Recent Developments in Thailand

by Chaturon Chaisang

Housing is significant both in economic magnitude and social importance. The major industrial countries clearly recognized this importance by building their economies around the housing sector. The key statistics for economic health are reflected in the number of housing starts and the affordability of interest rates. Likewise, the financial sector is built on this realization so that, for example, in the United States and the United Kingdom the ratios of outstanding mortgage loans to GDP are 50% and 60% respectively. These numbers represent a substantial part of the financial system of their countries.

Over the past two decades, the world has become more globalized with an increase in international integration of markets for goods, services and capital. Globalization is altering the world economic perspective, especially the global financial system, in fundamental ways. Together with the continuing global financial revolution, the financial world is more intricate. Deregulation and liberalization have encouraged further financial innovation which produces new instruments that outrun the reach of regulators.

In addition, financial innovation and deregulation have been accompanied by rapid credit expansion and a substantial increase in bank lending as a share of GNP in many countries. Undertaking domestic financial deregulation before developing successful supervisory and regulatory practices is a major cause of financial crises. Also, financial liberalization undertaken before the soundness of the domestic financial system and macroeconomic policy are established is another factor causing crises.

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MANY HAVE SUFFERED BURSTING REAL ESTATE BUBBLES

In this era, some financial crises have been caused by the bursting asset price bubbles. The world wide real estate boom reached its peak in 1990. In Europe, the European Property Index rose by 400% between 1980 and 1990 while average consumer price inflation went up only 150%. During the same period, the index of urban real estate values in Japan increased by 300%. Nevertheless, since 1990, the massive asset inflation has finally ended followed by the bust period of the real estate cycle, with serious consequences for mortgage lenders. The property value has dropped sharply, at least 20% of its nominal terms in the first year of the crash. The cycle of real estate booms and busts is a recurring event taking place in many parts of the world.

The real estate busts often lead to financial crises which threaten the health of the global financial system. In the late 1980s, an extraordinary number of U.S. financial institutions were classified as insolvent or capital deficient due to aggressive lending, investment practices and deteriorating asset values which resulted in the U.S. savings and loan crisis. Moreover, major banking crises erupted in Scandinavian countries and financial crises also took place in some Latin American countries, caused by poor lending practices in the real estate sector and banking system weaknesses. In the early 1990s, Japan's housing finance sector approached a crisis after its bubble economy burst. Two regional banks, seven housing loan corporations and several credit unions became insolvent due to excessive real estate lending.

Most recently, the turmoil in Southeast Asia has raised the question about the soundness of the financial system. Given the complexity and the pace of innovation in modern financial markets, effective monitoring requires a prudential process of examining and analyzing financial institutions' activities and data. In addition, transparency, accuracy and timeliness of data dissemination should be increased to improve the functioning of the markets. Nonetheless, the region's rapid growth had hidden financial weaknesses which were exposed with rising international integration.

THAILAND SHARES THE EXPERIENCE OF ECONOMIC TURMOIL

The Thai experience of economic crisis is a valuable lesson for countries that have not yet faced this difficulty.

The Thai economy has been in the transition period from an economy based on labor-intensive manufacturing to one of high-skilled, technologically sophisticated production. In the years following the launching of the Uruguay Round Negotiations in 1986, Thailand was responsible for autonomous liberalization actions reported to the General Agreement on Tariffs and Trade (GATT). With the GATT agreement, the world was no longer localized. In trade, the competition is increasingly stiff. In finance, international capital markets are more integrated, resulting in potential volatility of massive capital flows. With a shortage of skilled labor in high-tech industries, Thailand's competitiveness has deteriorated as a new wave of low-cost producing countries has emerged.

After enjoying very high growth rates in the past decade, the Thai economy has been in severe downturn. Since 1996 a number of critical signs have appeared; for instance, a broadening current account deficit and a severe drop in exports. The result has been a fall in aggregate demand and a need to restructure the industrial base. Following the Thai economy downturn, the value of real estate has also fallen. Investment in the housing sector has dropped drastically due to the moderation in economic activity, and a fall in housing demand combined with an oversupply of housing in the market. In the first half of 1997, newly launched housing projects declined by 70% compared to the same period in the previous year. Under these circumstances, many housing developers experienced serious cash flow problems and, therefore, are unable to repay their debts, plunging the financial sector into crisis.

Impact of Liquidity Crisis

The Thai financial market has been adversely affected by a liquidity crisis triggered by the failure of some financial institutions due to excessive real estate lending and consumer credits. Financial institutions have carried a huge burden of nonperforming loans. Since 1997 the nonperforming loans of the Thai commercial banks and finance companies

Table 1. Key Features of Financial Institutions in Thailand (end 1996)

Financial Institutions	*Operations Began*	*No. of Institutions*	*No. of Branches*	*Total Assets*	*Total Deposits*	*Total Credits*	*Home Loans*	*Home Loans to Total Credits (%)*
Government Housing Bank[1]	1953	1	169	214,167	101,793	198,500	190,461	96.0
Credit Foncier Companies	1969	12	0	3,518	6,321	6,742	2,576	38.2
Life Insurance Companies	1929	13	1,216	145,173	116,739	31,847	6,678	21.0
Commercial Banks [2]	1888	29	32,171	5,626,661	3,683,108	4,825,057	432,641	9.0
Finance Companies	1969	91	71	1,811,938	1,040,075	1,488,188	62,617	4.2
Government Savings Bank	1946	1	548	237,442	208,753	56,257	684	1.2
Bank for Agricultural & Agricultural Coop.	1966	1	629	272,067	118,417	165,622	0	0.0
Industrial Finance Corp. of Thailand	1959	1	23	143,803	0	103,234	0	0.0
Agricultural Cooperatives	1916	3,100	0	34,180	9,540	23,290	0	0.0
Savings Cooperatives	1946	1,200	0	254,500	91,400	212,600	0	0.0
Pawn Shops	1866	390	0	15,500	0	14,088	0	0.0
Small Industries Finance Corp.	1992	1	1	1,888	0	698	0	0.0
Export-Import Bank of Thailand	1993	1	2	34,624	0	32,533	0	0.0
Total		4,841	5,830	8,736,359	5,376,138	7,158,567	695,657	9.7

[1] Composed of 15 Thai banks, 13,138 branches, 14 foreign bank branches, and 19 BIBF Units.
[2] Composed of 47 main branches and 133 subbranches.

Source: GHB, BOT

have been increasing continually. Moreover, 58 insolvent finance companies, out of the total 91 companies, were suspended by the central bank for restructuring, recapitalizing and laying down the groundwork for the rehabilitation process. As of December 1996, assets of finance companies were 1.87 trillion Baht (exchange rate @25/$) which represented 27.8% of financial sector assets. (See Table 1.)

Reflecting the tight liquidity in the financial market, mortgage interest rates in Thailand have been raised several times. As a result, the accessibility of prospective home purchasers to affordable mortgage funds has been diminished. Moreover, the effect of the debt crisis on the housing finance sector is clearly linked to budgetary stringency and deflationary policies. The housing sector, therefore, suffers from not only the lack of capital resulting from tight liquidity but also from cuts in private- and public-sector investments.

The ongoing currency volatility has meant that the baht has fallen by about 45% since it was floated on July 2, 1997. It is the result of inevitable short-term shocks following one-time structural change. However, with macroeconomic policies adopted to help stabilize the Thai baht, involving fiscal retrenchment, improved exchange rate management and export promotion, the government is confident that it is now moving toward a more stable period. The baht stabilization will re-establish the international capital inflow which should improve the liquidity of the country. In addition to boosting Thai exports, the recent baht depreciation has made Thai properties 45% cheaper for those purchasing with foreign funds; this could lead to more property transactions, thereby injecting foreign investment capital into Thailand's real estate sector as well. (See Figure 1.)

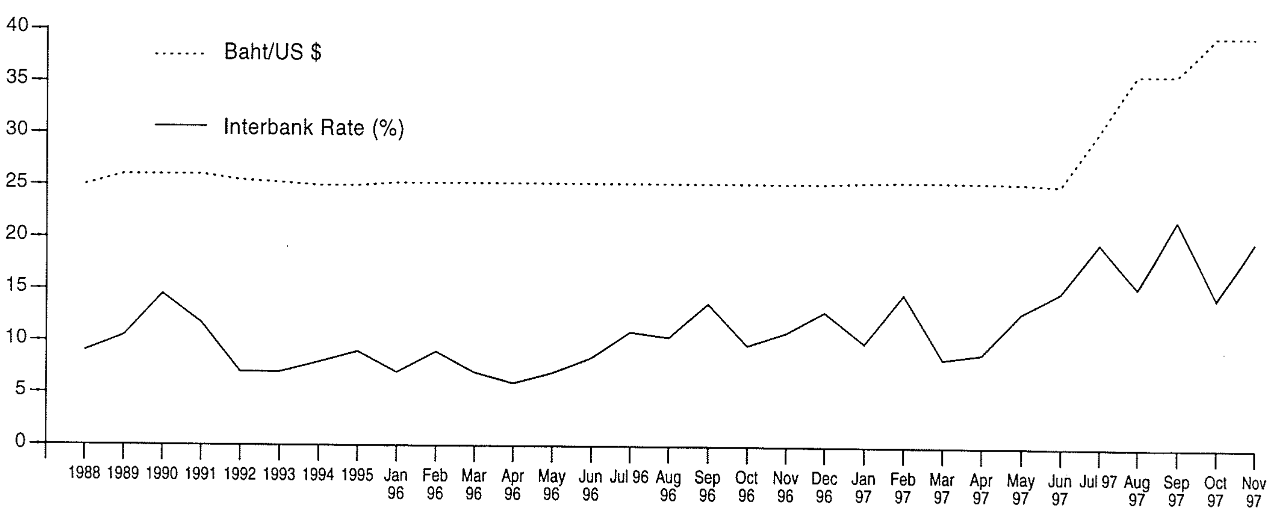
Even though we are now facing economic sluggishness, the government is attempting to solve the liquidity problem and further develop the housing finance system. Some of the important policy measures introduced to boost the Thai housing finance market are as follows;

CORRECTIVE MEASURES TAKEN

1. We established a secondary mortgage market in Thailand. Since legislative frameworks are requisite for facilitating operations of the secondary mortgage market, two laws regarding securitization were enacted in June 1997. The first is the Decree on Special Purpose-Vehicle for Asset Securitization and the second is the Decree on Secondary Mortgage Corporation. (Editor's note: See article, page 3, in the *Housing Finance International*, September 1997 issue.)

The introduction of a secondary mortgage market is intended to channel funds from the capital market to housing finance. It can address the problem that housing finance

Figure 1. Interbank Rates and Exchange Rates 1989–1997



institutions lend for long periods, while their main sources of funds are usually short-term savings and time deposits. The operation of a secondary mortgage market which will ensure a constant flow of capital to mortgage lenders can help solve the problem of this mismatching. Furthermore, funds from the capital market will increasingly flow to the housing finance sector, and thus increase the availability of mortgage loans.

2. The government passed a regulation allowing the private sector to set up mutual funds to invest in real estate businesses, so-called Real Estate Investment Trusts (REIT). These funds must be invested in real estate and will become a more important source of capital for the real estate sector.

3. The state-owned Property Loan Management Organization (PLMO) was set up as a means of providing liquidity to the property sector and helping to ease the level of non-performing loans held by finance companies. The PLMO mobilizes funds from the public through the issue of zero-coupon bonds and uses the proceeds to purchase at discounted prices for resale property loans, with their collaterals, from financial institutions. This will provide a credit facility for financial institutions to unload their property sector loans from their balance sheets and assist property developers in continuing investment projects via debt restructuring.

   Property loans eligible for purchase by the organization must be properties which are already in the progress of development and whose value must be strictly reappraised. Furthermore, financial institutions selling the loans must guarantee 50% of the remaining debt, as well as extend further credit to enable the completion of the projects. PLMO will charge property loan borrowers at market rates. The debtors stand to benefit from the restructuring of the debt, with the added flexibility that principal and interest payments may be extended until the project is sold; but they will be required to reduce the retail price to realistic levels and put forward clear marketing plans.

   Since being established, the PLMO has advanced 500 million baht to acquire housing loans of three projects. In the long term, the PLMO is likely to be transformed to the Asset Management Corporation (AMC) with its aim to manage, sell, or transfer assets and collaterals transferred from problem financial institutions. This is comparable to the Resolution Trust Corporation (RTC) in the U.S. and the Housing Loan Administration Corporation (HLAC) in Japan which were established to manage real estate assets of insolvent financial institutions.

4. To resolve the crisis of confidence, assure depositors and creditors of the solvency of financial institutions, and enhance the stability of the country's economic and financial system as a whole, the Financial Institutions Development Fund (FIDF) has undertaken necessary steps to protect depositors and creditors of financial institutions by insuring principal and interest payments to all depositors and creditors.

5. The entry of the International Monetary Fund (IMF) provides the basis for a $17.2 billion standby credit arrangement to improve Thailand's economic condition, restore confidence of investors and restructure Thailand's financial industry. The IMF, together with the World Bank are cooperating with the Thai government to formulate strategies to restructure the whole economy. The plan will cover upgrading technology in the industrial and agricultural sectors, boosting productivity, training programs for unskilled labor, tightening public-sector budgets and employing credit restrictions.

Role of the Financial Restructuring Authority

The government together with technical assistance from the World Bank and IMF has created the agency called "Financial Restructuring Authority" (FRA) as an independent body that would focus on cleaning up the problems in the financial sector and supervise 58 ailing finance companies. By maintaining a tight monetary stance and fiscal discipline, as well as progressive restructuring of the financial, export and industrial sectors, the overall economy including the real estate sector is expected to achieve a firm recovery within one-to-two years.

The Financial Restructuring Authority (FRA) is an independent entity with objectives as follows:

1. To review the rehabilitation plans of suspended finance companies.
2. To assist bona fide depositors and creditors of suspended finance companies.
3. To administer the liquidation of finance companies which the FRA considers it unable to rehabilitate.

The board of the FRA, which is appointed by the Minister of Finance comprises six persons as follows:

- A chairman who is a prominent person from the private sector.
- Three experts from the private sector, who must not be directors or otherwise have any control of financial institutions. One of them shall be appointed as the Secretary General.
- A representative from the Ministry of Finance.
- A representative from the Bank of Thailand.

The FRA's procedures in financial restructuring are:

1. The announcement of the Committee to Supervise the Mergers and Acquisition of Financial Institutions shall be observed as guidelines in considering rehabilitation plans, until any further changes.

2. While the suspended finance companies are under the supervision of the FRA, the powers of the Bank of Thailand and the Ministry of Finance relating to the restructuring of finance companies shall be transferred to the FRA, which will then have comprehensive and absolute power.

3. In the case where the FRA approves a rehabilitation plan of any finance company, such plan shall be submitted to the Minister of Finance for approval. If the Minister, upon recommendation by the Bank of Thailand, approves the plan, such finance company will be allowed to resume its operations as normal and will subsequently be brought under the Bank of Thailand's supervision.

4. The FRA shall sell, through public auction, assets of a finance company which is unable to be rehabilitated. Once the selling of assets is completed, the FRA shall appoint a liquidator.

The initial capital of the FRA is 500 million baht, which is a grant from the State. In each accounting period, should the FRA incur losses, the State will render financial assistance as needed.

Asset Management Corporation

The final institution set up to handle the crisis is the Asset Management Corporation. The AMC is a juristic entity with initial capital of 10 million shares, at 100 baht per share, totaling 1,000 million baht. The Ministry of Finance will purchase this amount of shares immediately after the setting up of the corporation and will gradually raise capital as needed, to maintain the debt-equity ratio at a moderate level. Private sector participation in the Corporation is encouraged.

The Corporation will primarily aim to bid for impaired assets of companies which the FRA deems unviable, but the Emergency Decree also empowers the Corporation to enter a bid for the purchase of good assets as well to support a competitive bidding process. Moreover, the Emergency Decree also empowers the Corporation to purchase impaired assets of financial institutions whose shares have been acquired and are under the control of the Financial Institution Development Fund (FIDF) in order to speed up the recovery path of the institutions.

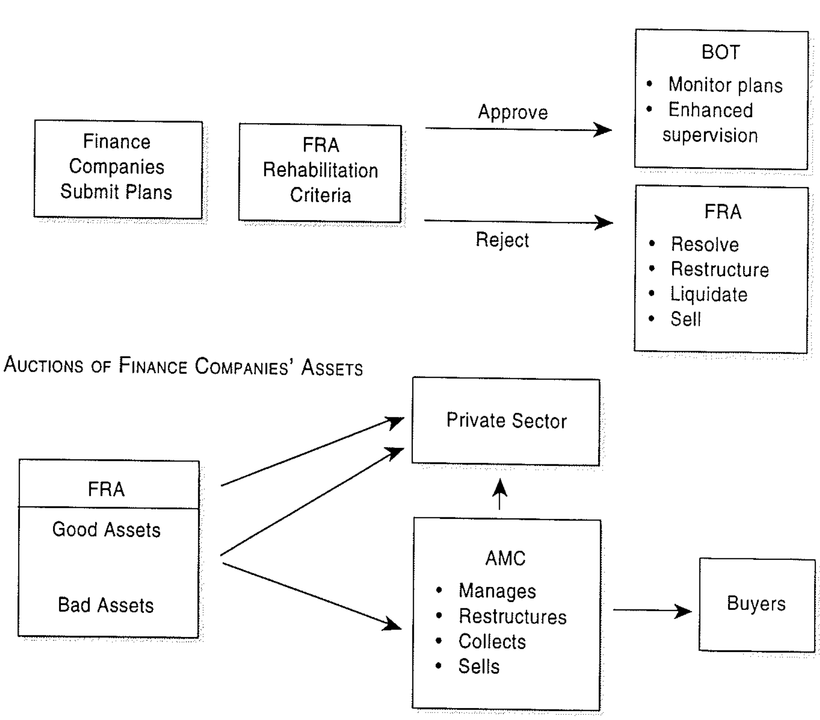
The Corporation will allow creditors of nonviable finance companies to convert proceeds from the sale of assets into equity, so as to minimize cash outflows.

The Corporation will manage assets purchased so as to enhance their value or will foreclose the collaterals and resell them as soon as possible.

To facilitate market-oriented operations, the Corporation is structured to have a board of directors and a manager appointed from prominent persons from the private sector.

The resolution plan for the finance companies is summarized in Figure 2.

Figure 2. Resolution for 58 Finance Companies



Finally, recent crises appear to have been the inevitable by-product of the transformation of international finance that has been taking place during the past 10 years. The global financial system has become stronger and more resilient. As the major industrial countries restructure their financial regulation, and surveillance activities in accord with developments in international markets, Thailand has also initiated financial reform to better withstand the vicissitudes of an open international financial environment. The financial sector has been liberalized through the BIBF, and there are plans to adopt further liberalization but with reform regulations in line with those of global trends.

The Thai government's financial policies, as outlined above, will enable Thai housing finance to cope with current problems and the new challenges emerging from the global market, and to be well positioned to play an important role in the future development of Thailand.

Although the country is in a tough period of economic crisis, it will improve as we move along. In the future it will be important to provide useful information and measures to prevent crises as well as ways of responding to them when they do occur. It is important to provide insights so that all participants can contribute to a dynamic global housing finance system.