Credit Insights

Recent surge in overnight interbank rates pose limited risks to the banking sector

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Over the past 2 months (April – May), the VND overnight interbank rate has risen by almost 400 basis points (bps) to its peak level over the past 12 months. As of 30 May 2024, the VND overnight interbank rate stood at 4.79%, compared with below 1% level in January 2024.

We view the surge in interbank rates reflects the tighter liquidity in the banking system following the withdrawal of market liquidity by the State Bank of Vietnam (SBV) to manage currency volatility. Small and some mid-sized banks in Vietnam are relatively more reliant on interbank funding for their operations and liquidity management. However, we expect the impact of higher interbank rates on banks to be manageable. Firstly, banks have coped with much higher funding costs in the past. And we expect interbank rates to normalize over the course of 2024 as currency pressures stabilize.

In April and May, we estimate that the SBV withdrew VND90 trillion worth of market liquidity through the sale of over USD3.5 billion to the banks. On May 22, the SBV raised its Open Market Operations (OMO) rate by 0.25% to 4.5% following the rise in the VND overnight interbank rate. VND/USD has depreciated by 4.3% since January 2024, and the devaluation appeared to have stabilized following SBV's recent actions.

Across the banking system, we view small and some mid-sized banks to have the weakest liquidity profiles due to their small deposit base, heavier reliance on short-term interbank funding for their business activities, and lower level of liquid resources on their balance sheets. For example, the average CASA deposits over total funding for these banks in Q1 2024 was 7%, lower than the industry average at 14%; mid-sized banks on average have market funds that exceed liquid assets and hence, are more vulnerable to liquidity risks.[1]

Nonetheless, small banks will continue to benefit from lower deposit rates since late 2023 when SBV reduced policy interest rates by a total of 100 basis points. We view small banks have sufficient headroom in their net interest margins to absorb the higher interbank funding costs as well as higher deposit costs. Since the start of May, the average 6-month deposit rate increased by 50-80 bps among medium and small-sized banks and by 10-30 bps among large banks as deposit competition picked up to meet rising credit demand. Banks will be able to pass on part of the deposit cost increases to their borrowers.

We believe that SBV typically manages the OMO rate in tandem with the overnight interbank rates to ensure that the OMO funding can serve as a reliable liquidity source for banks in times of need.

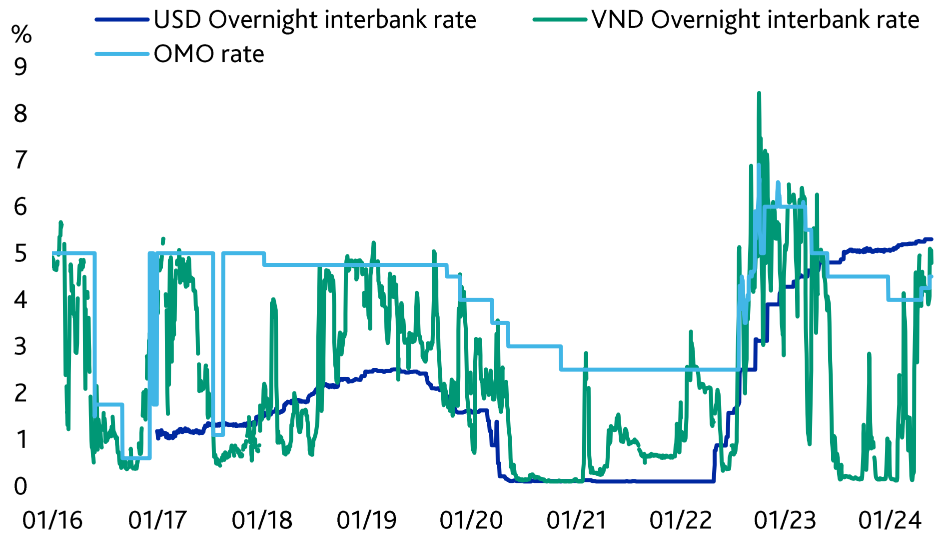
In our base case, we expect SBV will continue to prioritize the balance between supporting economic growth and managing risks such as inflation and currency devaluation. Domestic inflation - mainly driven by supply-side factors - has been under control. SBV has also utilized various tools to prop up its foreign currency reserves and manage currency expectations. As such, we expect interest rates to remain low over the course of 2024.

We view the negative gap between the VND interest rates and the US Federal Reserve (FED) rates since 2023 has a significant impact on market sentiment and has led to stronger market demand for USD. The recent OMO increase will help to narrow this gap as the market keenly awaits the normalization of Fed rates in the coming months.

[1] Refer to Sector Comment: Banking Sector – 3M2024 Update (24 May 2024)

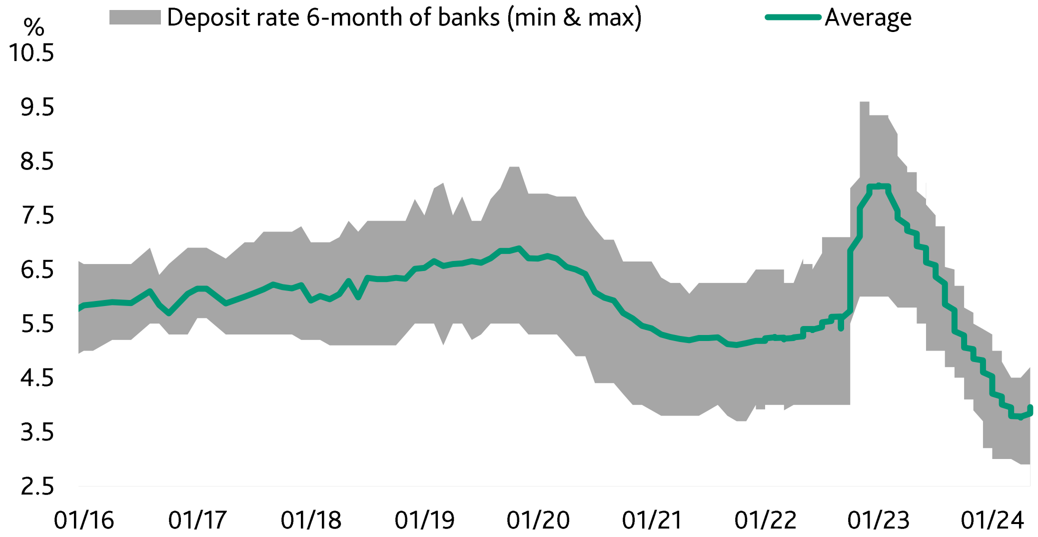
Banks can maintain their profit through stable NIM

Exhibit 1: OMO rate is typically higher than overnight interbank rate



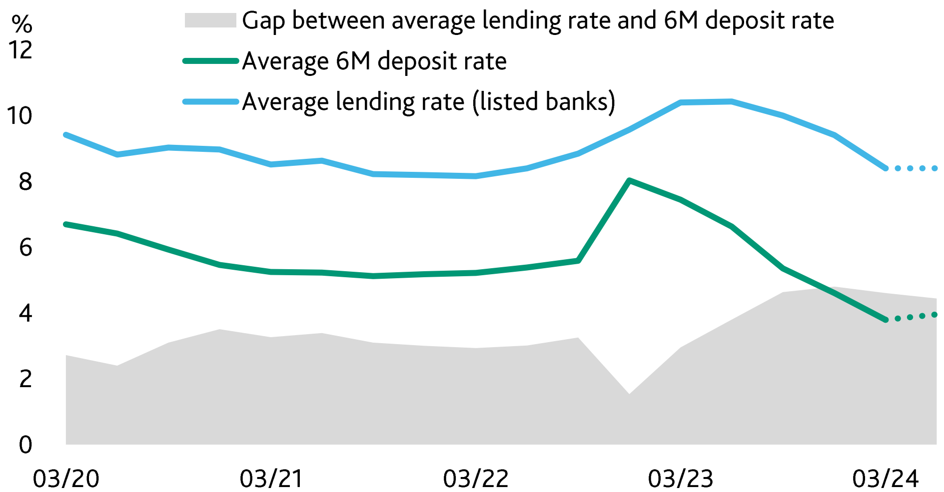
Source: SBV, Vietnam Investors Service

Exhibit 2: Deposit rate started to increase marginally in May 2024



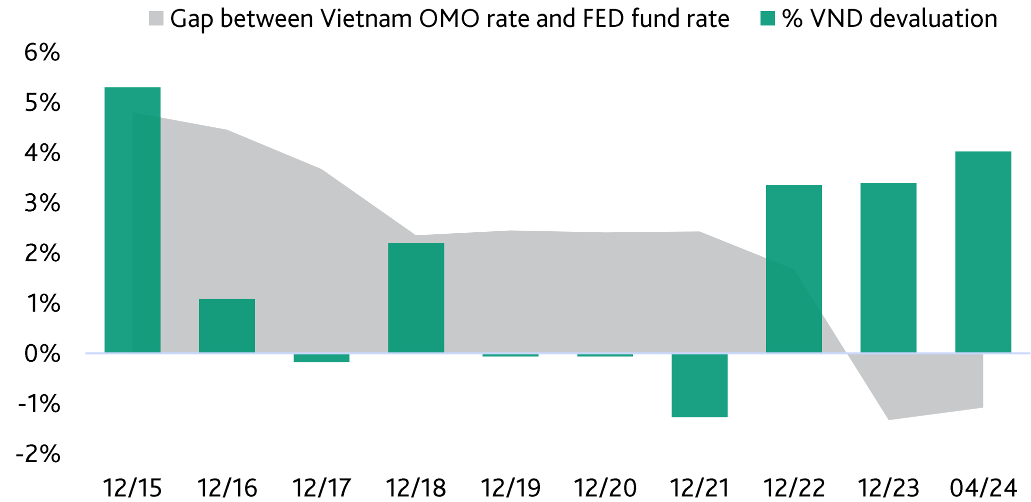
Source: Bank data, Vietnam Investors Service

Exhibit 3: Bank NIMs will improve in 2024



Note: The average lending rate is annualized, calculated by dividing total interest income from loans by total loans across listed banks.
Source: Bank data, Vietnam Investors Service

Exhibit 4: Interest spread will continue to narrow in 2024, lowering risk of further VND devaluation



Source: Federal Reserve Bank of St. Louis, SBV, Vietnam Investors Service

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