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Banking Sector: 9M2023 Update

9M2023 profits fell from the 2022 peak but recovery is within sight as net interest margin and credit pick up

Banks' return on average assets (ROAA) declined to 1.5% in 9M2023 from the 5Y peak of 1.7% in 2022, as credit growth weakened and funding costs surged following consecutive interest rate hikes beginning in Q4/2022. The sector-average non-performing loan (NPL) ratio worsened to 2.2% from 1.6% in 2022, mainly from retail and small and medium enterprises (SME) loans. Loan loss coverage ratio (LLCR) fell to 93% from 123% in 2022 and bank capital remained weak. We expect banks' net interest margins (NIM) to widen from Q4/2023 onwards as deposits adjust quicker to lower rates than loans. Credit demand will also pick up over time to improve bank profits.

Asset quality issues have spread from real-estate corporate borrowers to retail and SME borrowers. Multiple mass-retail, and SME-focused banks (e.g., NVB, OCB, VIB, TPB, HDB) saw a surge in NPLs from mortgages and vehicle loans as well as loans to property developers and construction firms. In addition, banks with sizable consumer finance activities (e.g., MBB, VPB) recorded a more significant increase in delinquencies than the sector average, as the slowing economy affected the income and repayment abilities of these higher-risk borrowers. In contrast, State-owned banks' (SOBs) asset quality remained steady; among privately-owned banks (POBs), ACB exhibited stable asset quality, underpinned by its prudent lending practices. We expect the sector's NPL formation rate to slow as borrowers' debt repayment capability improves amid stronger operating conditions and low-interest rates.

High funding and credit costs and lower asset yields resulted in year-on-year ROAA declines for some retail and SME-focused banks. VPB and TCB experienced the highest decline in ROAA from lower lending yields alongside rising funding costs. Profits for ABB, TPB, and EIB declined from slower credit growth and higher credit costs from their retail and SME loans. In contrast, ROAAs improved strongly for STB from improved NIM after resolving its legacy assets; other banks benefited from strong credit growth (MBB, MSB), and recovery of investment security income (ACB, OCB).

Loss absorption buffer weakened most significantly for small POBs. LLCR for POBs (e.g., TPB, LPB, STB) declined to 55% on average from 79% over 9M2023, much lower than the sector average of 93%. Small POBs' capital also remained weak from poor internal capital generation.

Liquidity remained stable. The sector loan-to-customer deposit ratio (LDR) held steady at 101% from a year ago, and the short-term funding to the medium and long-term lending ratio (SMLR) was 28% (below the regulatory limit of 30%).

Asset quality issues have spread from real-estate corporate borrowers to retail and SME borrowers

Banks' asset quality deteriorated in 9M2023 with the NPL ratio increasing by 0.6% point to 2.2% (Exhibit 1), mainly from retail and SME loans. Loan restructuring picked up since the introduction of Circular 02[1] in April 2023; restructured loans made up 1% of total banking sector loans as end-August 2023 and were not classified as NPLs.

Multiple mass retail, and SME-focused banks (e.g., NVB, OCB, VIB, TPB, HDB) exhibited a surge in NPL ratio by 1.2%-8.4% points coming from consumer loans (mortgage and vehicle loans) as well as real estate corporate loans (property developers and construction). We view the weakened debt serviceability was primarily among these highly leveraged retail and SME borrowers.

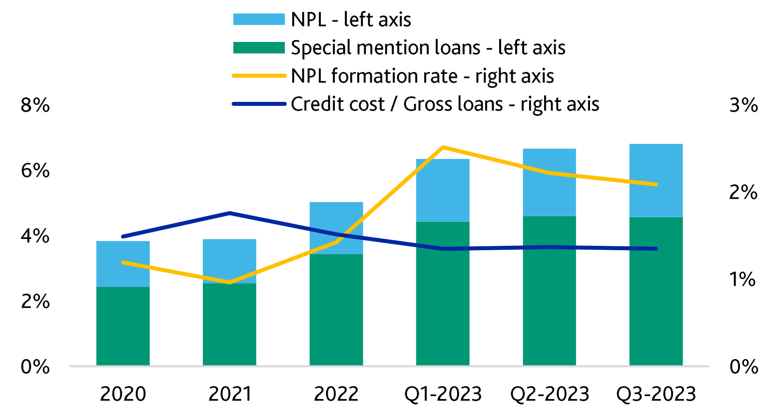
In addition, banks with sizeable consumer finance operations such as VPB and MBB also experienced a significant increase in delinquencies, as the slowing economy affected the income and repayment abilities of these higher-risk borrowers (Exhibit 2).

Many of these banks did not increase provisioning to address rising NPLs. Credit cost to gross loans declined to 0.8%-5% in 9M2023 from 1%-6% in 2022, resulting in weaker coverage (see in "Loss absorption buffer" section) – a credit negative.

In contrast, most SOBs' asset quality remained relatively steady with the NPL ratio only rising by 0.5% points, supported by their large and diversified corporate customer base. Among POBs, ACB exhibited stable asset quality, underpinned by its prudent lending practices and conservative loan growth.

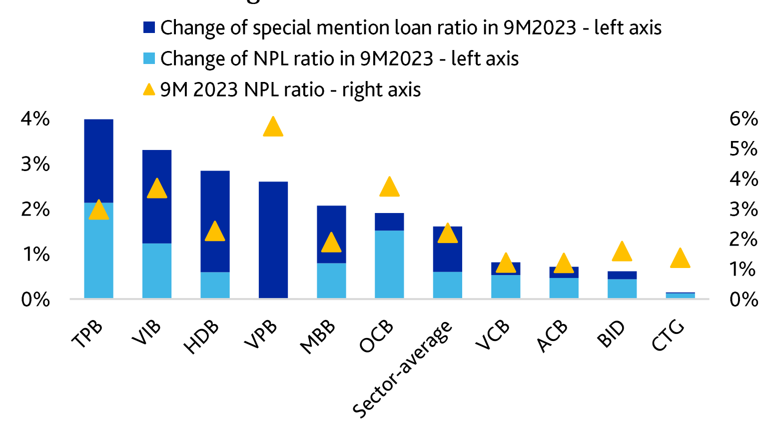
We expect the sector's NPL formation rate to slow as borrowers' debt repayment capability improves amid stronger operating conditions and low-interest rates. Most SOBs and ACB – with track record of resilient asset quality - will lead the sector's recovery.

Exhibit 1: The NPL formation rate slowed down, despite the NPL ratio remaining at a high level



Source: Company data, Vietnam Investors Service

Exhibit 2: SOBs and ACB maintained above sector-average asset quality with the smallest changes in overdue loan ratio



Note: Excluding NVB as an outliner with an NPL ratio of 26.3% in 9M2023
Source: Company data, Vietnam Investors Service

[1] Refer to Circular 02/2023/TT-NHNN: Regulations on credit institutions and foreign bank branches restructuring debt repayment terms and maintaining debt groups to support customers who are encountering difficulties.

High funding and credit costs and lower asset yields resulted in year-on-year ROAA declines for some retail and SME-focused banks

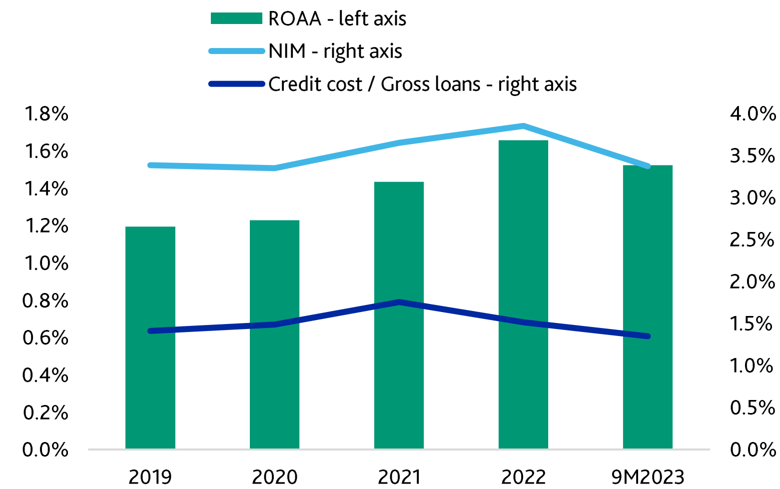
The sector average's ROAA declined to 1.5% in 9M2023 from the 5Y peak of 1.7% in 2022. This was driven by a narrower NIM (reduced by 0.5% point compared to end-2022) (Exhibit 3) given deposit rates adjusted quicker to higher rates than lending rates and weaker credit demand following consecutive rate hikes in Q4/2022.

VPB and TCB showed the largest ROAA declines by 1.6% and 0.7% points respectively as their asset yields weakened (Exhibit 4). Unlike peers adjusting higher lending rates following rate hikes, VPB showed unchanged asset yields given the bank's significant asset deterioration from retail loans. Meanwhile, TCB offered lower lending rates to support real estate developers.

In addition, profits for ABB, TPB, and EIB declined from slower credit growth (3.8% on average in 9M2023) and higher credit costs from their retail and SME loans.

In contrast, ROAAs improved strongly for STB given NIM recovery after resolving legacy assets; others benefited from their strong credit growth to corporate customers (MSB, MBB), and a recovery of security investment income (ACB, OCB). SOBs also showed resilience with lower credit costs due to stronger-than-industry LLCR.

Exhibit 3: ROAA decline was mainly driven by narrower NIM



Source: Company data, Vietnam Investors Service

Exhibit 4: Several banks showed significant declines in ROAA due to lower asset yield, weaker credit growth and higher credit costs

Source: Company data, Vietnam Investors Service

We expect 17 of the 27 banks covered by our analysis will struggle to achieve the 2023 profit plan (Exhibit 5).

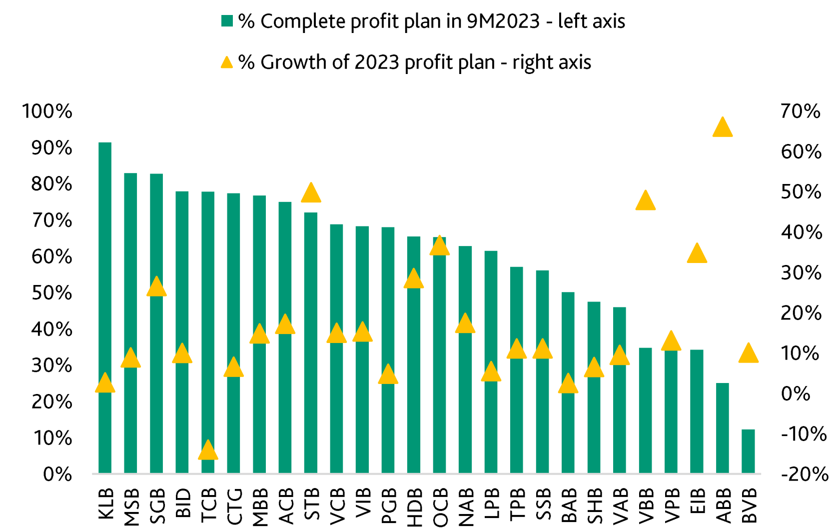
Several small POBs will fall short of their aggressive profit target, mainly driven by their subdued credit growth in 9M2023. Mid-sized and large POBs will also struggle from sizeable credit costs as these banks exhibit more significant asset deterioration. While banks with strong ROAA improvement and conservative plans are on track to achieve their profit plans for 2023.

We expect profitability to gradually recover in 2024 driven by a wider NIM with deposits adjusting quicker to lower rates than loans and credit demand picking up amid the economic recovery.

As high-cost deposits raised post-rate hikes in Q4/2022 mature, banks' deposit rates declined substantially; for Q3/2023, 12M deposit rates of SOBs and POBs were 5.45% and 5.7%, respectively (Exhibit 6).

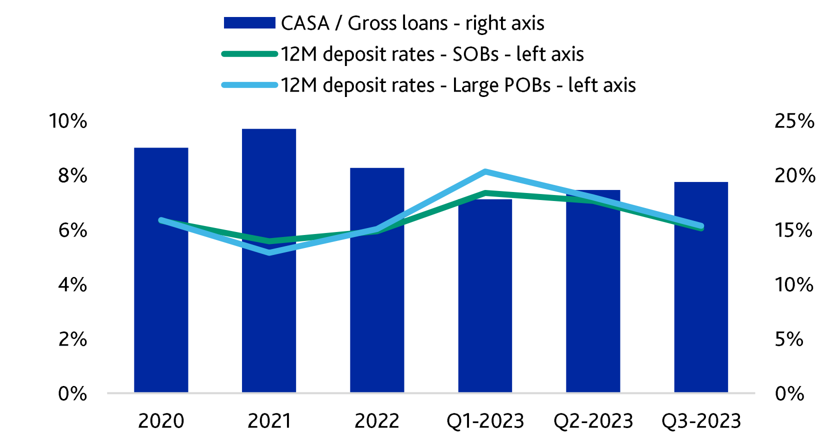
In addition, the current account and savings account (CASA) deposits started recovering given the low-interest rate environment. As such, we expect the banks' cost of funds will significantly adjust to lower rates. In addition, improving credit demand amid the economic recovery will enhance banks' lending yields.

Exhibit 5: Most banks will struggle to achieve the 2023 profit plan



Source: Company data, Vietnam Investors Service

Exhibit 6: Funding costs will significantly decrease given the low-interest rate environment and CASA recovery



Source: Company data, Vietnam Investors Service

Loss absorption buffer weakened in 9M2023 most significantly for small POBs

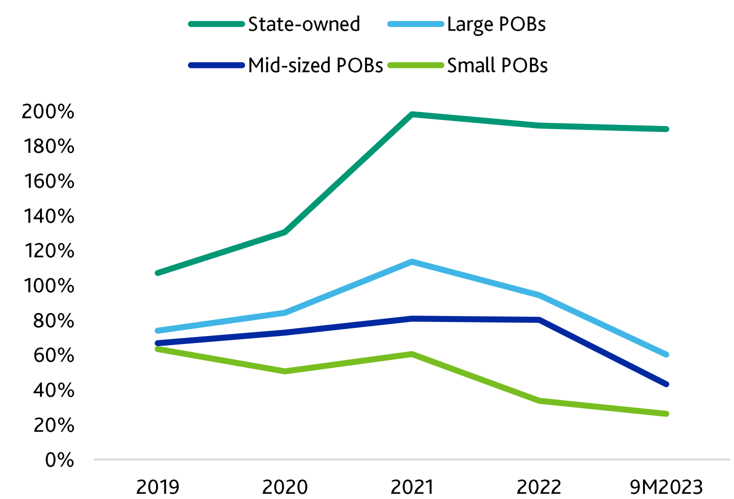
The banking sector's loss absorption buffer weakened in 9M2023 due to declining LLCR, weaker internal capital generation, and few meaningful capital raisings.

LLCR for POBs (e.g., TPB, STB, LPB) declined to 5-year low (55% on average as of end-September 2023, much lower than sector-average of 93%) given their significant asset deterioration (NPL rose by 0.8% to 2.9%) and modest provision charges. Meanwhile, SOBs maintained their strong LLCR at 190% due to their resilient asset quality (Exhibit 7).

The sector's capital level remained weak; Tangible common equity (TCE) fell to 8.7% of tangible assets, due to lower internal capital generation and few meaningful capital-raising plans (Exhibit 8). Only a few POBs completed capital-raising plans recently (Exhibit 9). Other banks such as BID and AGR will take a longer time to obtain the necessary approvals.

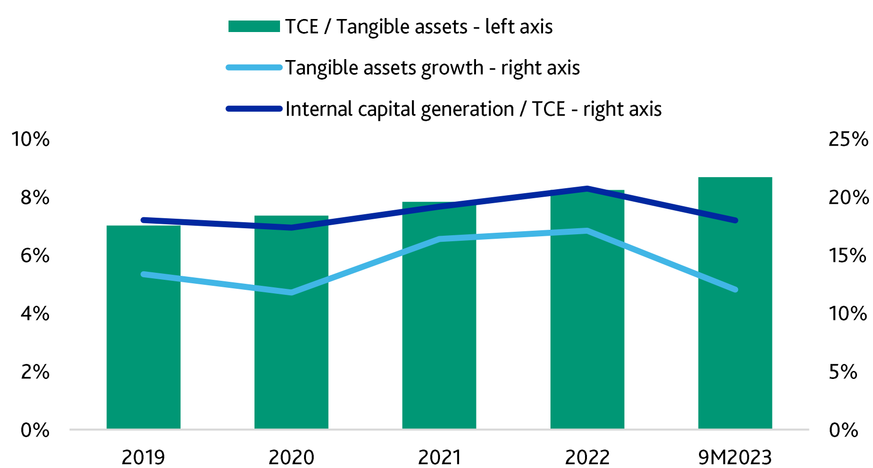
We expect the loss absorption buffer will recover modestly as improved bank profits will help strengthen their capital.

Exhibit 7: POBs showed stronger declines in LLCR compared to SOBs



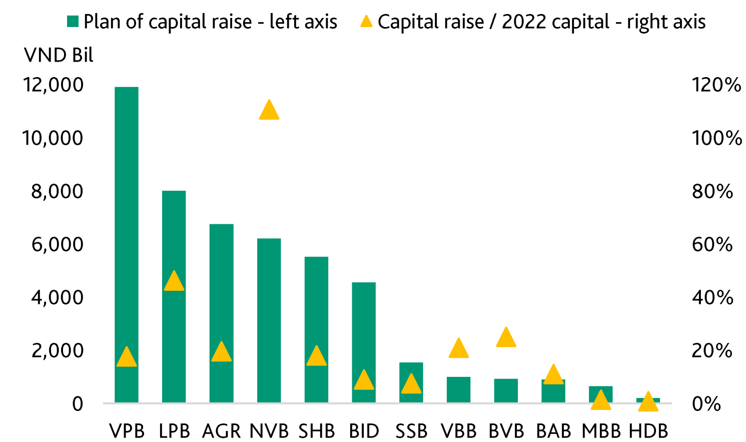
Source: Company data, Vietnam Investors Service

Exhibit 8: The sector's capital level remained weak



Source: Company data, Vietnam Investors Service

Exhibit 9: Only a few POBs completed capital-raising plans



Source: Company data, Vietnam Investors Service

Liquidity remained stable as the deposit growth caught up with credit growth

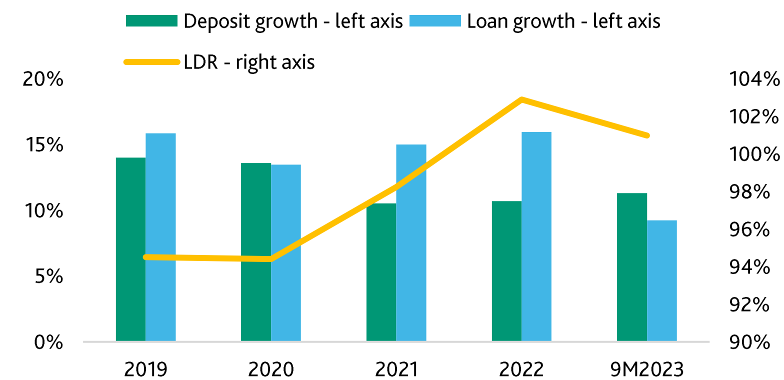
The sector's LDR held steady at 101% from a year ago as deposit growth (Exhibit 10) caught up with loan growth.

According to the State Bank of Vietnam (SBV), the sector's SMLR as of 9M2023 was still well-managed at 28%, below the regulatory limit of 30% from October 2023.

Banks focusing on long-term lending, for example, MBB, TCB, OCB VBB, and VIB actively raised long-term bonds to meet the stricter SMLR (Exhibit 11).

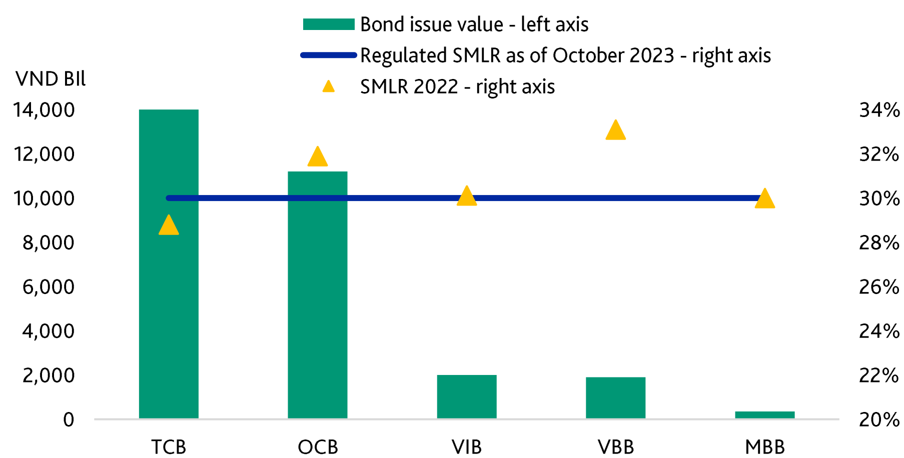
We expect the liquidity position to remain stable (Exhibit 12) given stronger deposit growth will keep pace with credit growth as the corporate cash flows recover alongside improved business conditions and higher funding stability from the stricter SMLR requirement.

Exhibit 10: LDR declined as the deposit growth caught up with slow credit growth



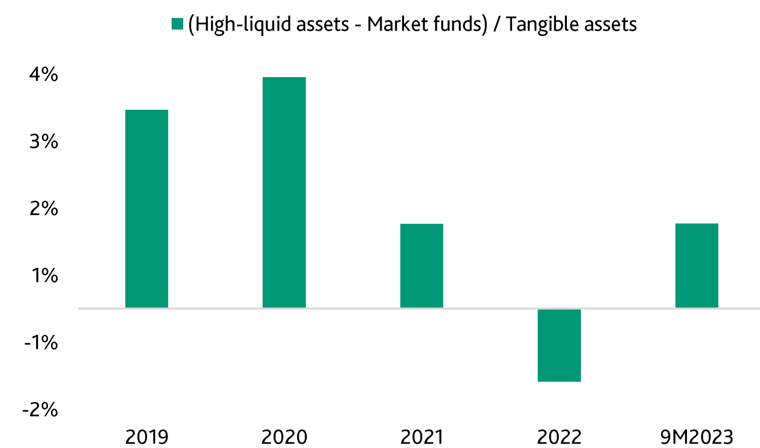
Note: 9M2023 represents year-to-date loan and deposit growth
Source: Company data, Vietnam Investors Service

Exhibit 11: Banks with high SMLR actively issued bonds in 9M2023



Source: HNX, Vietnam Investors Service

Exhibit 12: The liquidity position improved from the trough in 2022



Note: High-liquid assets consist of cash, balance at SBV, interbank deposit and lending, and government bonds.
Market funds consist of the State treasury's deposit, deposit and borrowing from other credit institutions, grants and trusted funds, and valuable papers issued.
Source: Company data, Vietnam Investors Service

APPENDIX

The banks included in our analysis are as follows:

	Short name	Full name	Classification
1	ABB	An Binh Commercial Joint Stock Bank	Small
2	ACB	Asia Commercial Joint-Stock Bank	Large
3	BAB	Bac A Commercial Joint Stock Bank	Small
4	BID	Joint Stock Commercial Bank for Investment and Development of Vietnam	SOCB
5	BVB	Viet Capital Commercial Joint Stock Bank	Small
6	CTG	Vietnam Joint-Stock Commercial Bank for Industry and Trade	SOCB
7	EIB	Vietnam Commercial Joint Stock Export Import Bank	Mid-sized
8	HDB	Ho Chi Minh City Development Joint Stock Commercial Bank	Mid-sized
9	KLB	Kien Long Commercial Joint Stock Bank	Small
10	LPB	Lien Viet Post Joint Stock Commercial Bank	Mid-sized
11	MBB	Military Commercial Joint Stock Bank	Large
12	MSB	Vietnam Maritime Commercial Joint Stock Bank	Mid-sized
13	NAB	Nam A Commercial Joint Stock Bank	Mid-sized
14	NVB	National Citizen Commercial Joint Stock Bank	Small
15	OCB	Orient Commercial Joint Stock Bank	Mid-sized
16	PGB	Petrolimex Group Commercial Joint Stock Bank	Small
17	SGB	Saigon Bank for Industry and Trade	Small
18	SHB	Saigon - Hanoi Commercial Joint Stock Bank	Large
19	SSB	Southeast Asia Commercial Joint Stock Bank	Mid-sized
20	STB	Saigon Thuong Tin Commercial Joint Stock Bank	Large
21	TCB	Vietnam Technological and Commercial Joint-Stock Bank	Large
22	TPB	Tien Phong Commercial Joint Stock Bank	Mid-sized
23	VAB	Vietnam Asia Commercial Joint Stock Bank	Small
24	VBB	Vietnam Thuong Tin Joint Stock Commercial Bank	Small
25	VCB	Joint Stock Commercial Bank for Foreign Trade of Vietnam	SOCB
26	VIB	Vietnam International Commercial Joint Stock Bank	Mid-sized
27	VPB	Vietnam Prosperity Joint Stock Commercial Bank	Large

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