed 100% in China and some other large Asian markets...
- ...but are moderate in a majority of EMs, and around the 50% level in Brazil, India, Russia and Turkey

Loans/GDP

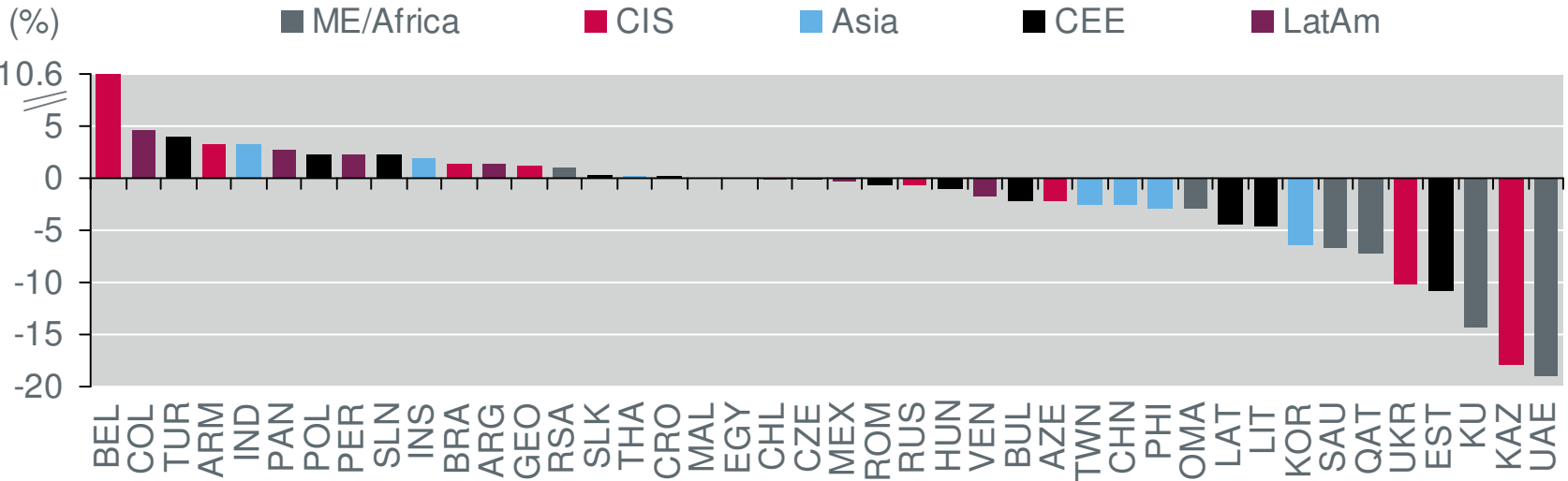


Loans and GDP data at end-2010; sovereign ratings indicated are Long-term foreign currency IDRs at 01 Sept 2011
 Source: National banks and bank regulators, Fitch Ratings calculations and estimates

Credit Penetration Only Increasing Gradually

- Leverage has tended not to increase sharply due to loan growth and economic recovery usually coinciding in same markets, and also low base effects
- Marked fall in leverage in some GCC countries driven by higher oil price; in Kazakhstan and Ukraine by reduced lending and economic recoveries

Change in Loans/GDP, End-2010 vs. End-2009

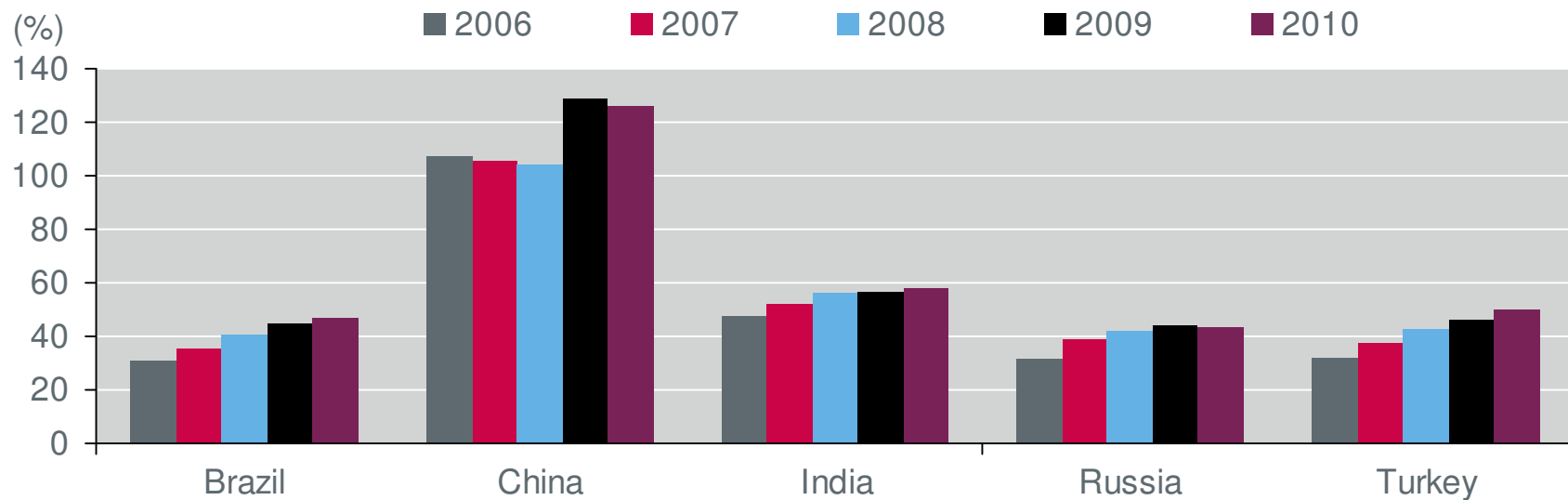


End-2010 vs. end-2009 data for all markets; Allowing for off-balance sheet exposures, Fitch estimates credit/GDP rose in China in 2010
 Source: National banks and bank regulators, Fitch Ratings calculations and estimates

Credit Penetration Only Increasing Gradually (cont.)

- Credit expansion in major EMs has generally not been running far ahead of nominal GDP growth
- Main exception was large boost to credit supply in China in 2009

Loans / GDP

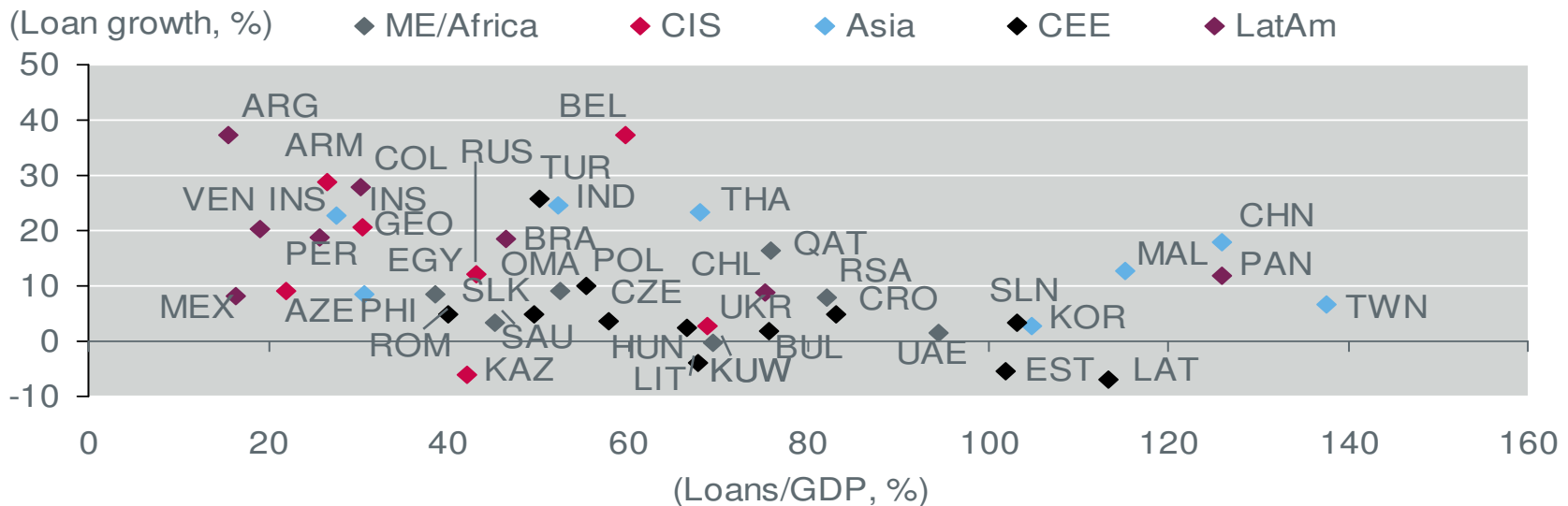


Source: Central banks, Fitch Ratings. India data for FY07 (Mar 31 2007) - FY11 (Mar 31 2011)

High Loan Growth, High Leverage Rarely Coinciding

- Most rapidly growing markets have moderate (e.g. Turkey, India, Brazil) or low (several LatAm countries, Indonesia) leverage, mitigating risks of credit build-up
- But China stands out for combination of both high growth and high leverage

Loans/GDP and Loan Growth

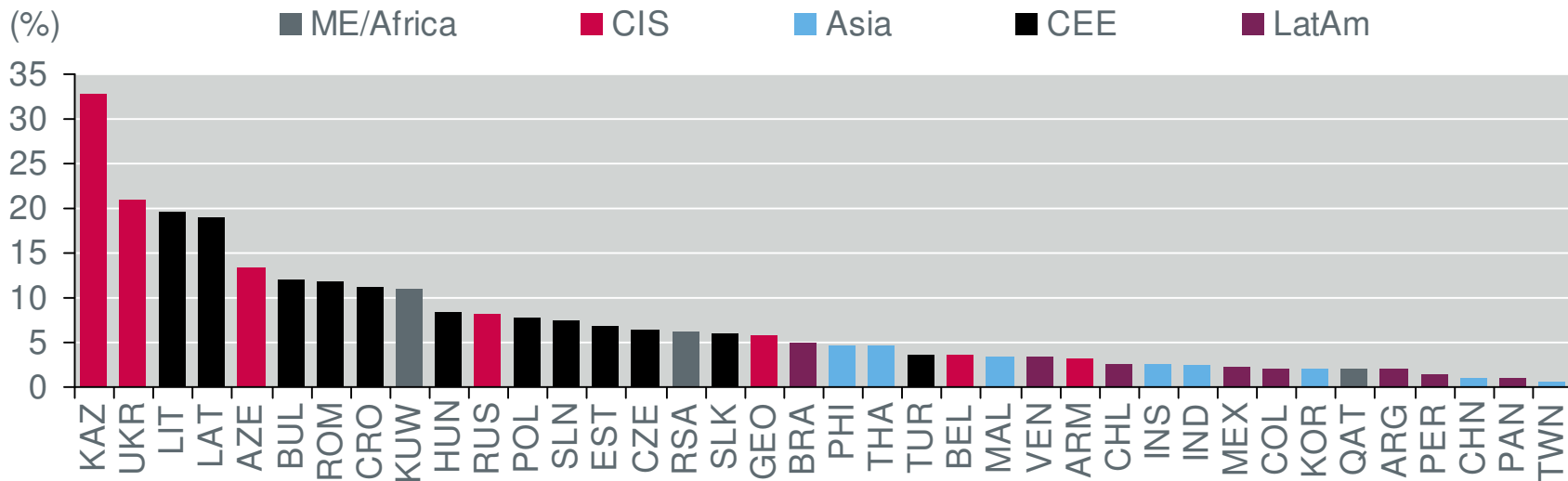


Loan growth during 2010, loans/GDP at end-2010, except PHI (Q310)
 Source: National banks and bank regulators, Fitch Ratings calculations and estimates

Low Legacy NPLs in Higher-Growth Markets

- Moderate levels of problem loans in most of Asia, LatAm and Turkey
- Much higher crisis-driven NPLs in CIS/CEE, where post-crisis loan growth has generally been limited and foreign currency balances are higher than LATAM

Impaired Loans

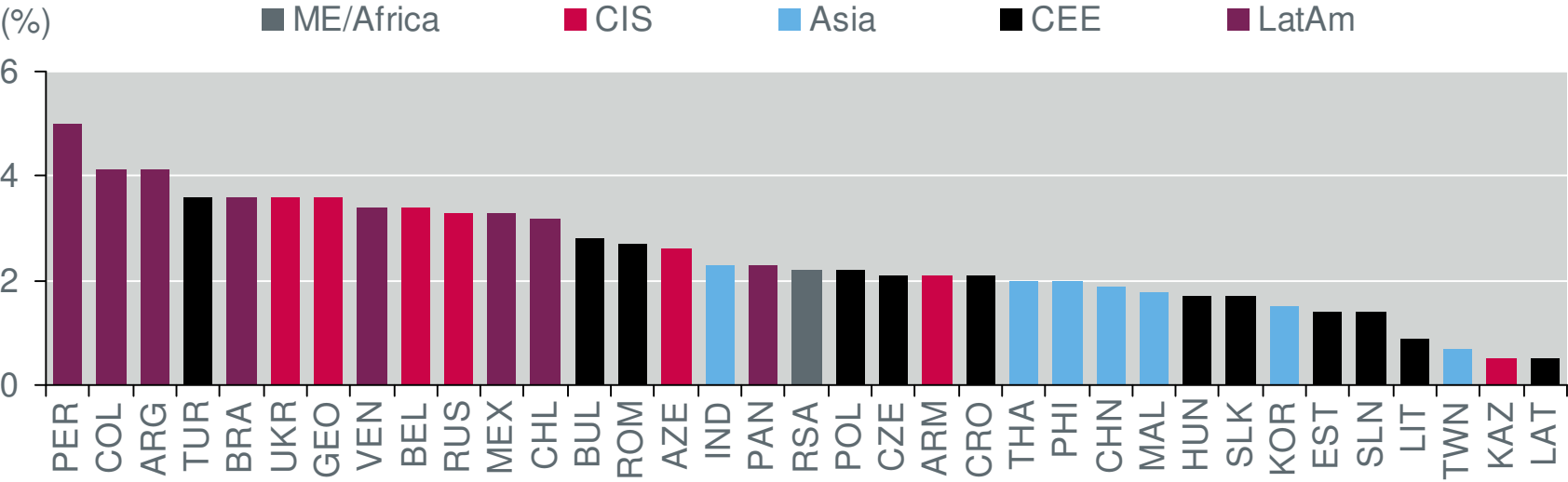


Impaired loan definitions differ across markets, and are not wholly comparable. End-2010 data except IND (31 Mar 11E), PHI (Q310). KUW (H110). AZE, UKR based on Fitch Ratings surveys of rated banks, rather than regulatory data. CHN excludes policy banks and credit cooperatives
 Source: National banks and bank regulators, Fitch Ratings calculations and estimates

Solid Pre-Provision Results in Many EMs

- Solid pre-impairment profit in LatAm, Turkey and Russia provides significant first line of loss-absorption capacity
- Tighter margins in much of Asia, CEE and Kazakhstan

Pre-Impairment Profit/Average Assets

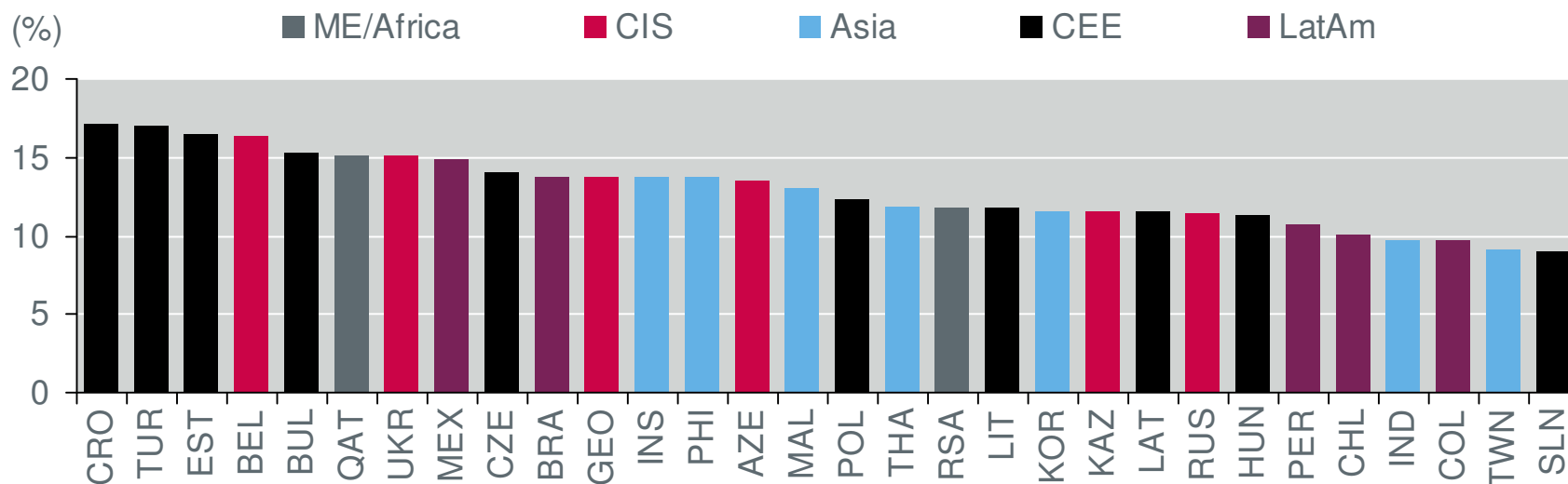


End-2010 data except PHI (9M10, annualised). IND (9M to 31 Dec 10E, annualised). CHN based on averages of rated banks
 Source: National banks and bank regulators, Fitch Ratings calculations and estimates

Most EMs Already Basel-III Compliant

- Amongst larger EMs, Turkey, Mexico and Brazil are among most soundly capitalised
- Large North Asian markets operating with tighter capital ratios (China equity/assets ratio just 6.2% at end-2010)

Regulatory Tier 1 Capital/Risk-Weighted Assets

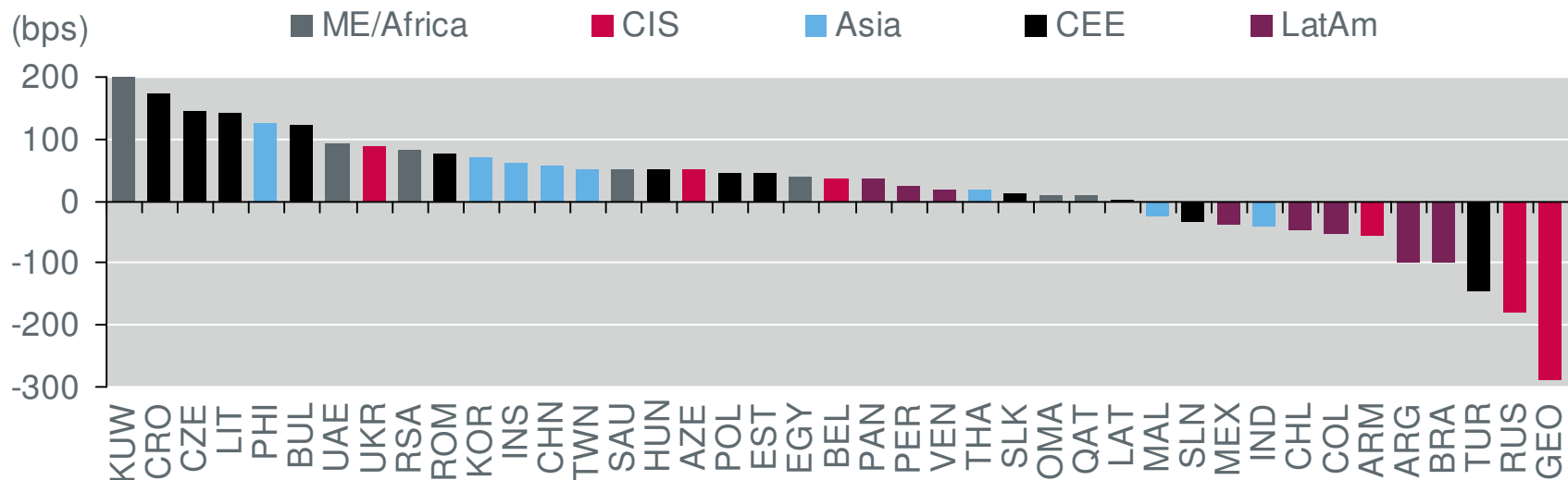


End-2010 data except for IND (31 Mar 11E), PHI (Q310)
 Source: National banks and bank regulators, Fitch Ratings calculations and estimates, IMF

Moderate Capital Pressure From Loan Growth to Date

- Asian capital ratios supported by both retained earnings and capital raising, as well as limited growth in some markets
- Moderate pressure on capital in Turkey, Russia and Brazil, but from high base

Change in Regulatory Tier 1 Capital Ratio, End-2010 vs. End-2009

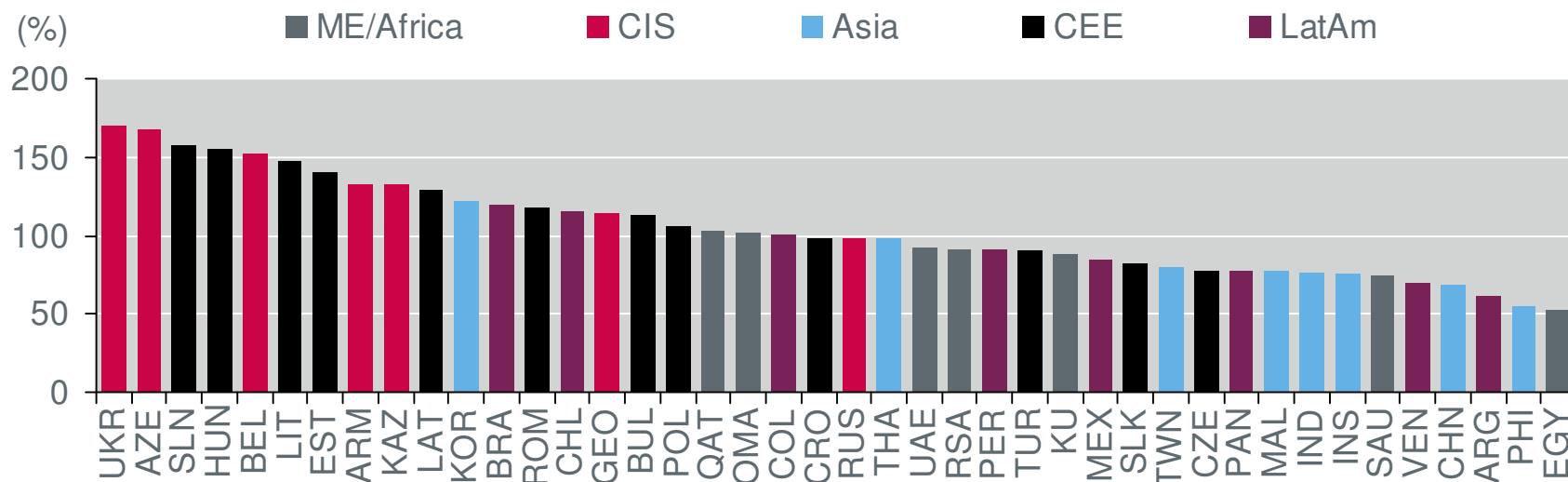


End-2010 data vs. end-2009, except IND (31 Mar 11E vs. 31 Mar 10), PHI (Q310 vs. 2009). ARG, ARM, BAH, CHN, EGY, INS, KUW, OMA, PAN, SAU, SLK, UAE, VEN show change in equity/assets ratio. ROM shows change in tier 1 leverage ratio. RUS, GEO ratios negatively impacted by non-inclusion of current year earnings in tier 1 capital; Source: National banks and bank regulators, Fitch Ratings calculations and estimates

Most EM Banks Deposit Funded, CEE/CIS Excepted

- Most Asian, LatAm and GCC systems, and Turkey, comfortably fund lending activities with customer balances
- Still high loans/deposits ratios in parts of CEE and CIS

Loans/Deposits Ratios

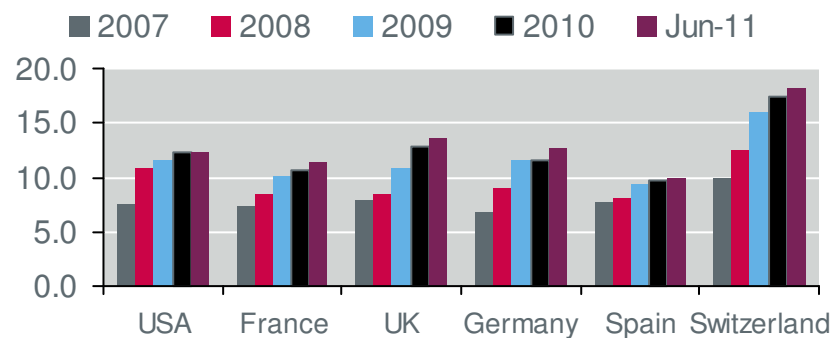


End-2010 data except PHI (Q310). For RUS, eurobonds excluded from deposits (included in regulatory data)
 Source: National banks and bank regulators, Fitch Ratings calculations and estimates

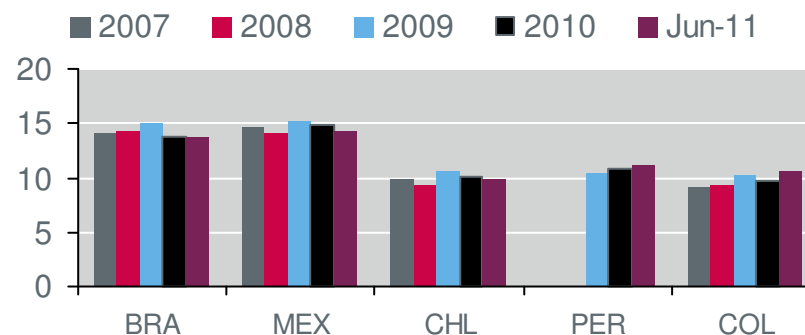
LATAM & Developed Markets Banks

- The 2008-2009 crises affected in different ways both group of banks
- The ability of each group to overcome the crisis has been also different
- LATAM its not isolated to global issues, but the contagion channels may be narrower than those of DM banks: less reliant in capital markets funding; simpler investment portfolio's and stronger profits
- Capital base have steadily improved for DM banks thanks to shareholders and government capital injections; but just slightly above LATAM banks
- Brazil & Mexico looks better in terms of their capital base

DM Banks: Tier 1 Capital Ratios



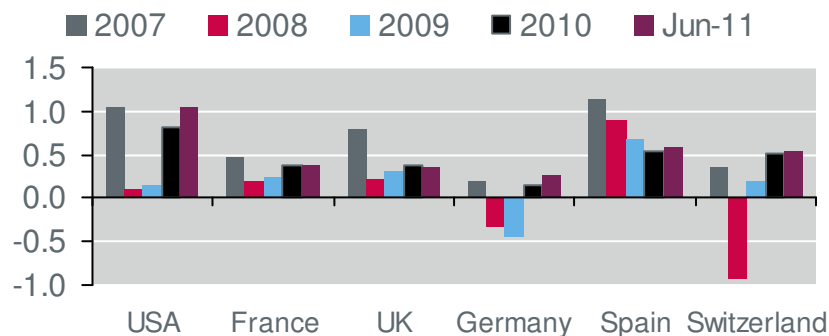
LATAM Banks: Tier 1 Capital Ratios



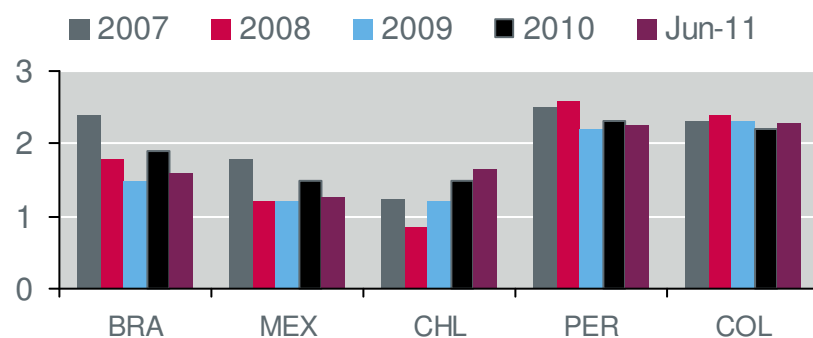
Note: Average based on selected largest banks in region for DM and EM.
Source: Fitch

LATAM & Developed Markets Banks

DM Banks: ROAA



LATAM Banks: ROAA



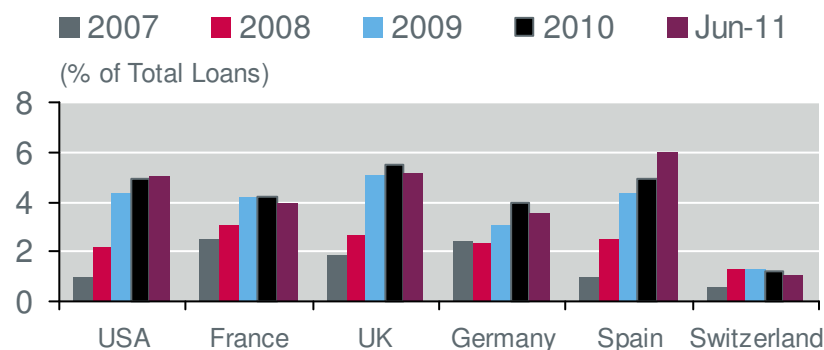
Note: Average based on selected largest banks in region for DM and EM.
Source: Fitch

- The past crisis was mostly an event of lower profits for LATAM banks; while for DM banks resulted even in losses and some of the recent improvement its explained by non recurring items
- EM Banks, as expected, remained more profitable even after the crisis
- Lower banking penetration in LATAM, fast growth and relatively higher margins may explain such difference; although, lower exposure to the volatility of the global capital markets may help as well
- Ongoing profit generation is key to help digest problem assets and sustain internal capital generation

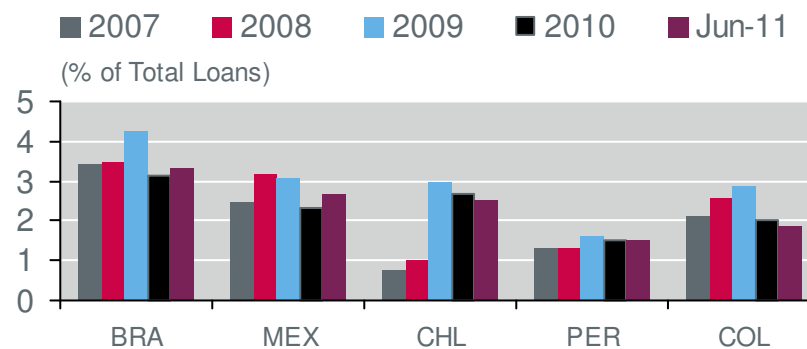
LATAM & Developed Markets Banks

- Most of DM banks posted large increase in their past due loans ratios; exacerbated by loan contraction
- LATAM banks past due loans have performed better thanks to a milder economic contraction and a quick recovery in economic activity after 2009
- Chile's performance is distorted by a substantive accounting change; 90 days past due loans grew similar to its peers
- Despite lower global expected economic growth for 2011 and 2012; LATAM banks should still perform better in terms of asset quality
- The expansion into new segments in LATAM may result in slightly different asset quality trends

DM Banks: Past Due Loans Ratio



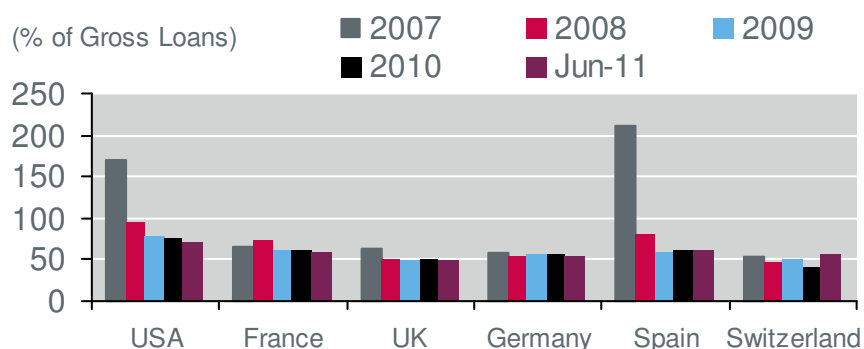
LATAM Banks: Past Due Loans Ratio



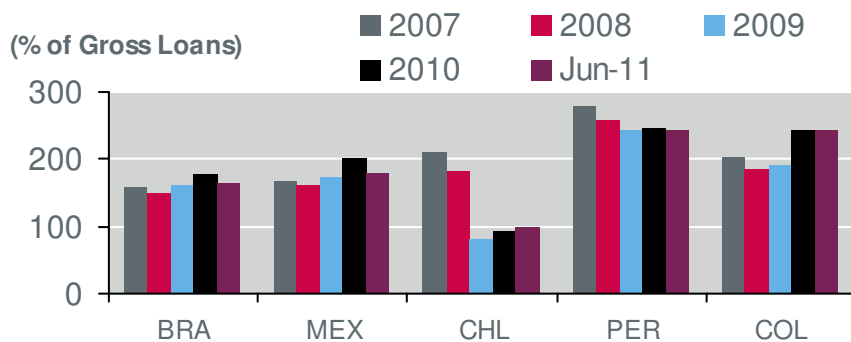
Note: Average based on selected largest banks in region for DM and EM.
Source: Fitch

LATAM and Developed Markets Banks

DM Banks: Loan loss coverage



LATAM Banks: Loan loss coverage

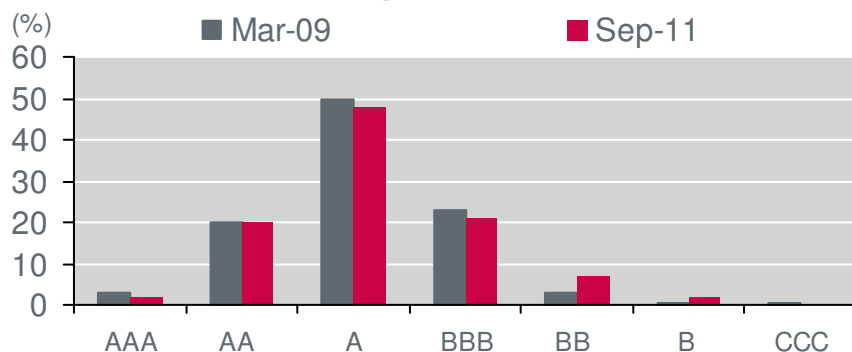


Note: Average based on selected largest banks in region for DM and EM.
Source: Fitch

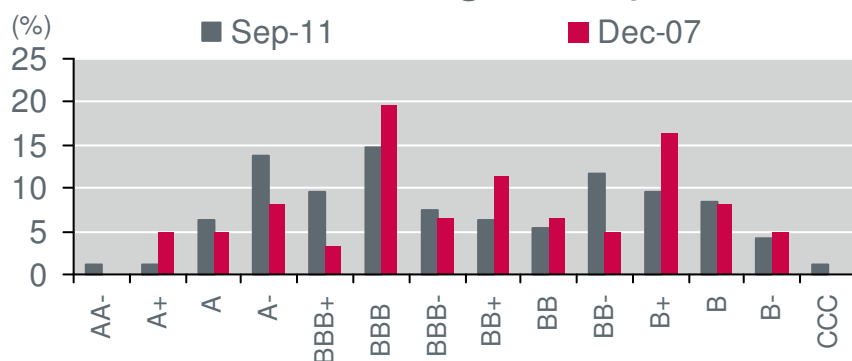
- Except for USA and Spain, most DM banks have preserved their loan loss coverage; although, still below the average of more than 150% for LATAM banks
- In LATAM, lower charge off needs and strong income generation have helped to preserve loan loss coverage
- Excess loan loss coverage may work well in an environment of higher impairments
- Higher earnings generation, healthy loan loss reserves and adequate capital bases will benefit LATAM banks in a case of another global economic downturn; DM banks may see their low profitability extend while troubled assets will take long to digest

LATAM and Developed Markets Banks

DM Banks: Rating Stock (4Q08-2Q11)



LATAM Banks: Rating Stock (4Q07-2Q11)



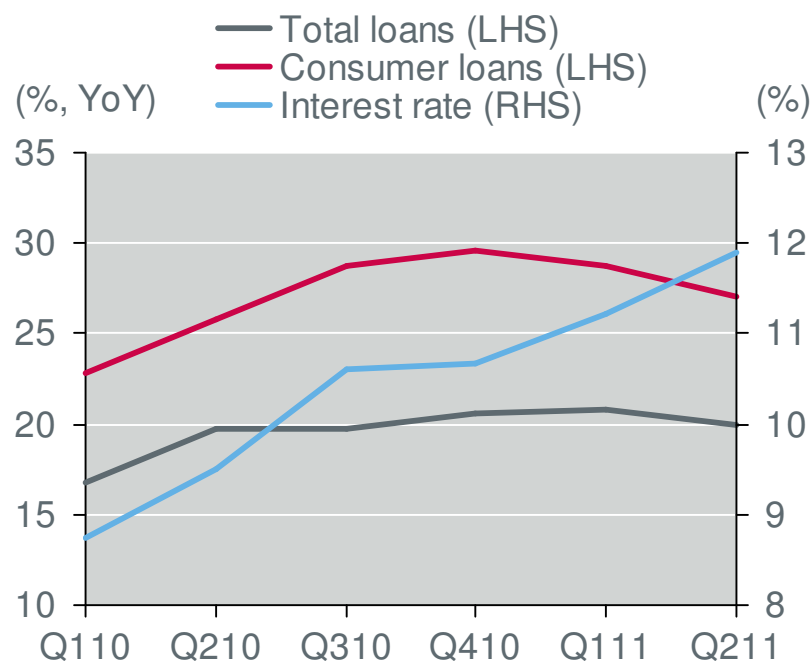
- LATAM bank ratings have steadily improved since 2007; most but not all of those changes due to changes in our view about their respective sovereign
- 53% of our rated universe is currently investment grade; 22% are within the AA/A category
- In late 2007: 48% was rated within the investment grade categories while just 18% was rated AA/A
- In 2004, just a number of banks were rated investment grade
- DM banks ratings have been migrating downwards, a larger number of ratings have migrated to their support floor; a situation that may change if resolution regimes evolve in the future

Note: Local Currency IDR is used for LATAM Banks; Foreign Currency IDR for DM Banks

Brazil: Strong Loan Growth Despite Tighter Monetary Policy

- Rapid credit growth is indisputable, and consumer lending and SMEs are strong contributors
- SELIC interest rate, cash reserve requirements were steadily increased by the Central Bank since early 2010 – but loans from public sector banks remains strong while the astringent monetary policy may be changing soon
- Higher capital charges have been imposed on some consumer loans
- Consumer loan growth is moderating, but overall loan growth will remain strong due to vigorous economic activity and the focus on SMEs

Total Loan Growth vs. Consumer Loans

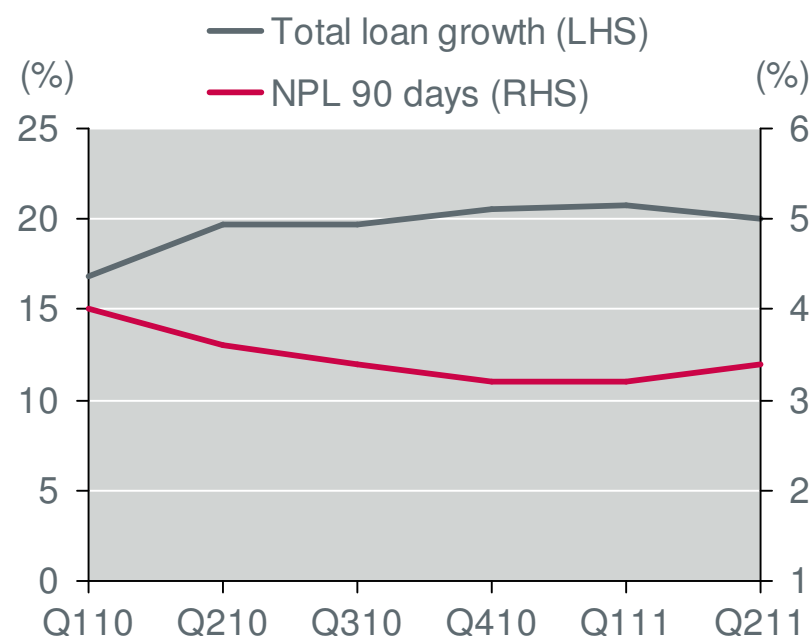


Source: BCB, Fitch Ratings

Brazil: Asset Quality Holds up, a Denominator Effect?

- Rapid loan growth will always be a red flag for bank analysis – specially when expansion into new customers occurs
- After a spike in impairments, especially for SMEs and consumer loans in 2008, overall asset quality remains reasonable
- Denominator effect? We think no!
- Historic lows for unemployment and above average economic growth suggest that some deterioration may persist; inflation it's a variable to consider
- Why we are not too worried?

Total Loan Growth (YoY) vs. Non-performing Loans

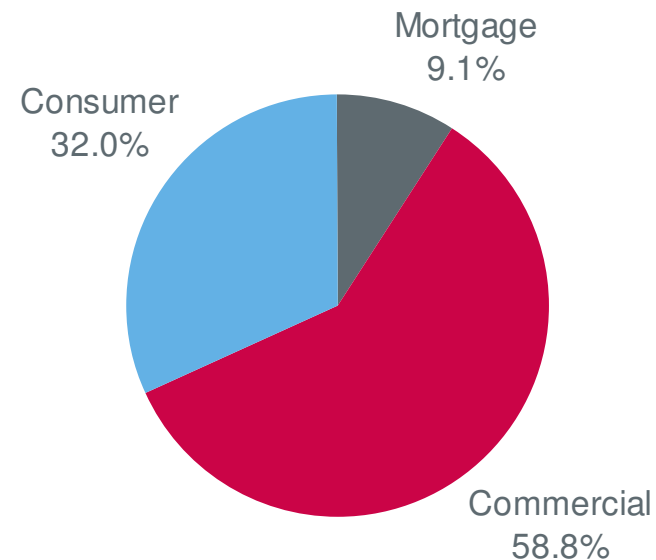


Source: BCB, Fitch Ratings

Brazil: The New Middle Class and Loans to Individuals

- Consumer lending and SME's are riskier by nature, but there is always an interest rate for an appropriate risk/return balance
- Secured consumer lending still accounts for the vast majority of Brazilian consumer lending
- Moderate loan to value, still high interest rates and its very low starting base (4% of GDP) are still features of Brazilian mortgages; although mortgage issuance is concentrated mainly with one public lender
- High net interest margin relative to most other EM banks, while overheads tightly controlled equals to a strong income generation capacity
- But: Not all banks are created equal

Sector Loan Portfolio

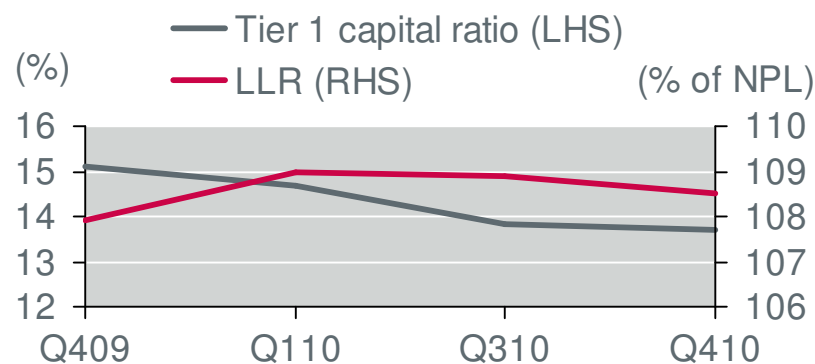


Data at end-H111
Source: BCB, Fitch Ratings

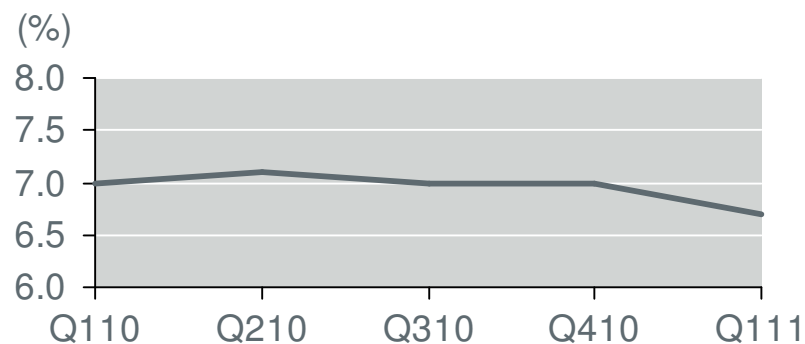
Brazil: Strong Balance Sheet and Healthy Profits

- Strong funding base, relatively controlled overheads, and high interest rates provide strong earnings to compensate higher credit costs
- High pre-impairment profit ratio relative to other EM banks, with almost average credit costs
- Capital adequacy has decreased but is still above the EM average and supported by the high income generation capacity of the system
- 100% loan loss coverage (even considering more strict impairment metrics) ratio in a proactive provisioning environment

Capital Ratio



Net Interest Margin

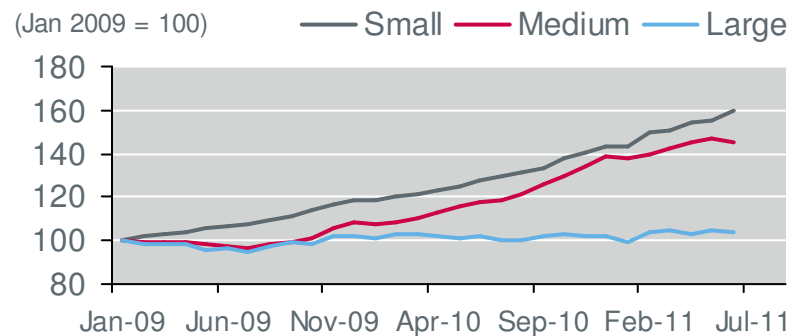


Source: BCB, Fitch Ratings

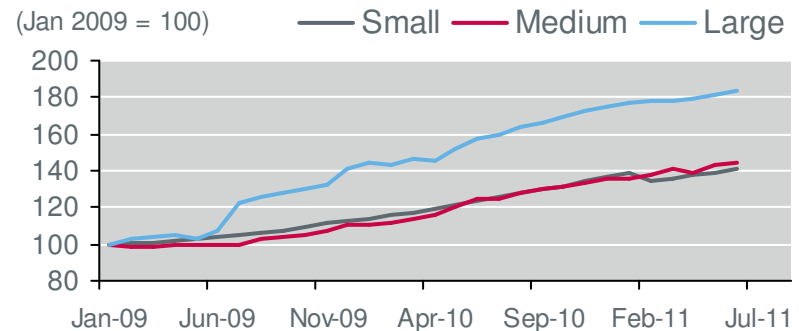
Credit Growth in Brazil: Key Components and Risks

- Its not all about consumer lending
- Loans to small and medium companies is increasing fast; some of this growth still on a secured lending basis
- Large companies are using their cash holding and easier access to capital markets
- Long term financing is also growing; requiring appropriate long term funding within the system
- Lower expected economic growth may result in lower loan growth and higher impairments on the commercial and SME's portfolio

Working Capital Loans



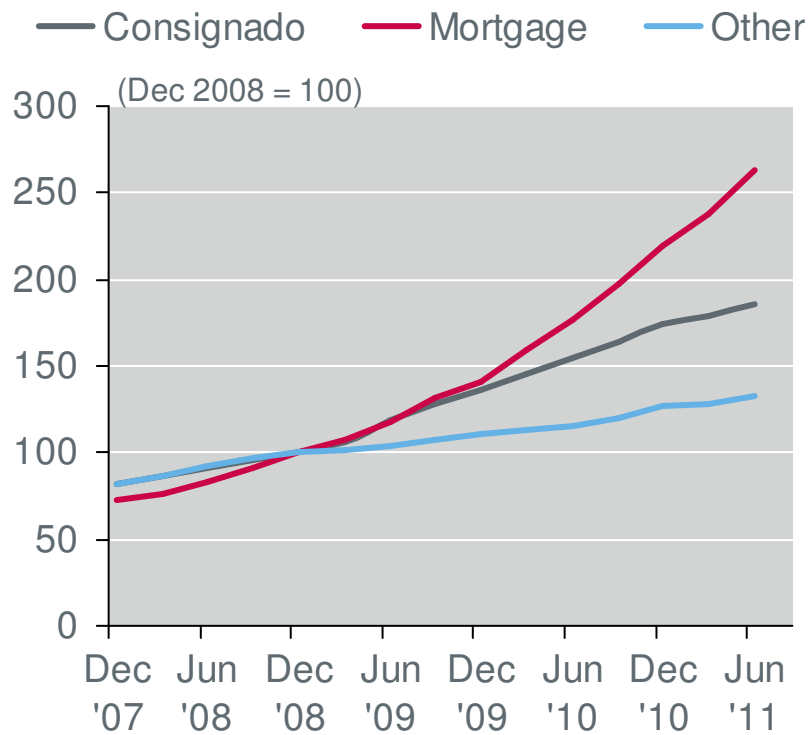
Non Working Capital Loans



Source: BCB

Credit Growth in Brazil: Key Components and Risks

Credit to Individuals

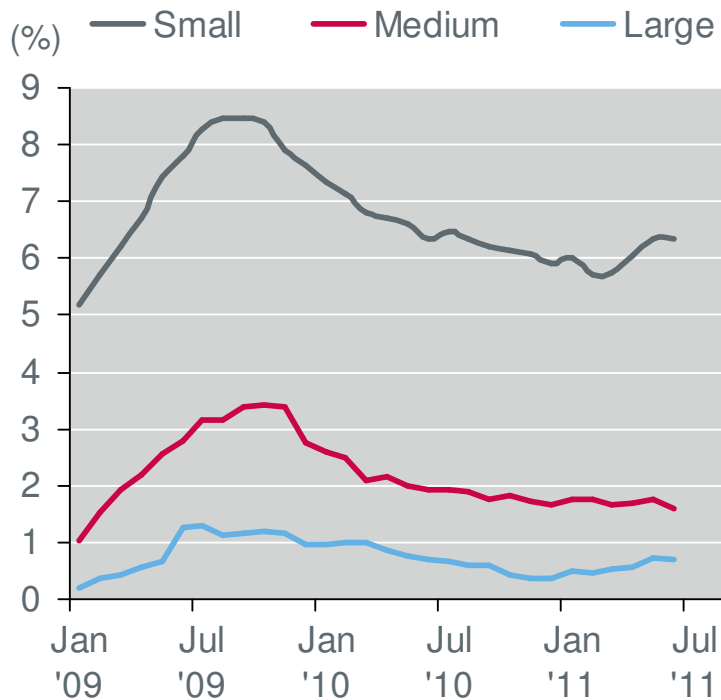


Sources: BCB

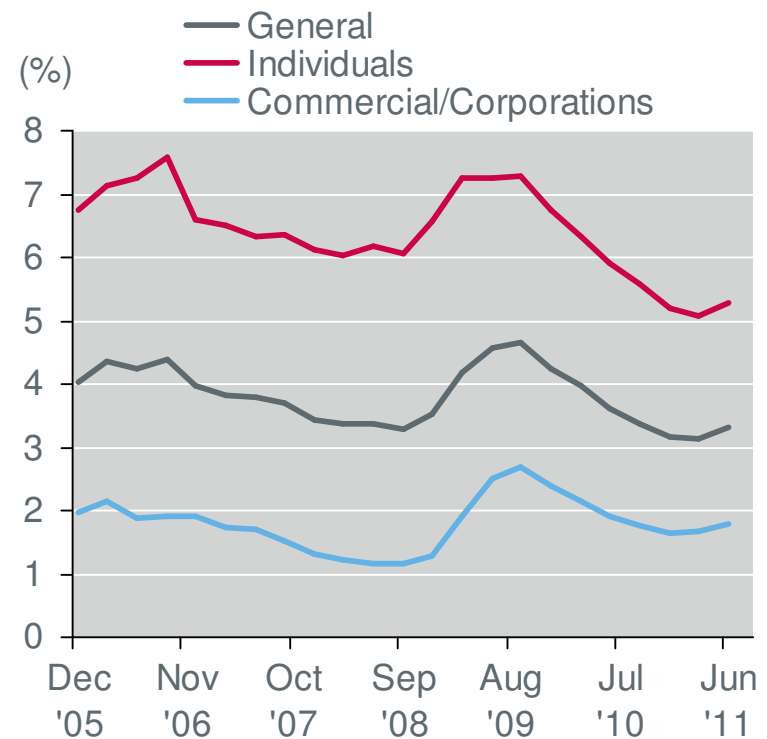
- Mortgage's remains as the fastest growing segment in loans to individuals; but from a low relative base
- Non secured lending is still growing somehow moderately; but certainly fast
- Consignado lending is approaching a more mature growth trend, as expected
- High interest rates are key to understand the risks of these exposures
- Operating under record low unemployment level's suggest that the expected trend for past due loans will be to rise
- Sustained inflationary pressures may erode the current payment capacity of individuals

Credit Growth in Brazil: Key Components and Risks

Past Due Loans - Working Capital



Past Due Loans – 90 Days

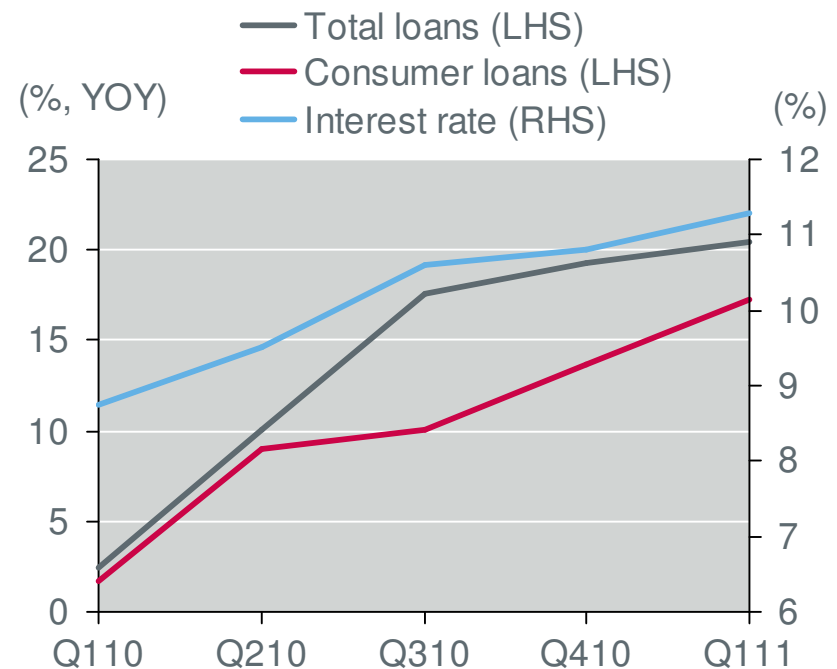


Sources: BCB

Peru: The New Kid on the Block

- One of the three banking systems in countries rated investment grade with banking penetration below 25%
- After an almost full stop in 2009, loan growth has regained strength, but below the 2005-2007 average
- Consumer loans have almost doubled as % of GDP in the last 4 years, but still remain around 6% (EM median 20%)
- Despite moderate growth, mortgage penetration is still limited although is higher than the median of other EM banks (3.7% of GDP vs. 2.8%)

Total Loan Growth vs. Consumer Loans

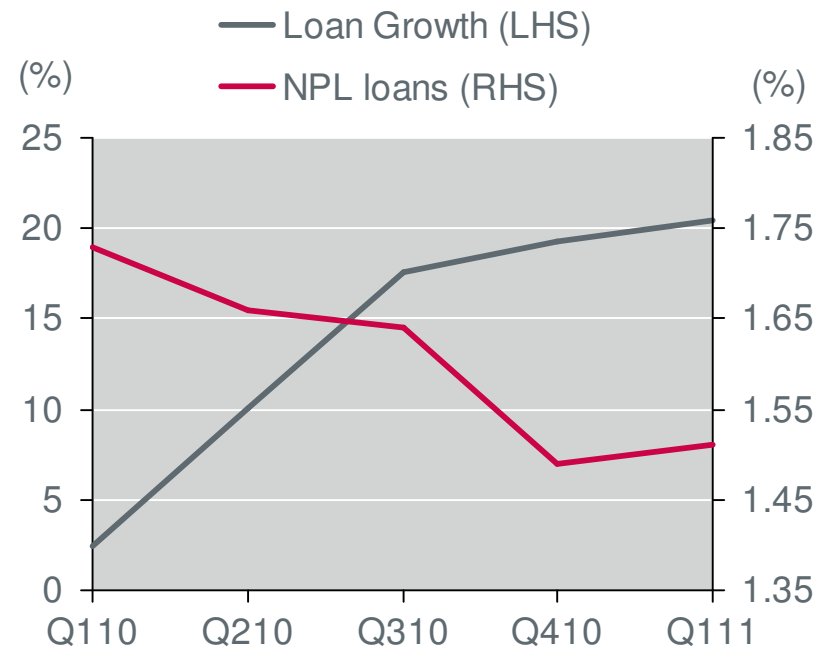


Source: Superintendencia, Fitch Ratings

Peru: Strong Asset Quality Ratios

- One of lowest NPL ratios among EM banks, even with a 30-D NPL definition
- Portfolio seasoning should increase impairments from very low level; but the denominator may help to dilute such possible trend
- Even in the group of higher income people, consumer loans are not frequently used
- Loans in foreign currency remain sizable compared to other EM banks; but funded by local FC deposits and backed by large share of international reserves
- Will the new kid behave?

Total Loan Growth (Y-o-Y) vs. Non-performing Loans

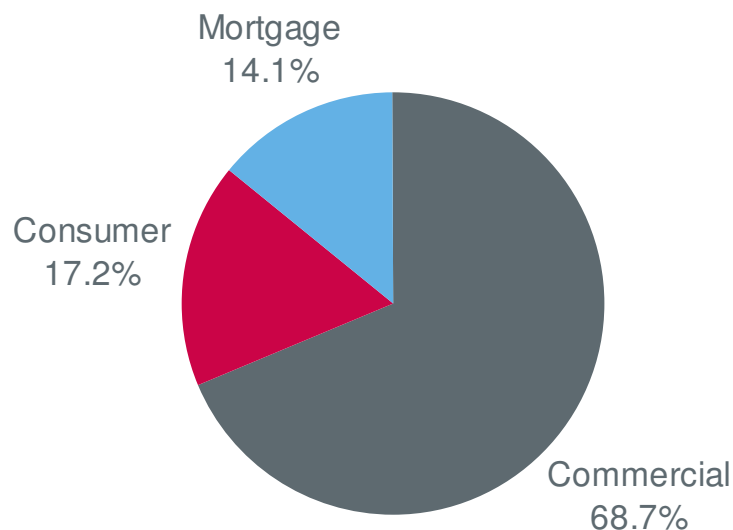


Source: Superintendencia Fitch Ratings

Peru: The New Middle Class and Loans to Individuals

- Interest rates for credit cards (the bulk of consumer loans in Peru) are very high, albeit lower than in Brazil
- Secured lending is less important compared to Brazil, but overall consumer loans will keep growing
- A significant portion of the current mortgage portfolio is not new
- One of highest NIMs in EM banks, and among the most efficient systems in terms of operating expenses
- A very concentrated banking sector may help in terms of banking supervision in an already well regulated system

Sector Loan Portfolio

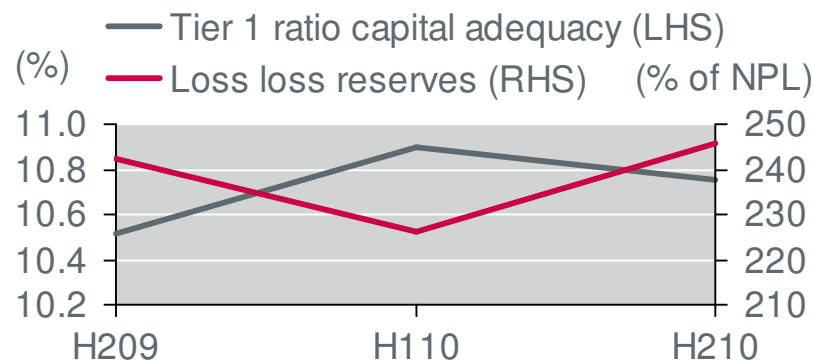


Data at end-H111
Source: BCB, Fitch Ratings

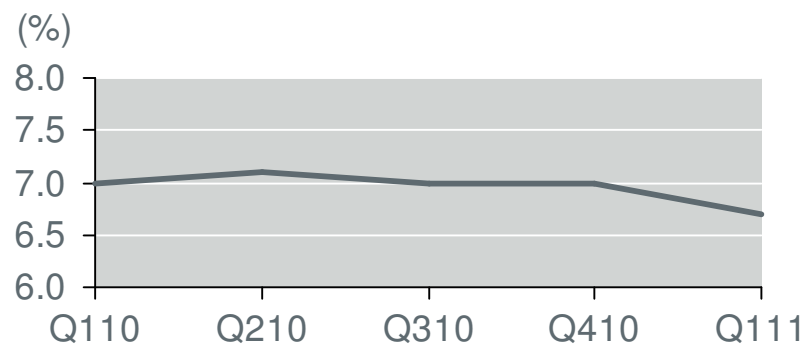
Peru: Strong Earnings Compensate Higher Leverage

- The highest pre-impairment profit ratio in our EM banks sample (5% of average assets); with below average credit costs
- Strong loan loss coverage underlines the industry strong income generation and provides a cushion against provisions pressures
- Loans largely deposit funded
- Tier 1 ratio is marginally improving, but new regulatory guidelines should sustain this trend
- Further growth will require conservative earnings retention

Capital Ratio



Net Interest Margin

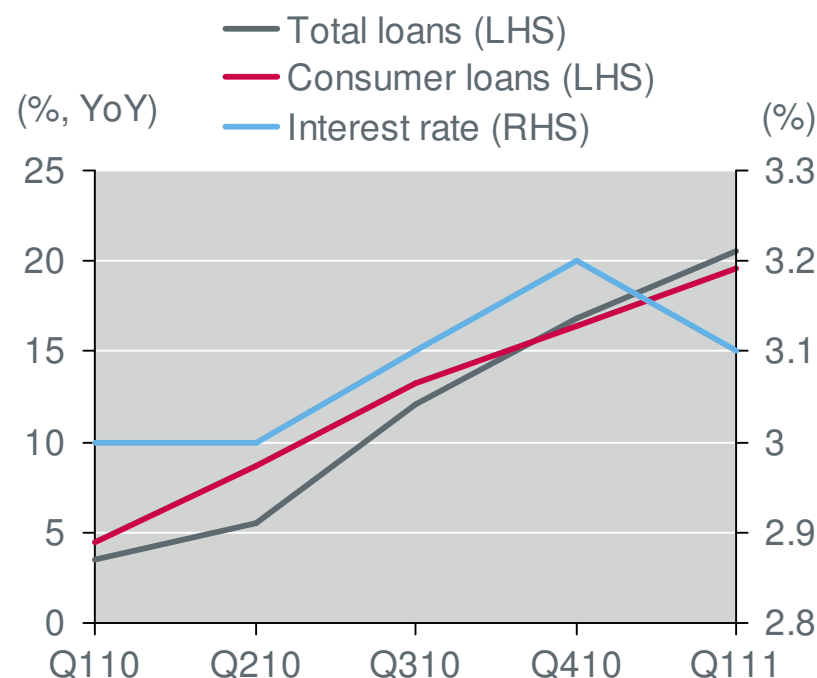


Source: BCB, Fitch Ratings

Colombia: A More Balanced Loan Dynamics

- Similar growth trend as Peru, temporary halt in 2009
- Despite continuous, but slightly conservative, interest rate increases by the Central Bank, so far strong economic activity is boosting loan growth
- More balanced growth among consumer and non consumer loans
- Higher capital charges have been imposed on some consumer loans
- Consumer loans to GDP still half of the EM bank medium (10% vs. 20%), but mortgages just 2% of GDP

Total Loan Growth vs. Consumer Loans

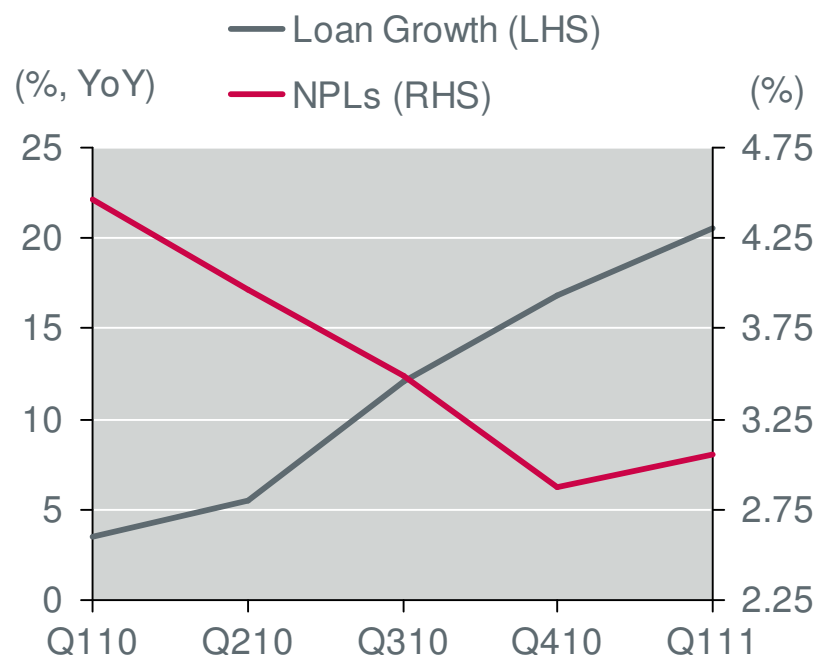


Source: BCB, Fitch Ratings

Colombia: Riding the Cycle in Very Good Shape

- Despite its 30+ days definition for impairments, Colombia NPL ratio of 3% as of Dec. 2010 well below EM bank median
- After spike in NPLs in 2008 and 2009 (especially on retail loans); 2010 brought a significant decrease in impairment. Recent changes (08-09) on loan loss provisioning rules have helped to improve loan loss coverage
- Expansion into other countries by Colombian banks may bring external noise to this trend

Total Loan Growth (Y-o-Y) vs. Nonperforming Loans

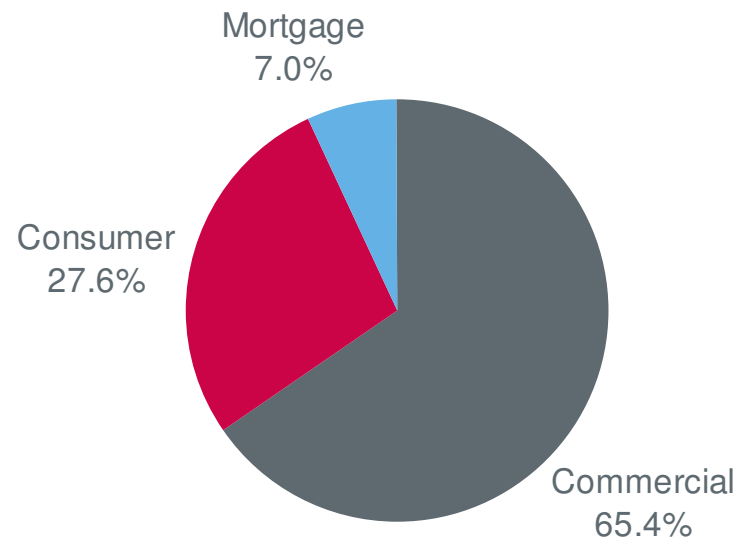


Source: BCB, Fitch Ratings

Colombia: Not a Freshman on Retail Lending

- Despite decreasing as proportion of total loans, mortgages have been offered in Colombia longer than in many other LatAm countries
- Fourth highest level of consumer loan penetration in LatAm
- Consumer loans more diversified than Peru but less secured lending compared to Brazil
- Retail loans to mid and mid-low income population is growing, but not new to the market

Sector Loan Portfolio

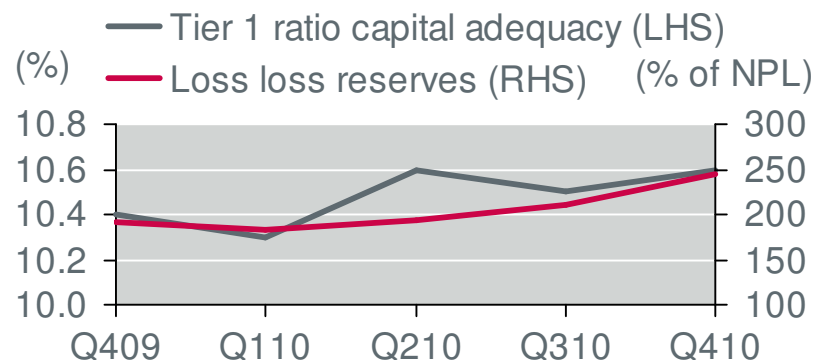


Data at end-H111
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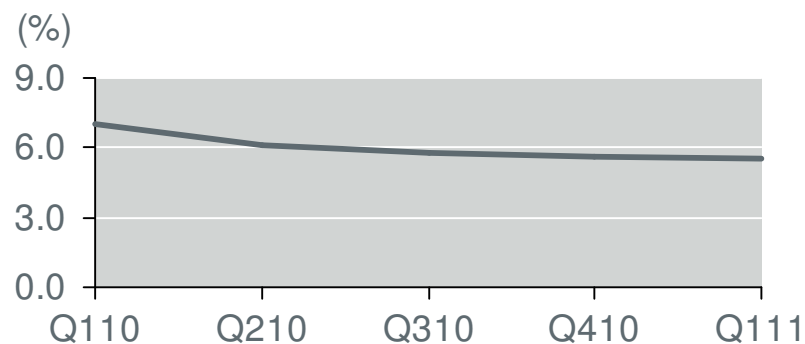
Colombia: Strong Earnings, Capital Can Improve

- The second highest pre-impairment profit ratio in our EM banks sample (4% of average assets); with below average credit costs
- The second highest loan loss coverage ratio after Peru
- Loans largely deposit funded
- Tier 1 ratio is among the lowest in EM banks sample, suggesting clear room for improvement
- Further growth will require a more conservative capitalization policy

Capital Ratio



Net Interest Margin



Source: BCB, Fitch Ratings

Conclusions

- LATAM and many EM banks have performed well during and after the crisis; the number of upgrade's have surpassed the number of downgrades
- The improvement of the operating environment in LATAM have been key for this success; while the strong financial position of the main banks have supported such trend despite the volatility of the global environment
- Fast loan growth always pose risks, although, the current mix of adequate capital base, low level of troubled assets, comfortable funding, strong earnings generations and improved regulatory environments acts as a strong defense cushion for the region
- The evolution of the loan portfolio profile in Brazil and elsewhere, requires constant monitoring and fine tuning of risk control tools
- Contagion risks from DM banks turbulence may be limited given the funding profile of the region; although, lower global economic growth affect EM banks as much as DM banks

Related Research

- All relevant Fitch research can be found on our website www.fitchratings.com under the appropriate sector headings
- EM Banking System Datawatch (1 June 2011)
- Mid-Sized Brazilian Banks: Adequate Performance for a Challenging Business Model (28 April 2011)
- Central American Banks: After the Crisis, an Uneven Evolution (28 Sep 2011)

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