

MGCCC jitters in Korea to continue while the government will try to prevent a bank run

MGCCC unrest will continue and get bigger once special inspections begin as default rates and non-performing loans (NPLs) are expected to rise even higher. But the government will lay out a rescue plan so that this issue does not escalate further to shake the financial system



MG Community Credit Cooperatives is a Non Bank Financial Intermediary in Korea

MGCCC began as a credit union back in 1963 when the New Village Movement began and MGCCC has been deeply rooted in the community since then. Asset amount (284 trillion KRW) is about twice bigger than the savings banks and it has a total of more than 1,300 branches. When the PF insolvency problem emerged last year, it was already well known that the weakest link would be local savings banks and community banks, including MGCCC. We also have flagged the risks in our previous notes and argued that the issue would reemerge as tight credit conditions continue. Please see details ([Strong headwinds ahead for South Korea's housing market](#), [Corporate debt is a concern for the economy](#)). Given the unique status of MGCCC – established as part of rural

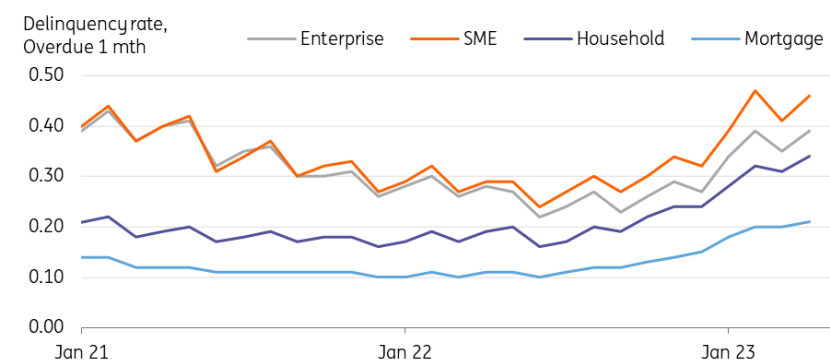
development project, MGCCC is not supervised by the FSS. When all mortgage measures were tightened between 2020 to 2022, MGCCC was able to apply looser lending standards than other banks and then it became the last resort for SMEs and self-employed to still take out loans. Also, they are governed by the Ministry of Interior and Safety, their detailed information was not directly reported to financial regulators. Amid the soaring delinquency rate, various irregularities began to emerge, and authorities tightened monitoring and inspection more closely.

Delinquency rates soared due to poor risk management

Recently, MGCCC's default rates soared from 1.9% as end of 2021 to 6% at the end of the second quarter of 2023 and the Ministry decided to conduct a special inspection on 100 out of 1,300 branches in July and August. Once the inspection begins then more bad cases will be revealed and the size of NPL will rise even more. Given the size of assets and provisions, we think the NPL issue will be sorted out eventually and delinquency rates will come down to a manageable level by the end of this year.

The Korea Federation of Community Credit Cooperatives is selling 700 billion won worth of bad loans to its subsidiary, loan company MCI while KAMCO will also purchase 500 billion won worth of bad loans from MGCCC. Financial authorities will come out to support work-outs and restructuring if further action is necessary.

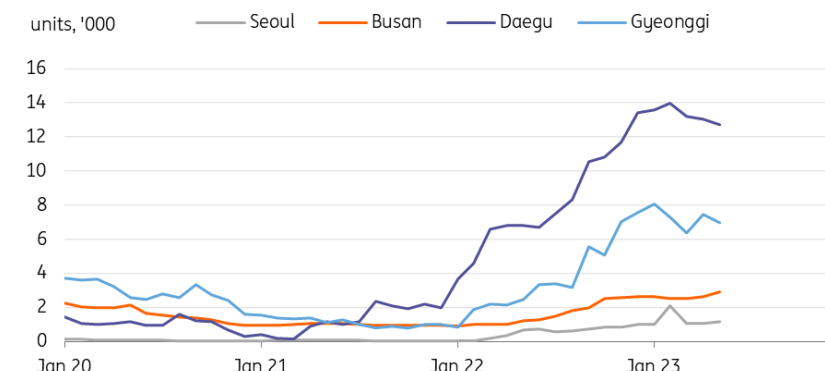
Banks' delinquency rates also rising, but lower than the MGCCC's rates



Source: CEIC

We estimate that MGCCC branches, which are based in areas where unsold units have increased the most would have a high delinquency rate, and the consolidation of branches is expected to continue for the time being.

Weak housing market is the main cause of the MGCCC's high delinquency rates



Source: CEIC

Bank run is a psychological issue once it gets out of control

But the bank run is whole another issue. The government will do its best to calm depositors' anxiety and prevent them from withdrawing their money. We think the government will put all possible and effective options on the table from the very beginning. The government learned from last year's experience how things could go wrong if it did not respond in time. The government already has offered tax credits if depositors apply for savings again to those who have terminated savings and is doing a large public campaign to inform them that all assets and liabilities at the closing branch will be transferred to the KFCCC or other branches and deposits up to 50 million won are protected by the KFCCC law.

The BoK watch

At this point, we think the market jitters will continue for a while and probably get bigger, but it still won't escalate into a financial crisis by rescue plans by the government and financial authorities. The Bank of Korea will not respond to the situation with rate actions at next week's meeting, because it may give the wrong signal to the market, but the BoK will spend a considerable amount of time explaining the situation and calm down the market jitters. We have argued no additional hike from the BoK is expected this year and a rate hike may be possible in the fourth quarter, and the current situation further confirms our view. But the communication of the BoK will become more complicated from now on. Since inflation remains above the target of 2% and upside risks are still present, the BoK would not want to give a signal of easing too early. But at the same time, the BoK should convince the market that restrictive financial conditions do more good than harm at this point.

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