SECTOR OUTLOOK
10 JANUARY 2023

***Important:** When lawfully using the information herein, you shall mention our English brand name of "**Vietnam Investors Service**" (in English and Vietnamese materials) and remark that "**Vietnam Investors Service's assessments, data, statistics or other opinions included in this publication are not based on credit ratings of any issuer or debt instrument. Vietnam Investors Service is applying for credit rating agency license and has not implemented any credit rating activity**".*

CONTACTS

Simon Chen, CFA
Executive Director

Phan Thi Van Anh
Director

Bach Hoang Anh
Associate Analyst

Banks

Slower operating conditions to weaken profitability, liquidity to stabilize with mid-sized and small banks most at risk

Bank profitability reached peak levels in 2022, supported by robust economic backdrop. However, bank operating conditions will weaken in 2023, as persistent macro headwinds and tighter financing conditions dampen credit demand and increase operating costs. Profitability will moderate from rising credit costs, narrower net interest margins, and lower fee income growth. Liquidity will stabilize but remain tight, with mid-sized and small banks most at risk.

Asset risks and credit costs will rise from deteriorating operating conditions. Problem loan formation will increase from weaker business cash flows, higher interest rates and operating costs, and refinancing difficulties in the corporate bond market. Credit exposures to sectors at risk such as export-oriented and manufacturing, real estate and construction are vulnerable to higher credit costs. Although loan loss coverage ratios have improved, small and mid-sized banks with low coverage are less prepared for asset quality stress and will likely need to set aside more provisions.

Net interest margins will contract following recent policy rate hikes. A mix of competitive and regulatory pressures will drive up deposit rates at a quicker pace than lending rates. Coupled with weakening credit demand, net interest margins will contract and more significantly for small banks with weak funding and tight liquidity.

Non-lending income growth will decelerate from unfavorable market conditions. Capital market-related fees will shrink from weak equity and bond market sentiment. Trading gains will likely diminish from higher interest rates and prolonged market volatility. Growth in bancassurance fees will also decline due to weak customer sentiment and lower cross-selling opportunities.

Capital levels will remain stable and weak by regional standards. Weaker profitability will hamper banks' ability to generate capital internally. On the flip side, slower credit growth will alleviate pressure on bank capital. Core capital levels are by far the lowest among regional banking systems. Without any meaningful capital raising, banks are vulnerable to event risks and will likely require extraordinary support in times of stress. Tier 2 subordinated bonds will help to supplement bank capital needs.

Liquidity will remain tight, with mid-sized and small banks most at risk. Funding costs will remain elevated from sluggish deposit growth, keen competition among banks and risk aversion in the interbank market. Regulatory support will play an important role to stabilize banking system liquidity. Large banks will be supported by their entrenched customer network. Mid-sized and small banks with heavy reliance on short-term market funding are most vulnerable to liquidity risks.

Asset Quality

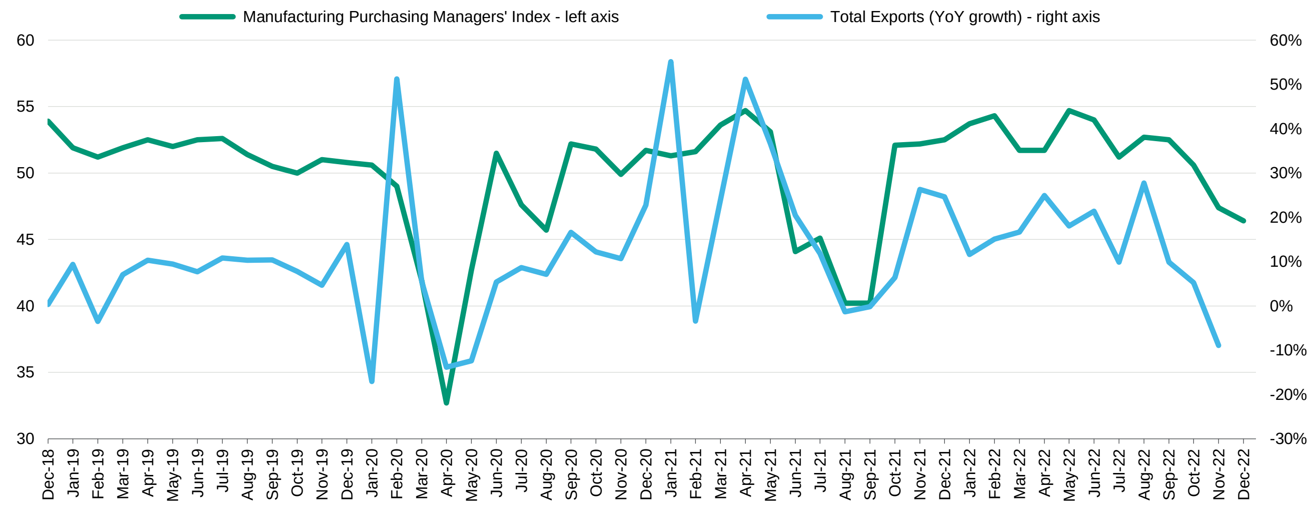
Bank operating conditions to deteriorate in 2023

2022 marked a year of strong growth for the Vietnamese economy despite increasing global and regional concerns around inflation, geopolitical stability, tighter financial conditions and slowing economic growth. Bank operating conditions will weaken in 2023, as persistent macro headwinds dampen demand for credit and increase operating costs.

External demand to soften

Persistent inflation, tighter financial conditions, geopolitical risks and financial market volatility are key risks to global economies in 2023. Economic growth is set to slow, and global trade to moderate from softer consumer demand. Vietnam - an increasingly important link in the global supply chain – will face a slowdown in manufacturing activity and contraction in exports, which has already surfaced in Q4 2022 (Exhibit 1).

Exhibit 1
Slowdown in manufacturing activity and exports surfacing in Q4 2022



Source: General Statistics Office of Vietnam (GSO), S&P Global

According to a recent survey conducted by Vietnam Chamber of Commerce and Industry on the business situation in southern Vietnam, close to 70% of respondents indicated new business orders had declined, signaling deteriorating business conditions.

As external demand weakens further, export-oriented sectors such as manufacturing, agriculture and fisheries are at risk of business slowdown and deterioration in cash flows.

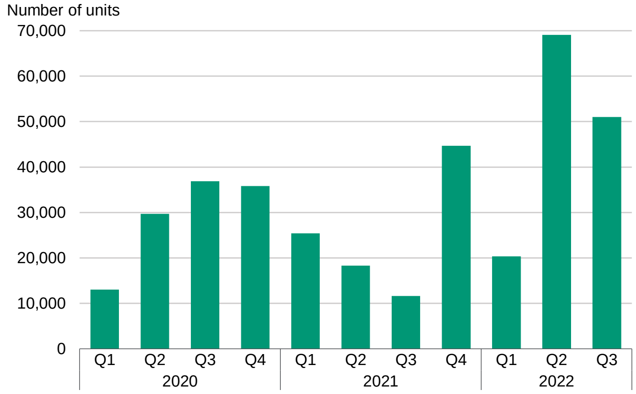
Real estate sector slowdown underway

The real estate sector is facing a downturn marked by liquidity stress, higher interest rates, slower home sales and weaker business cash flows.

The fallout of the corporate bond market has led to significant refinancing difficulties for many real estate developers, intensified by the increase in leverage through frequent bond borrowings over the past five years. Rising default risks of real estate-related bond issuers had sparked negative sentiment and risk aversion among bank lenders, equity investors and home buyers.

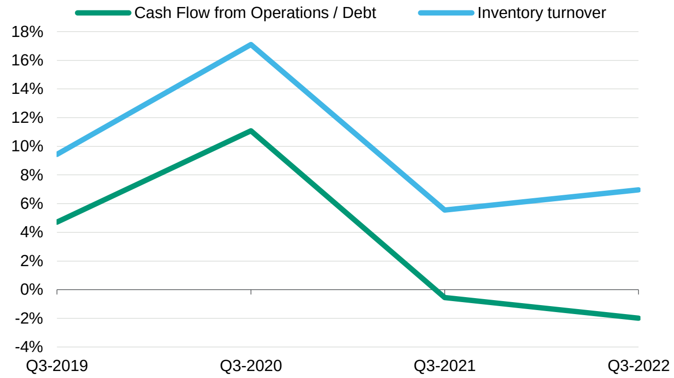
Since the start of Q4 2022, there are increasing reports of real estate developers offering significant discounts and alternative payment methods to boost project sales, as well as sharp falls in transacted prices due partly to fire sales by existing homeowners. Home buyer sentiment will remain weak and will weigh on real estate sales (Exhibits 2 and 3) and real estate developer cash flows (Exhibit 3).

Exhibit 2
Real estate sale transactions fell in Q3 2022



Source: Ministry of Construction, Vietnam Investors Service

Exhibit 3
Deteriorating sales and cash flows of real estate developers



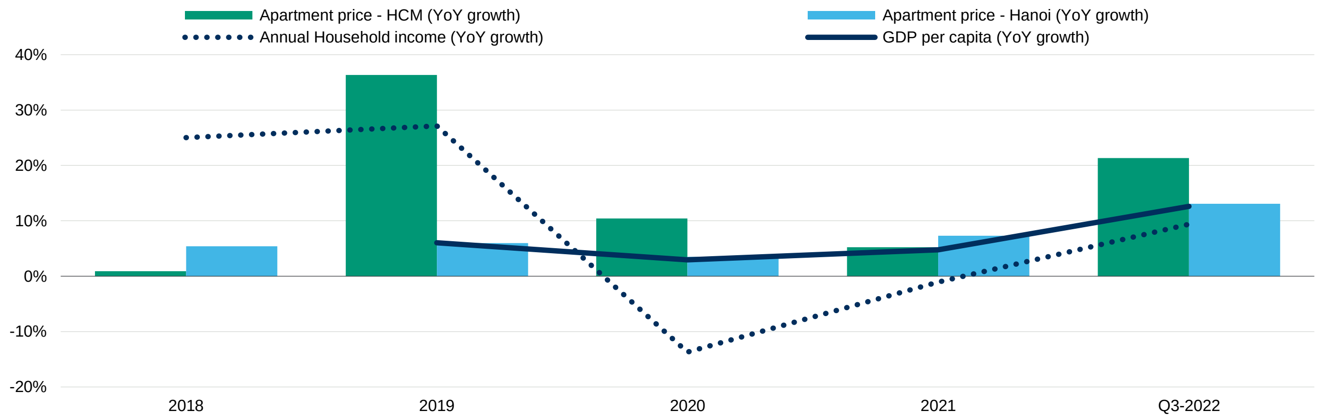
Note: Data includes Top 20 listed real estate developers in Vietnam
Source: Bank data, Vietnam Investors Service

Banks' exposure to the real estate sector includes direct lending to real estate developers and home buyers, as well as real estate-related assets pledged by borrowers as collateral.

Higher interest rates will also weigh on debt serviceability of home buyers. Over the past three years, home buyers enjoyed easy access to bank financing with high loan-to-value of exceeding 90% and longer tenors, fueling speculative activity and the sharp increase in property prices. Household borrower leverage has also risen as housing price growth far outpaced income growth (Exhibit 4).

A material and sustained decline in real estate price will likely result in a surge in problem loans and loan losses for banks.

Exhibit 4
Real estate price growth outpaced income growth over the past five years

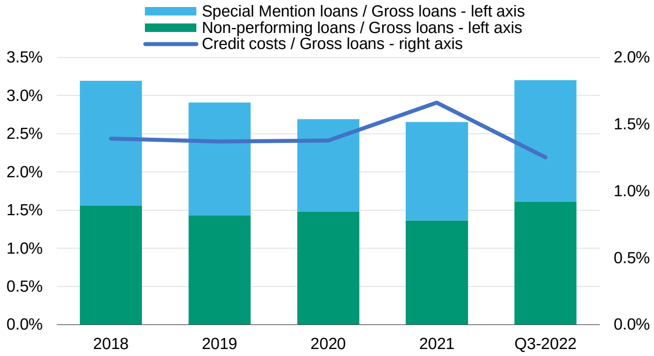


Source: GSO, Jones Lang LaSalle, Vietnam Investors Service

Asset risks and credit costs will rise from deteriorating operating conditions

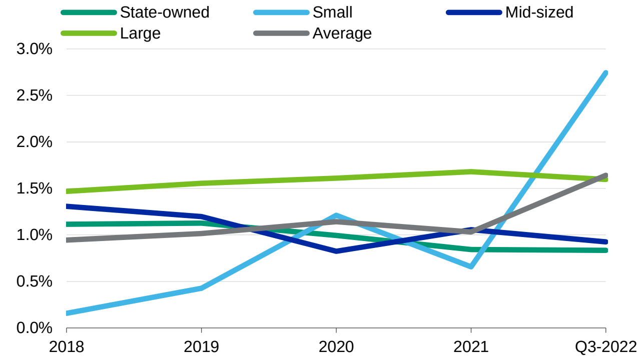
Over the course of 2023, problem loan formation will increase from weaker business cash flows, higher interest rates and operating costs, and refinancing difficulties in the corporate bond market. Over the first nine months of 2022, non-performing loan (NPL) ratios and special mention loan ratios have begun to increase (Exhibit 5). Moreover, loan restructuring will be more difficult after the pandemic-related loan restructuring program expired in June 2022. Credit costs will increase as problem loan formation continues to pick up (Exhibit 6).

Exhibit 5
Problem loans and credit costs



Source: Bank data, Vietnam Investors Service

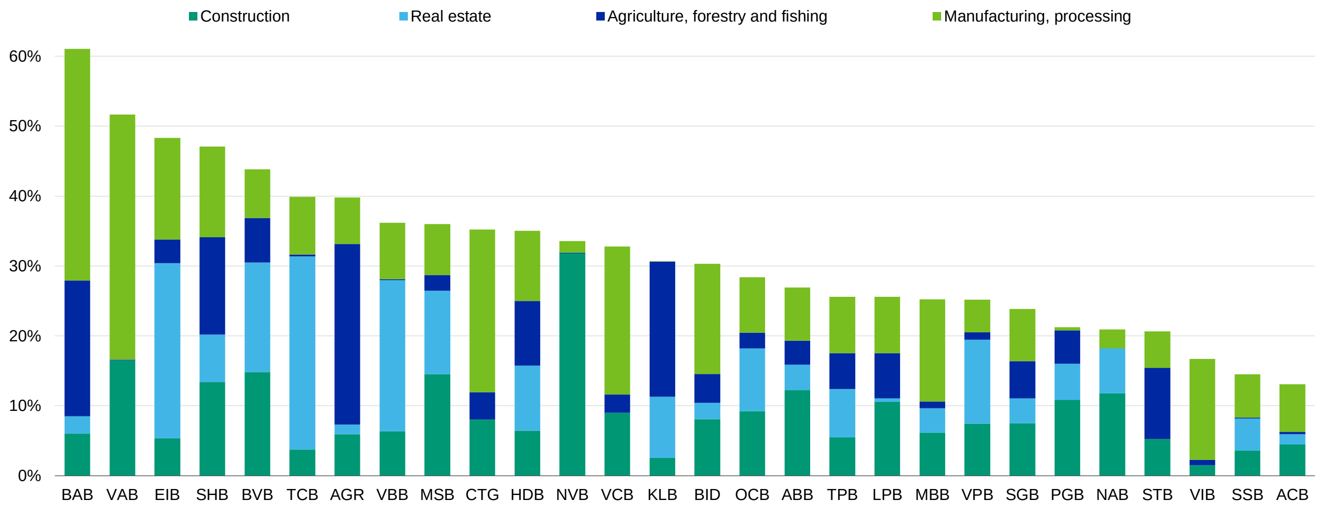
Exhibit 6
NPL formation rate



Source: Bank data, Vietnam Investors Service

Banks with concentration to sectors at risk such as export-oriented and manufacturing, real estate and construction are most vulnerable to increases in credit costs (Exhibit 7). Around 14% of total bank credit are loans to home buyers that will also face downside risks.

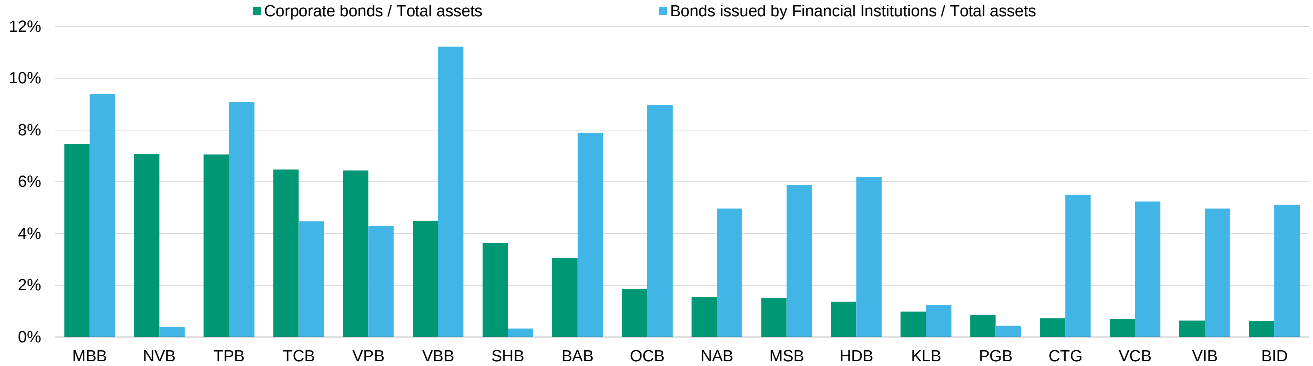
Exhibit 7
Bank loan portfolios have material exposure to sectors at risk



Note: Data as of end-2021. Refer to the Appendix for the full name of the banks
Source: Bank data, Vietnam Investors Service

Banks' exposure to bonds issued by non-financial corporates is modest at less than 2% of total banking system assets. Several banks have exposures exceeding 5% (Exhibit 8). Banks' investments in bonds issued by financial institutions are larger at around 4% of total banking system assets; but these instruments have arguably lower credit risk.

Exhibit 8
Banks have limited exposure to corporate bonds



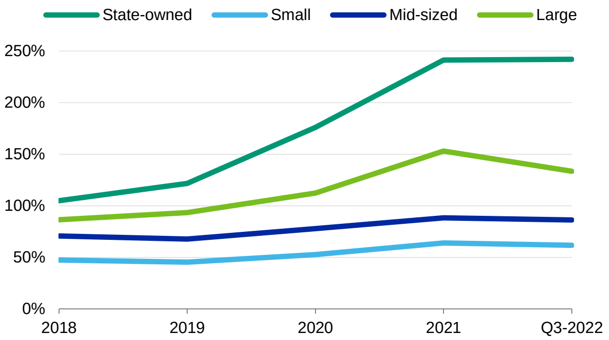
Note: Data as of end-September 2022. Refer to the Appendix for the full name of the banks

Source: Bank data, Vietnam Investors Service

Banks in general have actively resolved their legacy problem loans and improved loan loss coverage (i.e. loan loss reserves as a percentage of total non-performing loans) over the last five years (Exhibit 9).

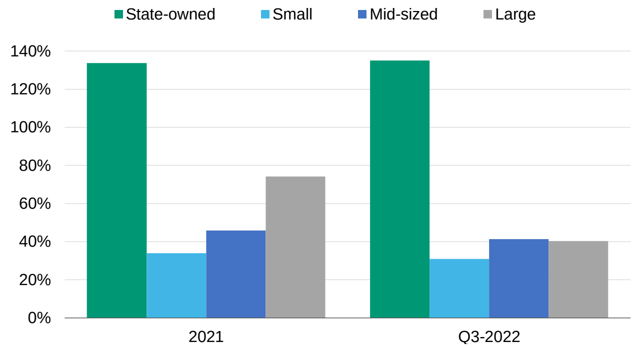
Small and mid-sized banks with low loan loss coverage ratios are less prepared for asset quality stress and will likely need to set aside more provisions. Including special mention loans, loan loss coverage ratios are much lower at between 30%-40% on average (Exhibit 10).

Exhibit 9
Loan loss coverage ratios for non-performing loans have improved



Source: Bank data, Vietnam Investors Service

Exhibit 10
Loan loss coverage ratios for non-performing and special mention loans are low for majority of banks



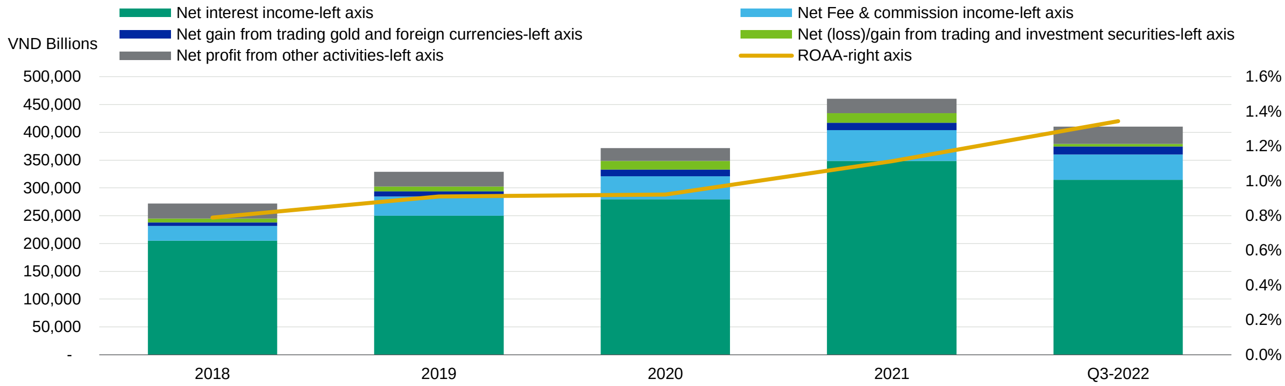
Source: Bank data, Vietnam Investors Service

Profitability

Profitability will moderate from 2022 peak levels

In 2023, weakening operating conditions will weigh on bank profitability. Return on Average Assets (ROAA) will decline from 2022 peak levels, as credit costs rise and revenue growth from key sources decline (Exhibit 11). Lending income growth will fall from narrowing net interest margins and moderating loan growth. Non-lending income growth will similarly diminish as fee-based and capital market-related income shrink.

Exhibit 11
Key sources of revenue – net interest income and fee income – under pressure in 2023



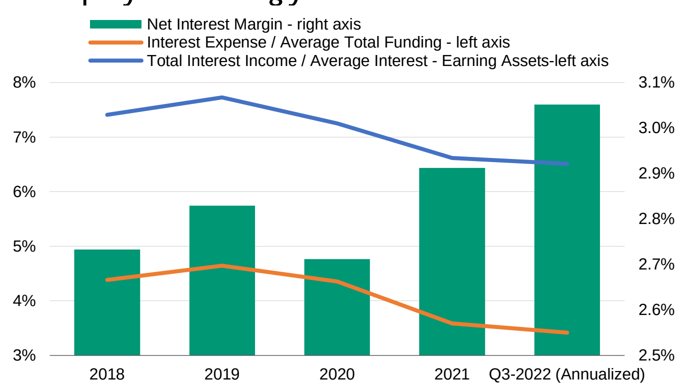
Source: Bank data, Vietnam Investors Service

Net interest margins will contract following recent hikes in policy rate

A mix of competitive and regulatory pressures will lead to banks raising deposit rates at a quicker pace than lending rates, and result in narrower net interest margins (Exhibit 12). Following the increase in policy interest rates by 200 basis points over September – October 2022, banks actively raised deposit interest rates to retain existing deposits and attract new deposits. On the other hand, loan interest rates did not reprice upwards as quickly due partly to competition for new loans, and State Bank of Vietnam's instruction for banks to lower lending rates.

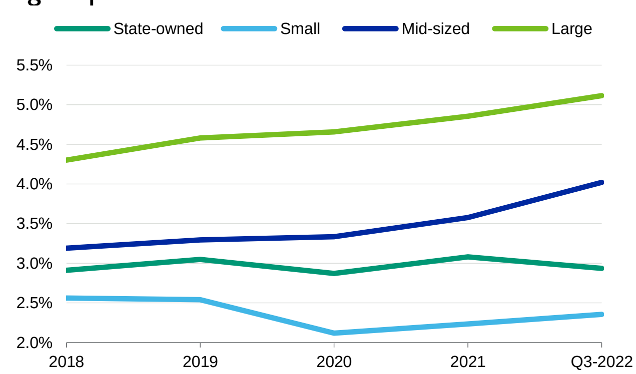
Given the policy focus to maintain macroeconomic stability and curb inflation, the regulatory stance on interest rates is likely to remain hawkish. Bank competition for deposits will remain keen. Coupled with weakening credit demand, net interest margins will contract and more significantly for small banks (Exhibit 13) with modest deposit franchise and tight liquidity.

Exhibit 12
Net interest margins set to narrow as deposit costs increase more rapidly than lending yields



Source: Bank data, Vietnam Investors Service

Exhibit 13
Small banks have lowest net interest margins driven by high deposit costs



Source: Bank data, Vietnam Investors Service

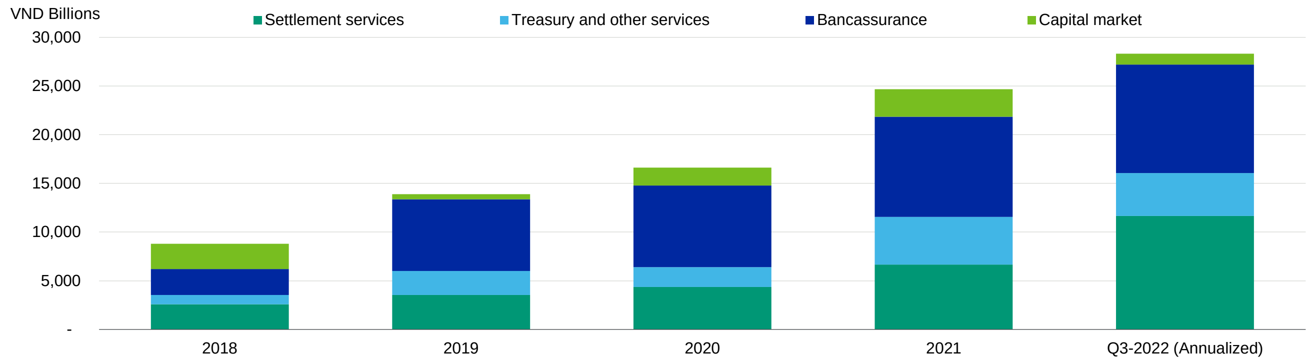
Non-lending income growth will decelerate from unfavorable market conditions

Capital market-related fees from custodian and advisory services, and securities underwriting (Exhibit 14) will shrink from weak sentiment in the equity and bond markets. At end-2022, the stock market index was down 33% from a year ago, and new corporate bond issuances shrunk significantly[1]. Trading gains will likely diminish from higher interest rates and prolonged

[1] Refer to Vietnam Investors Service report: Corporate Bond Market Perspective: New regulations will guide stable growth of corporate bonds, but keep new issuances subdued until 2H 2023, 11 November 2022

market volatility. Growth in bancassurance fees will also decline due to weak customer sentiment and lower cross-selling opportunities. The number of new bancassurance partnerships between banks and insurers and the associated upfront fee income will also decline.

Exhibit 14
Fee-based income and capital market–related income will weaken in 2023



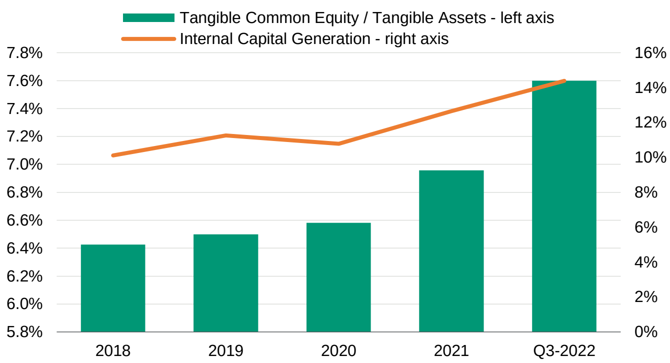
Source: Bank data, Vietnam Investors Service

Capital

Capital levels will remain stable and weak by regional standards

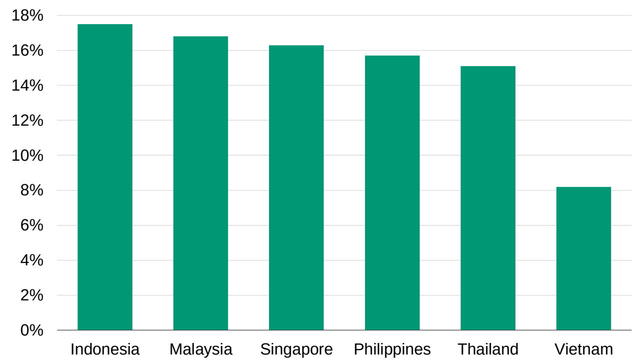
Weaker profitability will hamper banks' ability to generate capital internally (Exhibit 15). On the flip side, slower credit growth will alleviate pressure on bank capital. Core capital levels are by far the lowest among regional banking systems (Exhibit 16). Without any meaningful capital raising, banks are vulnerable to event risks and will likely require extraordinary support in times of stress.

Exhibit 15
Internal capital generation to weaken and weigh on bank capital levels in 2023



Source: Bank data, Vietnam Investors Service

Exhibit 16
Aggregate tangible common equity to risk-weighted assets as of Q3 2022

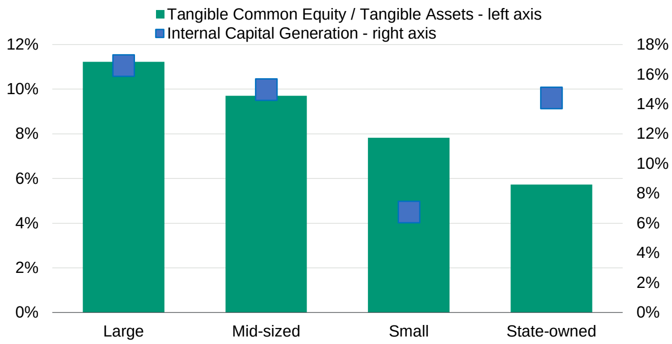


Note: Data as of 2021 for Singapore and Philippines
Source: Moody's Investors Service

State-owned banks have the lowest core capital ratios driven primarily by weak internal capital generation (Exhibit 17). Historically each year, state-owned banks are required to repatriate funds in the form of dividends to the government, and the government ownership and long administrative process hamper their ability to raise new capital from private sector investors. Many of the banks have resorted to supplement their capital needs through domestic subordinated bond issuances that qualify as Tier 2 capital (Exhibit 18).

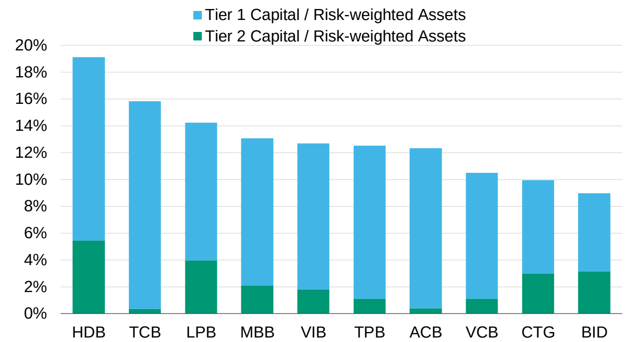
Around 25% of total value of bonds issued by banks in 2021 are in the form of Tier 2 subordinated bonds. Banks will increasingly rely on Tier 2 capital raising to supplement their capital needs, given the difficulties in new equity raising due to heightened investor risk aversion.

Exhibit 17
Capital adequacy ratios by group of banks as of 30 June 2022



Source: Bank data, Vietnam Investors Service

Exhibit 18
Tier 2 subordinated bonds help to supplement bank capital needs



Note: Data as of end-June 2022
Source: Bank data, Vietnam Investors Service

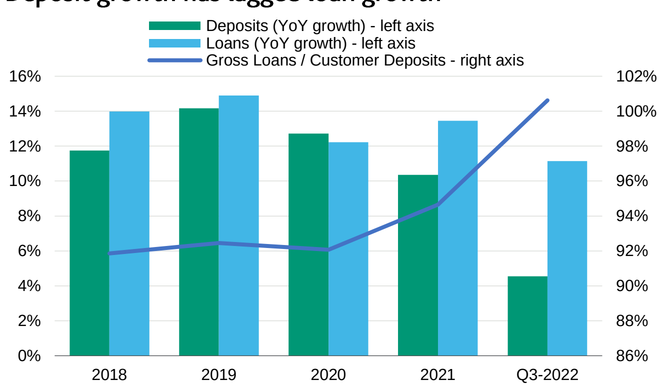
Funding and Liquidity

Liquidity will stabilize but remain tight, liquidity risks most acute for mid-sized and small banks

Liquidity will remain tight from sluggish growth in deposits, keen competition among banks to secure deposits for their lending activities and risk aversion in the interbank market. This will drive up funding costs particularly for small banks with limited physical network.

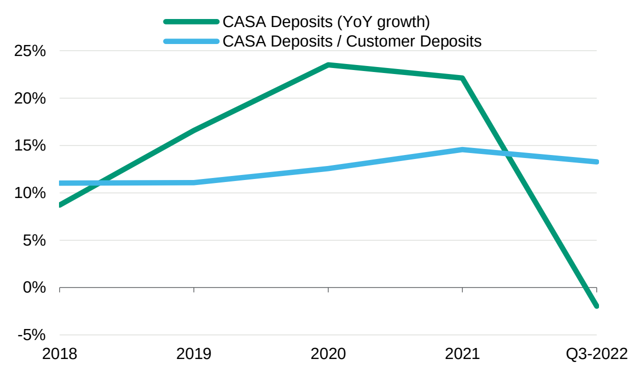
Weaker corporate cash flows and tight monetary policy stance will weigh on deposit growth. Even with loan growth moderating slightly from 2022 level of 14.5%, bank funding profiles will remain tight with many small and mid-sized banks competing actively for deposits to manage their high loan-to-deposit ratios (Exhibit 19). Core low-cost current account and savings account (CASA) deposits have eroded in 2022 (Exhibit 20), and competition for new deposits will remain keen. Large banks are less at risk due to their entrenched customer network, and also because they tend to benefit from flight to quality in times of stress.

Exhibit 19
Deposit growth has lagged loan growth



Source: Bank data, Vietnam Investors Service

Exhibit 20
CASA deposits started to shrink in 2023

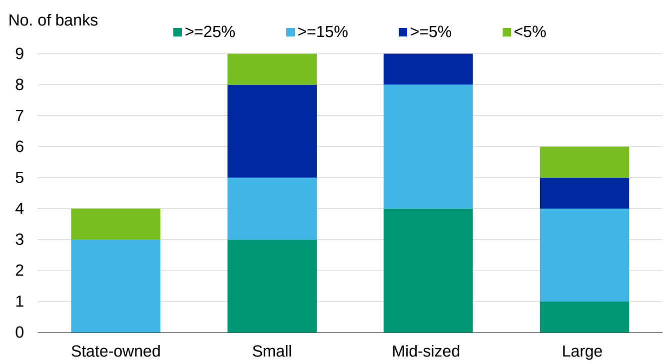


Source: Bank data, Vietnam Investors Service

Regulatory support measures will continue to play an important role to stabilize the liquidity situation in the banking system. In 2022, banks benefited from a series of policy actions such as the expansion of instruments eligible to access central bank funding, prompt intervention through public statements to instill depositor confidence, etc.

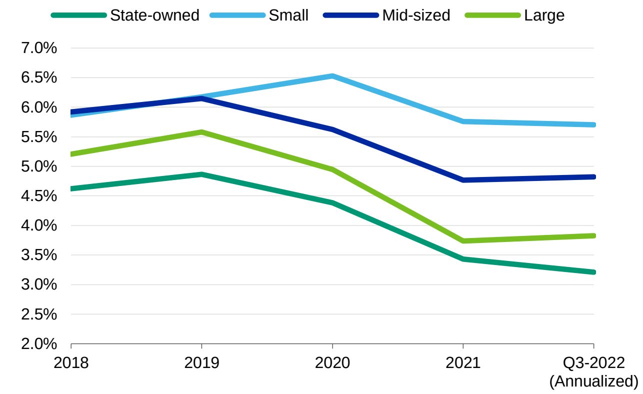
Liquidity risks are most acute for mid-sized and small banks that rely heavily on short-term interbank and market funding (Exhibit 21) and are most in need of rolling over existing funding in the absence of new deposits. These banks typically compete actively to attract new customer deposits with higher rates (Exhibit 22), require market funding to supplement deposits for lending activities, and maintain low level of liquid asset buffer to withstand liquidity stress and refinancing issues (Exhibit 23).

Exhibit 21
Mid-sized and small banks have high market funds as a percentage of tangible assets



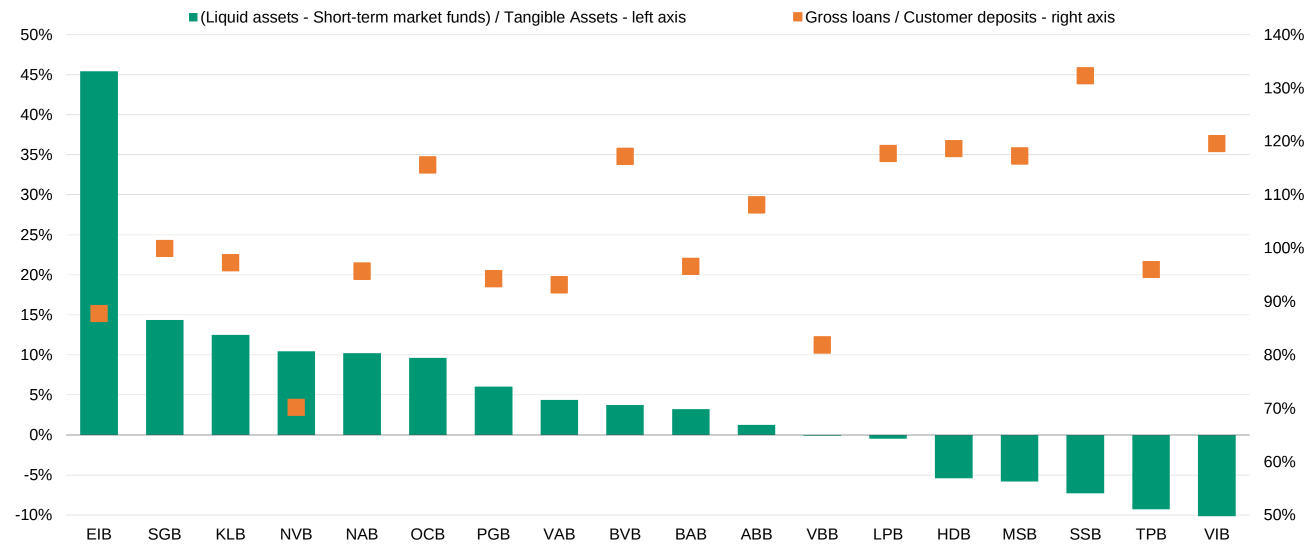
Source: Bank data, Vietnam Investors Service

Exhibit 22
High deposit funding costs reflect weak deposit franchise



Source: Bank data, Vietnam Investors Service

Exhibit 23
Banks with high loan-to-deposit ratios and low liquid asset buffer at most vulnerable to liquidity risks



Source: Bank data, Vietnam Investors Service

Although interbank liquidity has stabilized since the episode of deposit run in October 2022, liquidity providers are likely to remain prudent, which will, in turn, lead to higher rates for lending to small and mid-sized banks in times of market volatility.

Appendix

The banks included in our analysis are as follows:

Short Name of Bank	Full Name of Bank	Classification
ABB	An Binh Commercial Joint Stock Bank	Small
ACB	Asia Commercial Joint-Stock Bank	Large
AGR	Vietnam bank for Agriculture and Rural Development	State-owned
BAB	Bac A Commercial Joint Stock Bank	Small
BID	Joint Stock Commercial Bank for Investment and Development of Vietnam	State-owned
BVB	Viet capital Commercial Joint Stock Bank	Small
CTG	Vietnam Joint-Stock Commercial Bank for Industry and Trade	State-owned
EIB	Vietnam Export Import Commercial Joint Stock Bank	Mid-sized
HDB	Ho Chi Minh City Development Joint Stock Commercial Bank	Mid-sized
KLB	Kien Long Commercial Joint Stock Bank	Small
LPB	Lien Viet Post Joint Stock Commercial Bank	Mid-sized
MBB	Military Commercial Joint Stock Bank	Large
MSB	Vietnam Maritime Commercial Joint Stock Bank	Mid-sized
NAB	Nam A Commercial Joint Stock Bank	Mid-sized
NVB	National Citizen Commercial Joint Stock Bank	Small
OCB	Orient Commercial Joint Stock Bank	Mid-sized
PGB	Petrolimex Group Commercial Joint Stock Bank	Small
SGB	Saigon Bank for Industry and Trade	Small
SHB	Saigon - Hanoi Commercial Joint Stock Bank	Large
SSB	Southeast Asia Commercial Joint Stock Bank	Mid-sized
STB	Saigon Thuong Tin Commercial Joint Stock Bank	Large
TCB	Vietnam Technological and Commercial Joint-Stock Bank	Large
TPB	Tien Phong Commercial Joint Stock Bank	Mid-sized
VAB	Vietnam Asia Commercial Joint Stock Bank	Small
VBB	Vietnam Thuong Tin Joint Stock Commercial Bank	Small
VCB	Joint Stock Commercial Bank for Foreign Trade of Vietnam	State-owned
VIB	Vietnam international Commercial Joint Stock Bank	Mid-sized
VPB	Vietnam Prosperity Joint Stock Commercial Bank	Large

ASSESSMENTS AND OTHER OPINIONS INCLUDED IN VIETNAM INVESTORS SERVICE'S MATERIALS, PRODUCTS, SERVICES AND INFORMATION PUBLISHED BY VIETNAM INVESTORS SERVICE (COLLECTIVELY, "PUBLICATIONS") ARE BASED ON OUR OWN PERSPECTIVE. VIETNAM INVESTORS SERVICE'S ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS (1) BELONG SOLELY TO VIETNAM INVESTORS SERVICE AND DO NOT REPRESENT THOSE OF ANY OTHER PERSON OR ENTITY THAT VIETNAM INVESTORS SERVICE MAY OR MAY NOT BE ASSOCIATED WITH, (2) ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT, (3) ARE FOR REFERENCES ONLY AND DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, (4) ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO INVEST INTO, CONTRIBUTE CAPITAL, PURCHASE, SELL, OR HOLD PARTICULAR DEBT INSTRUMENTS OR FINANCIAL INSTRUMENTS AND (5) DO NOT COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. VIETNAM INVESTORS SERVICE ISSUES ITS ASSESSMENTS AND OTHER OPINIONS AND PUBLISHES ITS PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE. VIETNAM INVESTORS SERVICE'S ASSESSMENTS, OTHER OPINIONS IN THIS PUBLICATION ARE NOT INTENDED FOR USE AS CREDIT RATINGS ASSIGNED UNDER DECREE 88/2014 DATED 26 SEPTEMBER 2014 OF THE GOVERNMENT.

VIETNAM INVESTORS SERVICE'S ASSESSMENTS, OTHER OPINIONS, AND PUBLICATIONS ARE NOT INTENDED FOR USE BY NON-PROFESSIONAL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR NON-PROFESSIONAL INVESTORS TO USE VIETNAM INVESTORS SERVICE'S ASSESSMENTS, OTHER OPINIONS OR PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER.

ALL INFORMATION CONTAINED HEREIN (INCLUDING INFORMATION OF VIETNAM INVESTORS SERVICE AND/OR INFORMATION OF THIRD PARTIES WHO LICENSE VIETNAM INVESTORS SERVICE TO INCORPORATE ITS INFORMATION HEREIN ("VIETNAM INVESTORS SERVICE'S LICENSORS")) IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT VIETNAM INVESTORS SERVICE'S AND/OR VIETNAM INVESTORS SERVICE'S LICENSORS' PRIOR WRITTEN CONSENT AND/OR LICENSE. VIETNAM INVESTORS SERVICE'S ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS ARE NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES AND MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by Vietnam Investors Service from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. Vietnam Investors Service adopts all necessary measures so that the information it uses is of sufficient quality and from sources Vietnam Investors Service considers to be reliable including, when appropriate, independent third-party sources. However, Vietnam Investors Service is not an auditor and cannot in every instance independently verify or validate information received or in preparing its Publications.

To the extent permitted by law, Vietnam Investors Service and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if Vietnam Investors Service or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising.

To the extent permitted by law, Vietnam Investors Service and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, Vietnam Investors Service or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY ASSESSMENT, OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY VIETNAM INVESTORS SERVICE IN ANY FORM OR MANNER WHATSOEVER.

VIETNAM INVESTORS SERVICE MAY MAKE MODIFICATIONS AND/OR CHANGES TO ITS PUBLICATION AT ANY TIME, FOR ANY REASON. HOWEVER, VIETNAM INVESTORS SERVICE UNDERTAKES NO OBLIGATION (NOR DOES IT INTEND) TO PUBLICLY SUPPLEMENT, UPDATE OR REVISE ITS PUBLICATION ON A GOING-FORWARD BASIS. YOU ASSUME THE SOLE RISK OF MAKING USE OF AND/OR RELYING ON VIETNAM INVESTORS SERVICE'S ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS.

VIETNAM INVESTORS SERVICE

Vietnam Investors Service is applying for credit rating agency license and has not implemented this activity.