

The Effect of the Global Financial Crisis on Credit Union in Thailand

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The global financial crisis originated in the USA mid 2008 and since then has affected the world economy, including Thailand's economy. Though Thai GDP growth was 4.9% in 2007, in Quarter 4 of 2008, Thai GDP was -4% so that GDP in 2008 grew by only 2.6%. In 2009, GDP contracted severely, at -7.1% and -5.4% in Q1 and Q2 of 2009 respectively.

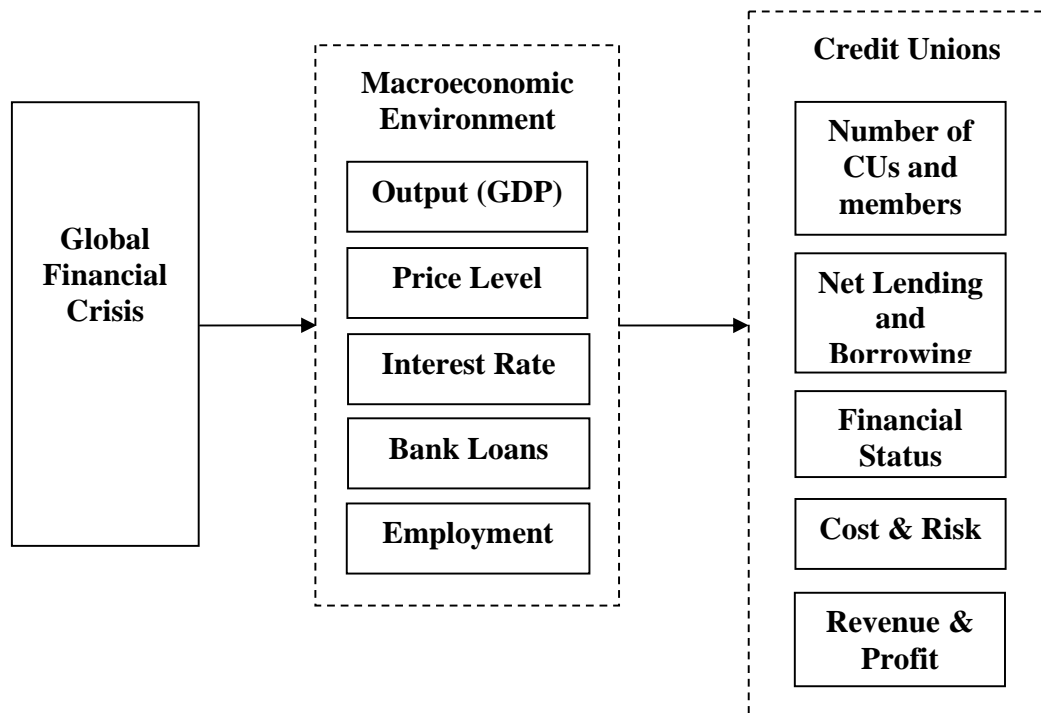
Additionally, almost all Thai key economic indexes have deteriorated. Export has been negative since November 2008. The number of foreign tourists has decreased since Quarter 3 of 2008. Capacity utilization has declined since November 2008. The Private Investment Index and Private Consumption Index have been minus since the end of 2008. The Unemployment rate increased from 1.4% in 2008 to 2.4% in January 2009. However, the unemployment rate increase in January 2009 was due to seasonal unemployment, which was at its highest peak for the year. By June 2009, the unemployment rate had decreased to 1.4%, or 5,500 thousand people, which was an increase of only 1,100 thousand people from the same period during the previous year. This was below expectation that there would be 1.3 million people unemployed. At the same time, the manufacturing sector has lacked liquidity owing to the banks hesitation to lend to them. For reason of this, liquidity has flooded the market and caused interest rates to go down.

If we consider the performance of credit unions (CUs) globally, we find that credit unions have hardly been affected by this global financial crisis. This brings us to an important question, whether CUs in Thailand have been affected by the global financial crisis or not.

1. Framework for the global financial crisis transmission channel on Credit Unions in Thailand

To analyze whether credit unions in Thailand have been affected or not, we will examine how the crisis has affected Thailand's macro economic environment by focusing on the changes in five key economic indexes: GDP, price level, interest rate, bank loans and employment. Then we will explore how the changes of macroeconomy have affected credit unions, such as the number of credit unions, the number of members of CUs, the net lending and borrowing of CUs, the financial status of CUs, the cost and risk of CUs and the revenue and profit of CUs (Figure 1).

Figure 1: Transmission Channel of Global Financial Crisis on Credit Unions in Thailand



2. Impact of the global financial crisis on Thailand's credit unions

From performance studies of CUs in Thailand, when data for 2008 when the crisis started, is compared with the data of previous years (2003 – 2007), there is no empirical evidence that the Global Financial Crisis has significantly affected CUs in Thailand.

2.1 The number of cooperatives and the number of CU members have expanded continuously

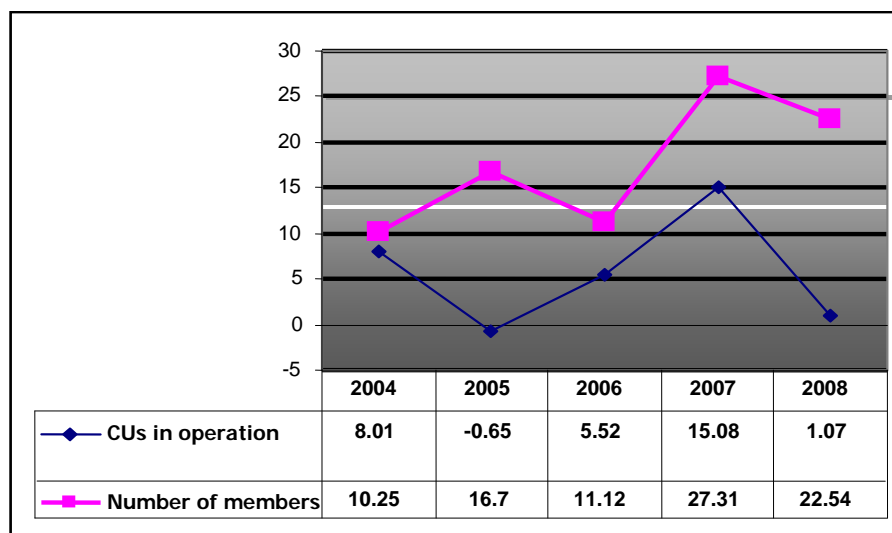
While the number of CUs increased from 287 in 2003 to 378 in 2008, the growth rate of CUs still in operation in 2008 had increased by only 1.07%, (though in 2007, the CU growth rate had increased by 15.08%).

However, the ratio of viable CUs to all CUs in 2008 was close to what that ratio had been for 2007, at 82% in 2008 and 83.7% in 2007, while it was 78.8% and 77.4% in 2005 and 2006, respectively.

The number of CU members in 2008 had been raised at a fairly high rate from 198,473 people in 2003 to 442,663 people in 2008. The membership growth rate in 2008 was very high, at 22.54%, and close to the membership growth rate level for 2007, at 27.31%. The growth rate in 2008 was higher than it had been from 2004–2006 when the number of members increased by 10.25%, 16.70% and 11.20%, severally.

These numbers indicate that even though the global financial crisis caused Thai GDP to contract greatly, it didn't have much effect on CUs. The contraction of Thailand's economy only slowed down the setting up of new CUs, though the membership of existing CUs still increased.

Figure 2: Membership growth rates and the number of CUs in operation



2.2 The performance of CUs has improved

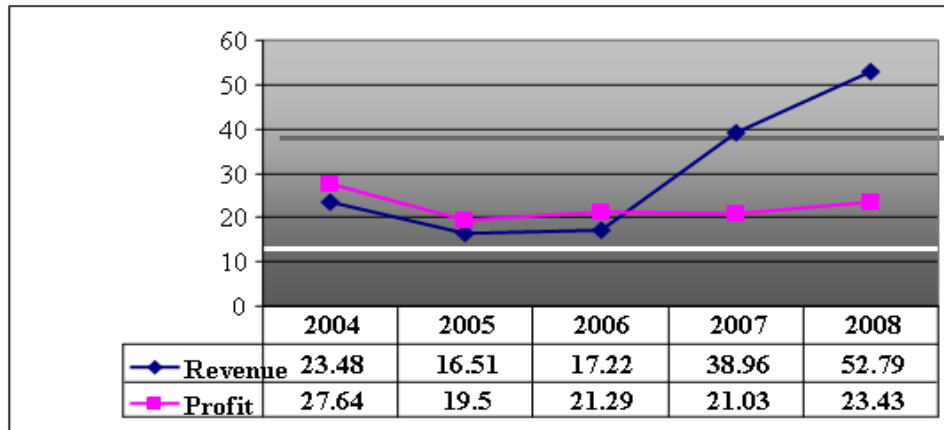
In 2008, CU performance was better than it had been in 2007, as we can see from the obvious revenue increase of CUs in the system.

The revenue of CUs in 2006 had increased by 17.22% compared to the previous year, and by 38.96% and 52.79% in 2007 and 2008, respectively.

As well as CU profit increase for 2008, CU growth rate was also higher than it had been in previous years. The profit of CUs in 2008 had increased by 23.43% compared to the previous year, while the profit of CUs in 2005 – 2007 was between 19.50% - 21.29%.

From the revenue and profit of CUs in 2008, the whole system showed the performance of CUs to be at a good level. This means that CUs were hardly affected by the crisis.

Figure 3: The growth rate of CU revenue and profit



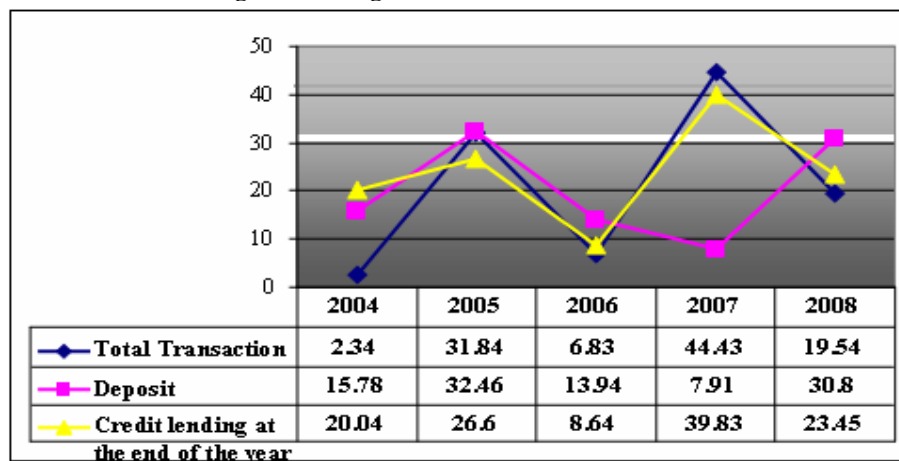
2.3 The total transactions of CUs have increased continuously

In 2008, the total transaction of CUs had increased to a fairly high level, at 19.54%, or 17,567 million Baht. Though this was a lower increase than in 2007, which had measured a growth level of 44.43%, the expansion of business transactions in 2008 was high because transactions in 2006 grew by only 6.83%.

Credit lending for CU members in 2008 grew at very high rate compared to previous years. In 2006, credit lending increased by only 8.64% compared to the previous year. In 2007, it increased 39.83%. Though the growth rate in 2008 had slowed down to the level of 7.91%, it later increased to 30.8% in 2008.

This indicates that the financial status of CUs is still good and the global financial crisis has had little effect on the revenue of CU members.

Figure 4: The growth rate of CU transactions



2.4 The financial status of CUs is still good

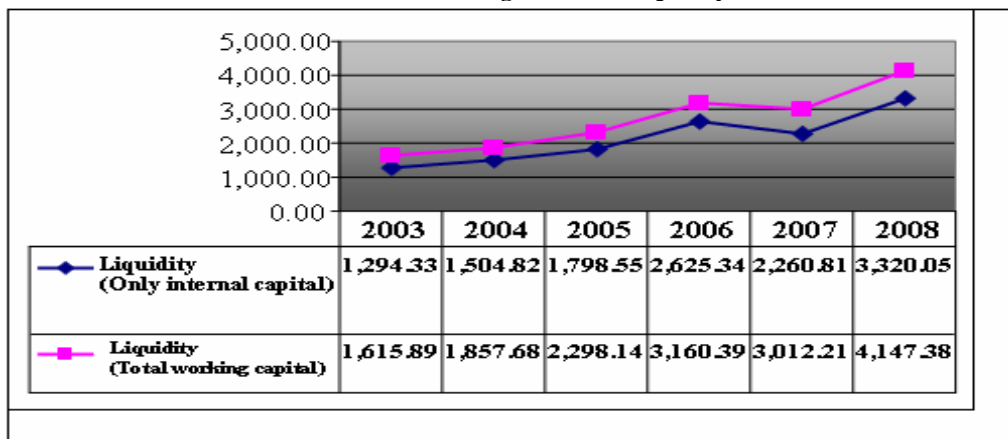
The working capital of CUs has increased continuously. In 2008, it totaled 16,467.93 million Baht. This was an increase from 5,939.22 million Baht in 2003. In 2006, it had increased 16.12% compared to the previous year and increased 26.17% and 26.75% in 2007 and 2008, respectively.

The ratio of internal capital to external capital has been constant for a long time. CUs have depended 95% on internal capital and 5% on the borrowing of external capital. In 2008, the internal capital to external capital ratio was 9.73%. This reflects that the financial status of CU's is still good.

The excess liquidity of CUs has increased. If we consider the total working capital to total credit that CUs lend to their members, we find that in 2008 the excess liquidity was 4,147.38 million Baht, which was more than the level for 2006 had been, at 1,615.89 million Baht. Compared to another year, excess liquidity in 2008 was 3.8 times more than it had been in 2003. If we solely consider the internal capital of CUs against their total credit lending to members, we find the liquidity of CUs to be at a good level, along with excessive liquidity increases every year.

From this data, the liquidity of CUs is still shown to be good, with CUs able to continue their businesses and serve their members continuously.

Figure 5: The liquidity of CUs



3. Economic risks that affect the operation of CUs

Though the CU system is secure and fairly closed, with CU members entering into partnerships together and CUs serving their members who are in the same workplace or community by mainly depositing or lending to them; an unstable economy, as I have mentioned, may in some aspects affect the operation of CUs, as CUs still partially connect to the economy beyond CUs. For example, CUs may borrow credit from other financial institutions, or from CU members as consumers, workplace labour, or as employers. This might therefore present operational risks for CUs, with CUs having to avoid such as:

3.1 The increased future risk in lending to members

NPLs in CUs are likely to increase because, firstly, economic growth has contracted and most business revenue has decreased, resulting in some business closures. CU members that borrow investment credit may lose their money and be unable to pay back their loans. Lending to other CUs may also be more risky because consumption has decreased, as well as the price of agricultural products, thus other types of cooperatives may also experience a decrease in their revenue, leading to a decreased ability to repay credit to CUs.

Secondly, the unemployment rate is likely to increase. CU members may lose their jobs and become more insecure in their revenue, especially if they are private cooperative companies. Some members may not be able to return their loans.

Economic contraction and an unemployment increase will also increase the lending risk. Loans will possibly become NPLs where members' CU loans are used in order to pay back existing debt, i.e. 3rd loan usage. (Table 1)

However, CU NPLs are not high in number as the risk in lending to members is quite low. CU members live in the same area, thus making risk assessment easy due to uncomplicated information access and debt collection.

Table 1: Use of CU Loans in 2008

Loan Usage	Million Baht	% to Total Credit
Service fees and household expenditure	1,599.94	18.32
Pay back existing debt	1,034.36	11.85
Seeds, fertilizer and herbicide	895.59	10.26
Buy or renovate buildings	672.81	7.71
Buy land, adjust land and water resources	166.85	1.91
Invest in livestock	90.82	1.04
Cost of processing and preparing products for sale	86.09	0.99
Buy cooperative shares	48.07	0.55
Buy work animals, water pumps, machinery	45.81	0.52
Rent and taxes	3.83	0.04
Lend to other cooperatives	1.65	0.02
Other	4,085.47	46.79
Total	8,731.29	100.00

3.2 The risk of increased interest rates on deposits

CU liquidity will increase as members' deposits increase; and CUs must bear a greater burden as interest rates on deposits increase. Therefore, CUs must set deposit interest rates carefully in order to prevent excess liquidity that might become a future cost for CUs in having to pay deposit interest.

4. Factors affecting the severity of impact of the global financial crisis**4.1 The working capital of CUs is almost all membership shared**

Because CU working capital is more than 95% internal capital that comes from members, CU operations do not depend on external capital. CU operations are therefore quite secure and stable.

4.2 The working mechanism of cooperatives and CUs is strong

The fund management of CUs is quite conservative. Thus, in 2008, CU assets were very high at the level of 16,467.93 million Baht. CUs also closely take care of their members and help them to save regularly and continuously. While CU loans to members are not high, CUs are able to collect debt repayments effectively due to their careful usage of grants and loan tracking traced to the pay back ability of their members. Thus, CUs are able to constantly generate cash flow in the system and to make revenue and profit.

4.3 The business of CUs is not so economy-related

The CU transmission channel for Thailand is quite limited in terms of the global financial crisis because CUs serve and do business mainly with members. Lending and borrowing from others cooperatives or financial institutions is very small, with CUs not investing so much in risky assets or in stock exchange.

4.4 The impact on Thailand's financial institutions is limited

Thailand's financial institutions have been developing their regulation standards over a long period of time ever since Thailand faced a similar economic crisis in 1997 – and this has strengthened the country's financial institutions. When the financial institutions are strong, CUs have not been very affected by such crises. However, where banks take more care

in granting loans, some economically affected members may turn to borrow more from CUs. Though transactions may increase, the chances of NPL increase may also expand.

4.5 The inflation rate is low

Though consumption has slowed, due to the impact of the global financial crisis in lowering price levels (negative inflation), CUs benefit by an increase to their members' real income (assuming there is constant money income but decreased product prices, you will be able to buy more), so that their members' deposits increase.

4.6 The interest rate lowers

The current global financial crisis is different from the crisis in 1997 because this time the financial institutions are not short in liquidity. To the contrary, liquidity is excessive because banks have been more cautious in granting loans, so that bank depositing is more than bank loaning, and the interest rate has been lowering too. CUs have been affected by this situation because CU interest rates are normally higher than those of commercial banks. When bank deposit interest rates lower, CU members will deposit more in their CUs or will buy more CU shares, thus increasing the excess liquidity of CUs. Moreover, the increased lowering of their loan interest rates will also increase the ability of CU members to pay back their loans.

4.7 The unemployment rate is lower than expected

There are 55,000 thousand people unemployed at present, which is lower than the expected level of one million people in 2009. With product prices and interest rates lowering, the combined impact of the global financial crisis on the revenues of CU members and others is not as serious as expected.

5. Recommendations in coping with the crisis

5.1 Increase flexibility in adjusting interest rates

CU managers should pay attention to the management of interest rate policy on deposits and closely follow the interest rate market situation. In addition, in order to prevent excess liquidity, all managers should adjust the CU interest rate to match the market interest rate.

5.2 Focus on mobilizing capital in the long run

To mobilize short run deposits may result in higher CU costs as CUs pay higher deposit interest to CU members, and the lower deposit interest rate of commercial banks makes CU members transfer their deposits from banks to CUs that pay this higher deposit interest rate. Therefore, CUs should focus more on mobilizing long run capital, especially in supporting members to buy more CU shares or to deposit on more fixed terms in order to easily manage liquidity and financial cost.

5.3 Grant loans more carefully

CU managers should focus more on loan grants to members due to their lower risk and easier debt collection, and CUs should be more careful in granting some kinds of loans, such as loans for making a living, because investment to make a living in economic conditions like today's are becoming more risky, or loans for buying durable goods (land and house) because CU members are not secure in their earnings.

Therefore, CUs should cooperate more closely with private companies in order to know if a company is at risk of shutting down, or if more employees will be fired, and which group of employees are at risk of being fired first.

5.4 Seek revenue from other sources

Today's economic conditions mean that despite a high loan demand that causes CUs to benefit more from lending, the lending risk also increases. Moreover, CUs have not diversified their revenue sources because almost all CU revenue comes from distributing loans to CU members.

I propose that CUs seek revenue from other sources in order to adjust CU revenue structure. For example: provide counter service, invest in high quality stocks when stock price is low, better utilize assets, land, buildings or CU staff, including the provision of better social welfare for members (life insurance, old-age insurance).

In conclusion, the impact of the global financial crisis can be positive or negative. On the positive side is opportunity to create more benefit. An increasingly higher demand for loans may be an opportunity for CUs to gain more from deposit interest. On the other hand, it may increase risk for CUs, especially the risk from lending. Given these economic conditions, CU management must therefore be undertaken more carefully.