

Vietnam at a glance

A closer look at the banking system

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- ▶ **2Q GDP rises to 5.0% y-o-y from 4.8% in 1Q, but the growth rate is still sub-trend**
- ▶ **June HSBC PMI slows to 46.4 from 48.8 in May, mostly on low domestic demand; a weaker China adds another drag**
- ▶ **With the Asset Management Company expected to begin operating on 9 July, we take a closer look at Vietnam's banking system**

Slow, steady progress

No country can sustain rapid growth rates without a functioning capital market to allocate capital efficiently. Vietnam's recent sluggish growth rates are reflective of decades of rapid economic growth with a financial system lagging behind in development. The banking sector has transformed since the late 1980s from one in which the State Bank of Vietnam (SBV) functioned both as a central bank and a commercial bank to one now with diverse participants ranging from state-owned to fully foreign-owned banks. But in the past decade, most of the country's credit was allocated to enterprises that did not invest capital productively. In this report, we examine the source of credit extended in the past decade. Our analysis shows that state-owned banks provided most of the loans to the economy.

The recent lending growth slowdown reflects both the government's commitment to improve the efficiency of the economy and diffuse the build-up of bad debts. A high NPL (non-performing loans) ratio and anaemic risk appetite caused the year-to-date (Jan-Jun) credit growth rate to be a meagre 3.31%. The overnight interest rate has hovered near 1% owing to high liquidity. As a first step to reform the financial system, the Prime Minister approved an asset management company (AMC) to resolve half of the bad debts from banks. The AMC is expected to begin operations on 9 July 2013.

For now, the economy operates below potential and will continue to do so until more progress on management takes place. While Vietnam's economy has made a vital U-turn in the past two years, urgent work remains to create an economic system that fosters Vietnam's productive enterprises.

Low-hanging fruit

- ▶ Economic indicators show that output is below potential; this is because of a deleveraging process that began in late 2010
- ▶ State-owned banks, while still dominant in the share of total lending, have reduced their positions significantly
- ▶ The NPL ratio has fallen since 2012, but domestic firms are still underperforming; the AMC is designed to alleviate the debt burden

Table 1. HSBC Vietnam Manufacturing PMI and its sub-indices

	Jun-13	May-13	Apr-13	Long-Term Average
PMI Index	46.4	48.8	51.0	49.3
Output	45.0	48.9	51.5	49.6
New Orders	44.9	49.1	51.8	49.4
New Export Orders	49.3	51.3	50.1	49.8
Backlogs of Work	44.6	43.9	48.0	47.9
Stocks of Finished Goods	51.7	47.1	49.2	49.1
Employment	47.0	49.2	51.9	50.1
Output Prices	44.1	49.8	48.0	50.6
Input Prices	51.0	53.2	55.1	56.7
Suppliers' Delivery Times	51.0	50.0	50.2	51.2
Stocks of Purchases	49.0	46.4	47.6	47.5
Quantity of Purchases	45.5	48.2	52.5	48.9

Source: Markit, HSBC; Less than 50 and falling Less than 50 and rising or same Greater than or equal to 50 and falling Greater than or equal to 50 and rising or same

A glance at Vietnam's latest HSBC manufacturing PMI readings might make one's heart skip a beat: activity continues to contract. The June reading deteriorates further to 46.4, mostly because of weak domestic activity. The new order sub-index is particularly ugly in June at 44.9, a huge slide from 49.1 in May. Even employment, which has held up well thus far, slipped further to 47.0 from 49.2. Managers are taking no chances and reducing their purchases sharply. The impressive acceleration in April has since disappeared, mostly owing to persistent weakness in domestic demand. The slowdown in China and Korea has added another blow.

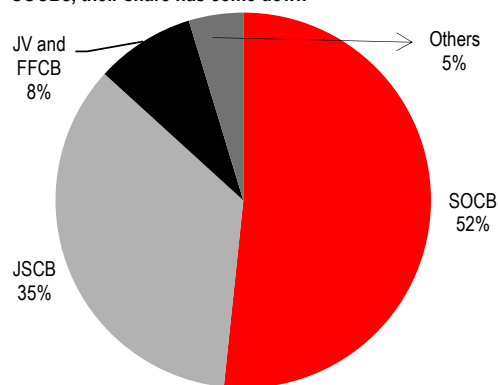
But the short-term pain is expected – Vietnam's road to economic recovery is likely to be bumpy because of the country's ongoing deleveraging process. Most observers are not disappointed with the 2Q 2013 GDP growth print of 5.0% y-o-y. What is most important is whether the short-term (but very acutely felt) pain is going to be rewarded by long-term gains: a more efficient economy that is supported by a financial system that rewards productive investment. To answer this question, we take a closer look at Vietnam's banking system.

Table 2. Vietnamese banking sector

Ownership	Name of bank	Licence date	Charter capital (VND bn)
SOCB	Vietnam Bank for Agriculture and Rural Development	1996	29,154
SOCB	Vietnam Bank for Industry and Trade	2009	26,281
SOCB	Joint Stock Commercial Bank for Foreign Trade of Vietnam	1996	23,174
SOCB	Bank for Investment and Development of Vietnam	2012	23,011
SOCB	Housing Bank of Mekong Delta	1997	3,055
JSCB	Bao Viet Bank	2008	1,500
JSCB	Petrolimex Group Bank	1993	2,000
JSCB	Nam A Commercial Bank (NAMA Bank)	1992	3,000
JSCB	BACA Commercial Bank	1994	3,000
JSCB	Vietnam Capital Bank	1992	3,000
JSCB	Orient Bank (OCB)	1996	3,000
JSCB	Global Petro Commercial Bank	1993	3,000
JSCB	Kien Long Bank	1995	3,000
JSCB	Viet Nam Thuong Tin Bank	2006	3,000
JSCB	Western Rural Commercial Bank	1992	3,000
JSCB	Great Trust Bank	1993	3,000
JSCB	TienPHong Bank	2008	3,000
JSCB	Nam Viet Bank	1995	3,010
JSCB	Saigon bank for Industry & Trade	1993	3,040
JSCB	Vietnam A Bank (VIETA Bank)	2003	3,098
JSCB	Great Asia Bank	1993	3,100
JSCB	Mekong Development Bank	1992	3,750
JSCB	Southern Bank	1993	4,000
JSCB	Anh binh Commercial Bank (ABB)	1993	4,199
JSCB	Vietnam International Commercial Bank (VIB)	1996	4,250
JSCB	Eastern Asia Commercial Bank (EAB)	1992	5,000
JSCB	OCEAN Bank	1993	5,000
JSCB	Vietnam Prosperity Commercial Bank (VPBank)	1993	5,050
JSCB	Housing development Commercial Bank (HD Bank)	1992	5,300
JSCB	Southeast Asia Commercial Bank (SeAbank)	1992	5,334
JSCB	LienViet Post Bank	2008	6,400
JSCB	Maritime Commercial Bank	1991	8,000
JSCB	Vietnam Technological and Commercial Bank	1993	8,788
JSCB	Saigon-Hanoi Commercial Bank	1993	8,865
JSCB	Asia Commercial Bank (ACB)	1993	9,376
JSCB	Military Commercial Bank (MB)	1994	10,000
JSCB	Saigon Bank (SCB)	2001	10,584
JSCB	Saigon Thuong Tin Commercial Bank- Sacombank	1991	10,740
JSCB	Vietnam Export-Import Commercial Bank (Eximbank)	1992	12,355
JV	VID Public Bank	1992	\$62.5mn
JV	INDOVINA Bank Limited	1990	\$165mn
JV	VINASIAM Bank	1995	\$61mn
JV	Vietnam-Russia Joint Venture Bank	2006	\$168.5mn
FFCB	Shinhan	2008	7,547
FFCB	HSBC	2008	3,000
FFCB	Standard Chartered	2008	3,000
FFCB	ANZ	2008	3,000
FFCB	Hong Leong	2008	3,000

Note: SOCB= state-owned commercial banks (5 banks); JSCB = joint stock commercial banks (34 banks); JV = joint venture (4 banks); and FFCB = fully foreign-owned commercial banks (5 banks)
Source: SBV, HSBC

Chart 1. While most lending in Vietnam is still dominated by SOCBs, their share has come down



Source: OECD, SBV, HSBC

Table 1 contains a list of Vietnam's 48 banks, ranging in size and ownership. Vietnam's largest five commercial banks are majority state-owned (SOCBs) and were created post the late 1980s reform period to fulfil specialised policy lending functions. Traditionally, SOCBs' customer base has been state-owned enterprises (SOEs), but they have expanded into more traditional commercial banking activities and are no longer considered formal policy institutions (The World Bank, 2001; ASEAN Economic Bulletin, 2009; SF Fed, 2011).

Chart 1 shows that SOCBs dominate lending in Vietnam (data for year 2011). Note that while 52% of total loans originated from SOCBs, their market share has declined significantly since 2001. Chart 3 shows that SOCBs' share declined from close to 80% of total loans in 2001 to 52% in 2011.

Joint-stock commercial banks (JSCBs) are more diversified than SOCBs because they are established under a joint venture contract with capital by a Vietnamese bank and one or more foreign bank (foreign banks are limited to 49% ownership). Their customer base tends to be small and medium-sized enterprises (SMEs) and retail finance. Their market share has risen significantly since 2001 from 9% to 35.3% in 2010. Since 2006, the State Bank of Vietnam (SBV) allowed five foreign banks to operate as wholly foreign-owned banks, including HSBC.

Chart 2. Vietnam leveraged up significantly from the early 2000s until 2010 but has since de-levered drastically

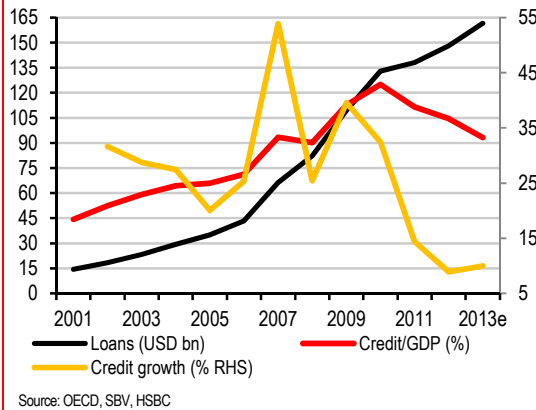
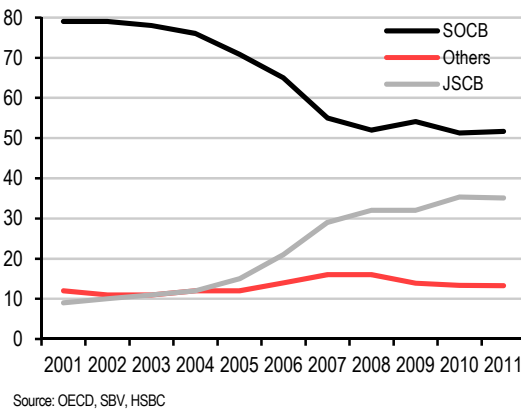


Chart 3. SOCBs are still major players but their share of the credit space is declining (% of total loans)



Vietnam's banking system has developed rapidly: total credit rose from USD14.5bn in 2001 to

Table 3. Bad debts (according to the SBV)

	USDbn	NPL ratio	Credit growth (% y-t-d)
Jun-13	7.6	4.7	3.3
Feb-13	8.3	6.0	-0.2
Jun-12	12.7	8.6	8.9*

Source: Saigon Times Daily, Bloomberg, Reuters, HSBC; * denotes end of 2012 credit growth

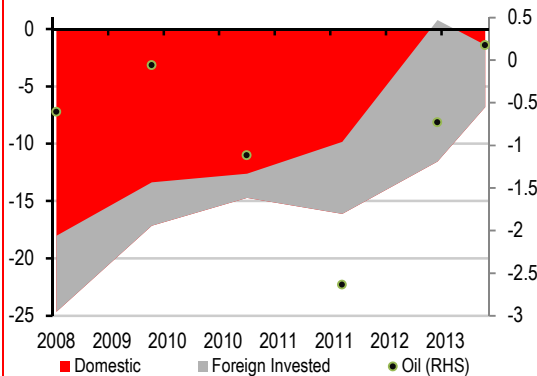
USD133bn in 2010. Much of the issue surrounding the current economic malaise traces its origins to this rapid leveraging process, which began in the early 2000s. During this period, the country's credit to GDP ratio rose sharply from 44% in 2001 to 125% in 2010. A report of Vietnam's top 200 firms in 2007 by UNDP shows that most of the lending to SOEs was reckless, in most cases firms did not have to provide collateral to acquire the loans. In cases where collateral was provided, the banks often failed to conduct proper due diligence, assuming the implicit backing of the state in the event that the loan defaulted.

After two episodes of high inflation (23% y-o-y in August 2011), the government realised that Vietnam could no longer bear the cost of a troubled banking system, inefficient SOEs and unproductive public investment.

Chart 2 reflects the consequences of the government's resolve. Credit growth has dropped sharply in the past two years as the government tightened public investment and the private sector held back consumption. As a result, the credit-to-GDP ratio (red line) dropped to 104.5% in 2012 from 125% in 2010. If credit expands by 10% this year, the credit-to-GDP ratio will drop further to 93.3%.

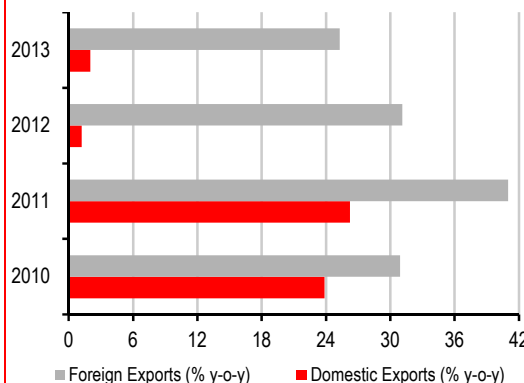
Despite the improvement in the credit-to-GDP ratio, NPLs continue to weigh on the banking system. Some of the loans were non-collateralised or backed by assets, such as real estate, that were booked at inflated values. Many of them turned into non-performing loans when asset prices declined. Given limited data, it is difficult to gauge the exact NPL ratio of Vietnam's banking sector. Table 3 shows estimated bad debts in USDbn based on the SBV's stated NPL ratios for the whole banking system. According to statements from the SBV, the current NPL ratio is 4.7, which is equivalent to USD7.6bn of bad loans; however, some rating agency puts the estimate as high as 20% of GDP.

Chart 4. Vietnam is both more and less stable; NPL ratio is high but the trade balance has improved significantly; higher refining capacity and weaker demand drove oil balance into surplus (USDbn)



Source: CEIC, HSBC

Chart 5. Domestic firms are suffering from weak credit conditions; foreign firms with ample liquidity are excelling



Source: CEIC, HSBC

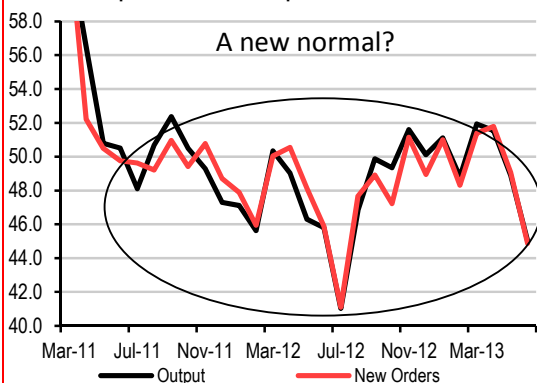
The government has stated that it will not pay for the recapitalisation of the banks as it is committed to fiscal consolidation. Moreover, the central bank is unlikely to use monetary stimulus to save the poorly managed banks as the SBV tries to contain inflation and gradually wean SOEs off the state's support. The government already reduced public spending and investment to cut the budget deficit, which leaves no room to support the banking sector. This means that banks will have to make their own efforts to recapitalise by selling assets or securing help from external sources. Aid agencies such as the World Bank, the Asian Development Bank and the IMF have stated their willingness to lend, should Vietnam require support. But this seems like an unlikely option as

it risks sending the signal that the government has run out of solutions. Given Vietnam's underdeveloped insolvency regulations, banks would prefer to roll over bad debts rather than liquidate them below book value.

The SBV rolled out a banking sector reform roadmap called Decision 254. First it categorised banks based on their fiscal health. The AMC is part of the government's effort to fix banks that were identified by the SBV in this process as having high levels of bad debts. The plan is to issue securities to banks to buy the bad debts at book value. The AMC is due to operate on 9 July.

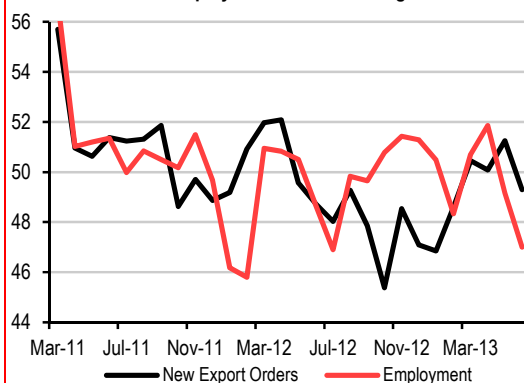
What is noteworthy during this period is that Vietnam's fundamental competitiveness has

Chart 6. Output has been below potential since 2011



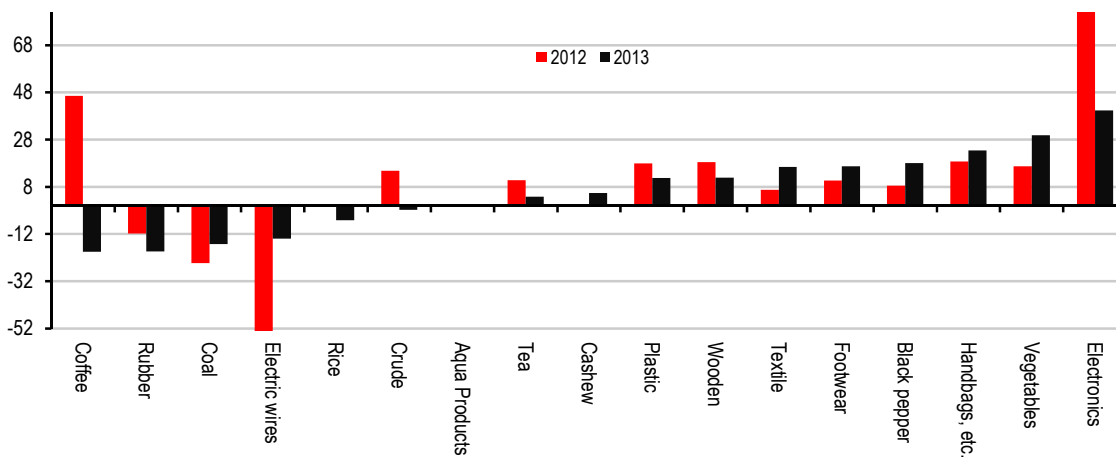
Source: Markit, HSBC

Chart 7. A loss of employment shows the drag intensifies



Source: Markit, HSBC

Chart 8. Weak global prices have dragged down commodity exports while manufacturing rose (exports % y-o-y)



Source: CEIC, HSBC

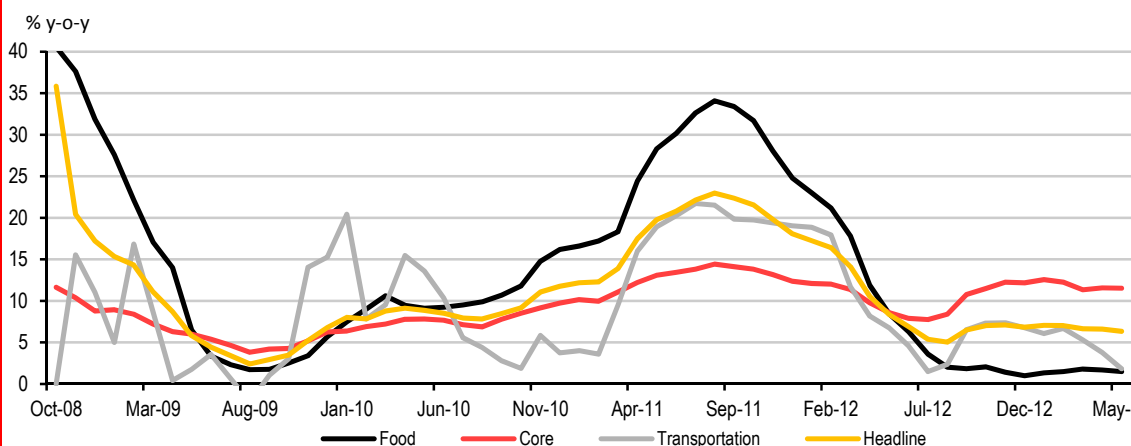
remained. For example, rising energy production capacity has improved the oil trade balance, albeit slowly and at levels below potential. Year to date, the country has an oil trade surplus of USD 175m. Rising refinery investment and investment into wind power generation will raise Vietnam's energy independence. But this won't be enough: the country's supply of electricity is still significantly below demand.

While the cooling of the economy has exacerbated the country's NPL problem, the macroeconomic picture has become more stable. Vietnam is running a year-to-date trade deficit of USD1.4bn

despite contracting commodity exports and sluggish external demand. This is because of strong investment in manufacturing exports. But as Chart 5 shows, domestic firms are not doing as well and strong export growth has been primarily driven by foreign firms.

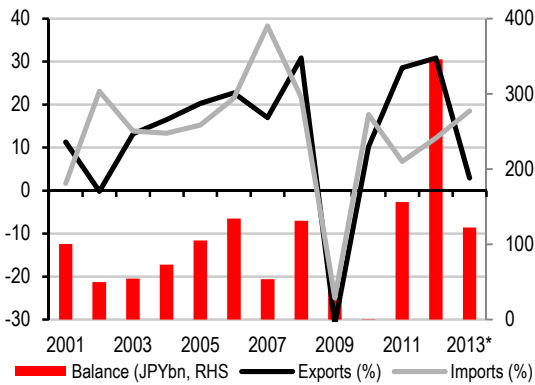
Inflation has also been contained, staying in single digits. Headline inflation rose slightly to 6.7% y-o-y from 6.4% owing to higher service costs. We expect inflation to be contained thanks to weak commodity prices. The SBV recently adjusted the VND:USD reference rate by 1% after keeping the rate steady since end 2011, but we do

Chart 9. Consumers' and firms' demand for food have been low, driving inflation down. Weak global commodity prices also kept transportation costs steady (inflation % y-o-y)



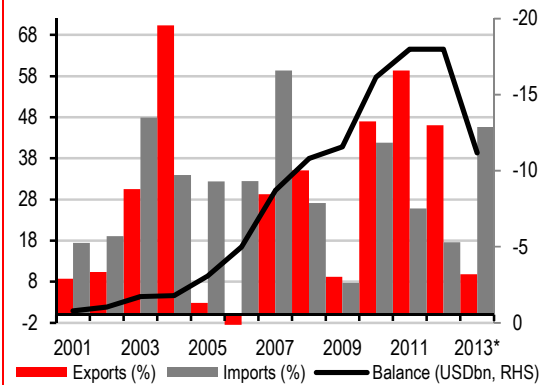
Source: CEIC, HSBC

Chart 10. Trade relations with Japan are increasing thanks to a surge in manufacturing investment



Source: CEIC, HSBC; * Only data until May

Chart 11. The trade deficit with China has risen; Vietnam's exposure to China demand is not as high as US, EU and Japan



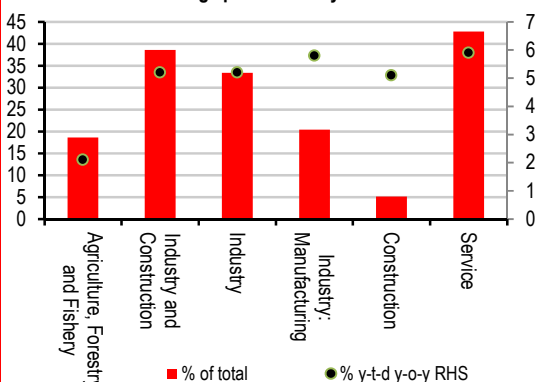
Source: CEIC, HSBC; * only data until May

not think it will significantly affect inflation as the supply and demand dynamic is stable (see ['Vietnam: A little nudge: deposit caps and VND/USD rate lowered'](#), 27 June 2013).

Vietnam continues to attract high FDI inflows. Year-to-date registered FDI rose by 22% to USD5.8bn with most of the investment coming from Japan. Charts 10 and 11 show that Vietnamese imports from both Japan and China rose, reflecting the trend that more new investment in manufacturing is flowing to Vietnam from China and Japan. As such, even though credit growth has contracted on a real basis, the employment picture in Vietnam has not deteriorated significantly thanks to new investment.

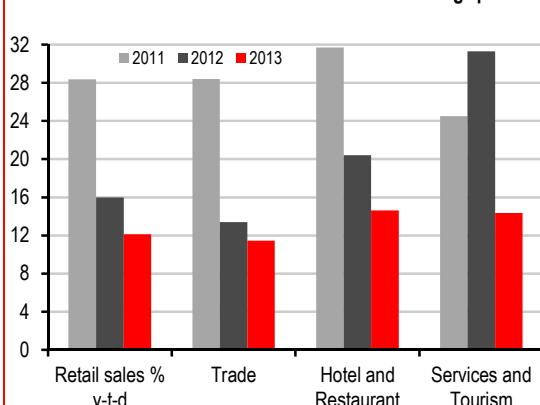
While Vietnam is holding up better than expected during the deleveraging process, this does not mean the situation is sustainable. Whether Vietnam's current growth sacrifice is worthwhile remains to be seen. So far, the government appears to be committed to improving the management of the country by gradually improving the capacity of its institutions. The SBV is slowly making progress in its management of monetary policy. The appointment of two new technocrats to the Politburo will hopefully translate to more efficient governance of the economy (see ['Vietnam at a glance: Getting the house in order'](#), 3 June 2013).

Chart 12. 2Q 2013 GDP growth was 5.0% y-o-y; manufacturing and services are holding up the economy



Source: CEIC, HSBC; Note that Vietnam recently rebased its GDP to 2010 year, which makes statistical analysis difficult as it only released two quarters of data

Chart 13. Retail sales have decelerated but are not falling apart



Source: CEIC, HSBC

Table 4. Main HSBC Forecasts

	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013f	Q3 2013f	Q4 2013f	2012	2013f
GDP (% y-o-y)	4.8	4.7	5.4	5.5	4.8	5.0	5.1	5.3	5.0	5.1
CPI, average (% y-o-y)	16.0	8.6	5.6	7.0	6.9	6.6	5.9	3.9	9.3	5.8
Trade balance (% GDP)	0.9	-1.1	0.9	1.4	0.8	-1.0	-1.8	-0.4	0.2*	-3.5*
OMO rate, end quarter (%)	13.0	10.0	8.0	7.0	6.5	6.0	6.0	6.0	7.0	6.0
VND/USD, end quarter	20,900	20,905	20,860	20,843	20,935	21,000	21,000	21,000	20,843	21,000

*Denotes year-end in USDbn
Source: CEIC, HSBC estimates

We remain watchful of Vietnam's progress, which so far has been painful, especially for the SME sector, but necessary to improve the efficiency of the country's investments and build a brighter future.

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