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Regulatory pressures persist for Vietnamese banks despite positive performance in 2019

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In recent times, whenever Vietnam is mentioned in the headlines, it usually refers to the country being a beneficiary of the ongoing US-China trade war – causing a surge in Vietnamese exports as corporations seek a manufacturing haven. The country even clocked in an unprecedented 7.31% growth for GDP in the 3rd quarter this year[1], contributing to raising the nine-month GDP to the highest level over the past nine years. However, if we take a closer look, the Vietnamese banking system is definitely an area of interest – where the State Bank of Vietnam (SBV), the nation's central bank, attempts to stimulate Vietnamese commercial banks and ultimately the country's economy. In the past, the SBV has been credited for reducing the non-performing loan (NPL) ratios of Vietnamese banks from 3.61% in 2013 to 2.18% in 2018. In the present, the current agenda for SBV is to improve the regulatory environment for Vietnamese banks through increased macroprudential supervision, imposing a Basel II-compliance on the institutions. As the Jan 2020 deadline for the Basel II requirements loom closer, we analyze Vietnamese banks' performance by observing the time series for the NUS-CRI Aggregate (median) 1-year Probability of Default (Agg PD) for publicly-listed Vietnam-domiciled commercial banks in Figure 1 below.

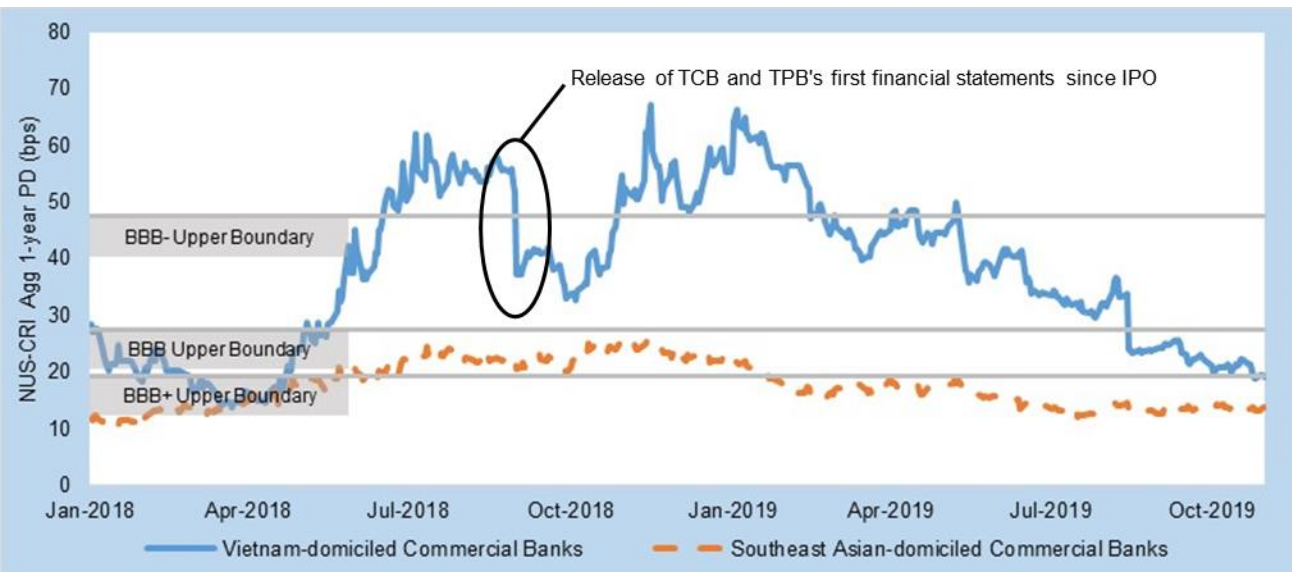

Figure 1: NUS-CRI Aggregate 1-year PD for Vietnam-domiciled commercial banks and Southeast Asia-domiciled commercial banks from Jan 2018 to present, NUS-CRI PD implied rating boundaries[2]. *Source: NUS-CRI.*

In general, we observe that Vietnamese bank's Agg PD has been increasing through 2018, peaking at about 70bps in Dec 2018, signaling a deteriorating credit profile. However, in 2019, we see a consistent fall in Agg PD throughout the year, resulting in an Agg PD of about 18bps in Oct 2019, being very close to the Agg PD of Southeast Asian-domiciled commercial banks during the same period. This is a considerable achievement considering that Vietnam's sovereign rating is BB by S&P, one of the worst rated sovereigns in Southeast Asia,

[1] In the 3rd quarter of 2019, Vietnam GDP grew by 7.31% quarter-on-quarter

[2] The NUS-CRI Probability of Default Implied Rating (PDiR) provides a more conventional interpretation of PDs – it translates NUS-CRI 1-year PDs to letter ratings by taking reference from the historical observed default rates of S&P's rating categories.

whereas Vietnamese banks' credit profile performs similarly to that of the region median. Only rarely, corporates are allowed to "pierce the country ceiling", i.e. where a corporate can have a better credit rating as their country of domicile.

Throughout 2018, the prominent issue for Vietnamese banks is to manage its Capital Adequacy Ratios (CAR) in order to meet regulatory requirements from SBV. To comply with the Government's plan to be Basel II compliant by 2020, banks continued to devise plans to raise Tier 1 and Tier 2 capital. At the beginning of 2018, 10 banks announced plans to raise their charter capital by at least USD 1.4bn. One strategy to accomplish this is by allocating stock dividends instead of cash dividends, so that banks can keep as much cash in-house as possible in retained earnings. Employee Stock Option Plans and issuing new common shares are also common ways utilized to increase capital, but alludes to risk generated from stock dilution. State-owned commercial banks such as the Bank for Investment and Development of Vietnam Joint Stock Bank (BIDV) have also been issuing long-term bonds with terms from 5-10 years to maintain its capital adequacy levels. BIDV has recently completed its second bond issuance in 2018, adding a total of VND 430bn (USD 18.5mn) to its Tier 2 Capital. Vietinbank also issued VND 2.43tn worth of bonds (USD 105mn) as an addition to Tier 2 Capital. As the Basel II deadline looms, Vietnamese banks rely on the above corporate actions to seek capital from retaining cash earnings or from bond funding. Even with long term benefits of a more robust macroprudential environment for Vietnamese banks, the short term implications from the rush to procure quality capital imposes balance sheet and regulatory risk – taking up unsustainably high levels of debt or the risk of excessive share dilution, continuing to be a difficult story for banks in 2018 and affecting Agg PD.

On a side note, the abrupt drop in Agg PD in end-August 2018 can be attributed to the release of the first financial statements of 2 banks which had their Initial Public Offering (IPO) in 2018, namely the Vietnam Technological & Commercial Joint Stock Bank (TCB) and the Tien Phong Commercial Joint Stock Bank (TPB). These banks had inaugural Probabilities of Default of 10.57bps and 13.12bps respectively, both lower than the Agg PD at the time, resulting in the Agg PD dropping 14bps from 51.62bps to 37.24bps on the last day of August.

However, at the dawn of 2019, Vietnamese banks have posted double-digit profit growth rates with net interest income growth being the main driving force. This in turn led to improvements in asset quality because the banks utilized the profit growth to write off remaining legacy problem loans. Aggregate net income for the banks also rose 35 per cent to VND 70tn (USD 3bn) last year from the previous year, despite a moderation of credit growth. Further, the SBV released a report showing that the return on assets (ROA) ratio of the domestic banking system surged to 0.7 by the end of November 2018 from 0.57 at the end of 2017 while the return on equity (ROE) ratio also increased by 1.42% to 9%. With strong financial metrics, 2019 Agg PD for Vietnamese banks seen consistent decline, a testament to its bolstering credit profile.

Looking forward, we see Vietnamese banks facing headwinds due to the increased regulatory challenge faced by Vietnamese banks in the future, especially due to the looming deadline of Basel II implementation in January 2020. The adoption of Basel II standards would be positive if banks pay greater focus on the risk profile of their exposures and better price risk. Under Basel II, the definition of risk-weighted assets is expanded by incorporating additional capital charges for operational and market risks, while adopting a more granular and stringent approach to credit risk. However, Basel II adoption will increase pressure on banks to raise more capital, which could hinder their ability to maintain current growth rates. That said, Vietnam continues to lag the global banking capital standards, which have already moved into Basel III or beyond. Even as strong margins and profitability has been reported in 2019, it is also believed that some legacy NPLs continue to be under-reported, with asset quality potentially masked by high credit growth. The persistently strong credit growth, including in newer areas of retail lending, could present new asset quality issues in the event of slower economic growth.

Credit News

JPMorgan pours USD 130bn of excess cash into bonds in major shift

Nov 4. JPMorgan Chase pours more than USD 130bn of excess cash into long-dated bonds and cuts the amount of loans it holds, under Federal Reserve's capital rules that treat loans as riskier than bonds. Comparing to its rivals, JPMorgan has less room to hold riskier assets. Instead of adding more risk to its balance sheet, JPMorgan prefers to return the money back to its shareholders by dividends and share buybacks. Some regard its major shift as the right thing to do, given JPMorgan's idiosyncratic capital constraints, while some have a bleak outlook for the banking industry, seeing the bank is acting like the next recession is coming. (FT)

Global funds dump India company bonds as credit worries persist

Nov 1. Foreign investors' net sales of Indian rupee company bonds hit USD 372.2mn in October, the highest in five months, making it the seventh straight month of outflow and the longest streak since 2016. Facing the slowest economic growth in six years and credit market strains, India's central bank has taken actions to boost the economy, while oversea investors still worry that the government would borrow more to fund its fiscal deficit. Money is leaving amid the sharp jump in credit spread in October. A lack of progress in strengthening the nation's banking sector and better prospects for other emerging market currencies than the rupee also contribute to the outflow. However, not all investors are pessimistic, as bonds issued by better quality issuers still have compelling valuation. (Bloomberg)

Bank run in rural China tests faith in thousands of lenders

Nov 1. Starting with an unverified rumour about the insolvency of Yichuan Rural Commercial Bank, thousands of customers had lined up to withdraw their money. This bank run, prompting the local authority to arrange more than CNY 30bn of liquidity injections, revealing the Chinese public's uncertainty over the health of small lenders. Confidence in the financial strength has dwindled since May when the government seized a bank and imposed losses on some of creditors. Depositors worry that the government would reduce the state guarantee for banks. Small banks are particularly vulnerable in this case since they've been pumping money into risky loans and investments for years. (Bloomberg)

Fine print on Argentine bonds becomes crucial as default looms

Nov 1. Bond investors in Argentine market are paying a premium for bonds that they think will give them more negotiating power as default looms. Notes that require a higher percentage of investors to sign off on any deal are regarded as a protection for investors in a restructuring, and thus they are often traded at a premium of about 25% over those with a lower threshold. Collective-action clauses have a particular significance for Argentina investors because of the outsize role they could have played in the 2001 default. (Bloomberg)

Chinese bank raises more than USD 7bn with record convertible bond

Oct 29. A Chinese bank has raised more than USD 7bn in an offering of convertible bond and drew more than USD 1tn worth of orders. Issuance of convertible bonds by Chinese companies has hit a record USD 39.3bn in the year to date, up more than 80% from the full-year total in 2018. The market of convertible bonds in China had picked up because companies can raise money more cheaply and flexible by issuing convertible bonds than straight debt, amid regulator's more stringent requirements for capital raising. China's stock market performance in 2019 has also made the prospect of owning equity more attractive to domestic investors. (FT)

Turkey eyes Euroclear tie-up to boost demand for local bonds (Bloomberg)

Property rebound surges in Australia on low rates, easy credit (Bloomberg)

Default risk rises rapidly in frontier markets (FT)

Regulatory updates

Big central banks move to wait-and-see mode

Nov 3. Amid a concentrated burst of interest rate cutting of the world's central banks and a loosened global financial condition, the Fed, European Central Bank and Bank of Japan are now moving to a wait-and-see mode and not plan to drive rates any lower. In the developing world, the pace of easing has also slackened, as policymakers now appear content to wait and to see if their policy staves off a deeper slowdown in the months ahead. (Reuters)

Bank of Japan, leaving rates unchanged, suggests further lowering is possible

Oct 24. Bank of Japan kept its rates unchanged given strong domestic demand and capital expenditure but did not rule out the possibility of further rate cuts. BOJ said it would reduce the rates as long as uncertainties remain about reaching the central bank's 2% inflation target. Global risks including the US-China trade tension have shown signs of releasing, leading to stability in financial markets and lessening pressure on the Japanese central bank to act right now. The new forward guidance gives the bank room for discretion, and the bank is still open to easing options other than rate cuts. (WSJ)

Federal Reserve delivers third rate cut but signals it is done for now (FT)

US Treasury considers selling 50-year bonds (FT)

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