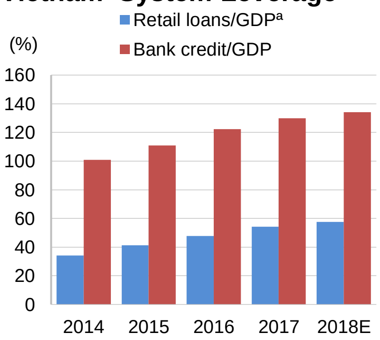
Consumer Lending in Vietnam

Rising Leverage Adds to Risks in Financial System

Special Report

Vietnam System Leverage



[a] System figure proxied from top 11 banks
Source: Fitch Ratings, SBV, banks

Fitch-Rated Vietnam Banks

	Long-Term IDR/Outlook/VR
Vietnam Joint Stock Commercial Bank for Industry and Trade (Vietinbank)	BB-/Positive/b
Joint Stock Commercial Bank For Foreign Trade of Vietnam (Vietcombank)	BB-/Positive/b
Asia Commercial Joint Stock Bank (ACB)	B/Stable/b
Military Commercial Joint Stock Bank (MB)	B+/Stable/b+

Source: Fitch Ratings

Rising Risks: Fitch Ratings believes recent consumer loan growth will make the banking system increasingly susceptible to shocks. Risk is rising as we expect household leverage to increase from a level that is already high because loan traction is likely to remain strong. Prolonged and rapid credit growth heightens the risk of asset-quality deterioration when banks remain burdened by large bad-debt issues and thin capital buffers. However, the risk of a spike in impairments in the near term appears limited amid the supportive economic environment.

Consumer Leverage Increases: The Vietnamese banking system's credit leverage, measured by total bank credit/GDP, of 134% far exceeds the 'BB' median of 60% and 'BBB' median of 55%. The increase in recent years has been primarily driven by the consumer sector, whose leverage jumped to 58% of GDP by end-2018 from 31% at end-2013, based on our estimates. This is much higher than that of the Philippines (10%) and Indonesia (17%).

Eroding Debt-Servicing Capability: Consumer debt is also growing faster than national wage levels, which suggests an erosion in borrowers' loan-servicing capability. Fitch estimates Vietnam's consumer debt per labour force rose to 83% of the national mean annual income of workers by end-2018, from 42% at end-2013. We expect this ratio to rise as consumer-loan growth is likely to continue outpacing income growth.

Largely Secured; Asset Quality Untested: Retail loans formed 44% of total loans at end-2018, up from 32% at end-2013, for the top 11 domestic banks. The banks' exposures in this segment tend to be secured by property, which should help recovery prospects in the event of default, and the rising share of retail loans has also helped banks, especially state-owned banks, reduce loan concentration risks in state-linked corporations.

Nevertheless, we believe rapid credit growth often masks asset-quality issues and the higher exposure to real estate would also make banks more vulnerable to a property downturn. Some smaller banks (not rated by Fitch) have also been active in the unsecured and micro-consumer loan segment, whose borrowers tend to be of lower quality than traditional banking clients.

Regulatory Safeguards: We think current policy settings for the consumer sector are accommodative, notwithstanding recent policy changes. State Bank of Vietnam (SBV) has introduced and proposed several measures, such as higher risk weightings, over 2016-2019 to discourage banks from over-lending to the real-estate sector, and also imposed lending caps on the micro-consumer loan sector, which should deter over-borrowing and help ease the build-up in systemic risks.

Ratings Sensitivities: A material deterioration in asset quality in the event of stress in the property sector and/or broad consumption fallout – neither of which is our base case – would be likely to exert negative pressure on the banks' Standalone Credit Profiles.

We have, to a certain extent, factored these risks into the Standalone Credit Profiles of the Fitch-rated banks that have Viability Ratings (VRs) in the 'b' category, but we view them as among the strongest in the system. The rating impact would hinge on the severity of the fallout – whether it pervades other parts of the economy, denting consumer and business confidence – and the extent to which it becomes a binding constraint on the banks.

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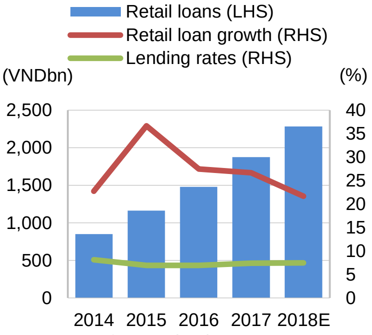
Retail Loan Growth vs. Rates



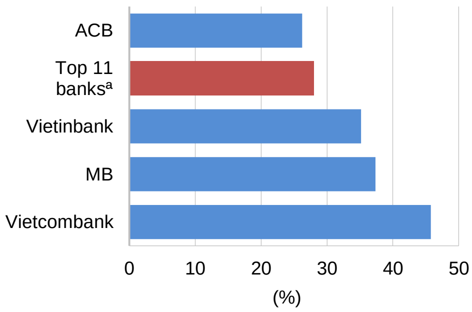
Aggregate of top 11 banks
Source: Fitch Ratings, World Bank, banks

Retail Lending in Vietnam

Consumer lending in Vietnam has increased strongly since 2013 on the back of rising affluence amid strong economic growth. We estimate that the top 11 Vietnamese banks[1], whose combined loans make up roughly 70% of system loans, have expanded their consumer portfolios by a 28% CAGR over 2014-2018, outpacing non-consumer credit's 15% CAGR. As a result, the proportion of consumer loans has increased to an estimated 44% of total loans by end-2018, from 32% at end-2013.

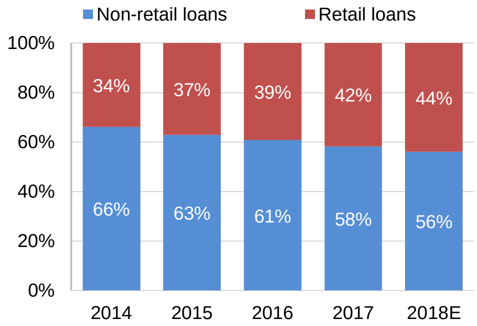
The loan compositions of Fitch-rated banks indicate that a significant proportion of their retail loans are mortgages (36% of retail loans) and household business loans, which are largely backed by property. We expect a rising urban population, higher contributions from domestic consumption underpinning GDP growth, and greater acceptance towards mortgage financing to continue to drive retail-loan demand over the next few years.

Retail Loan Growth
2014-2018 CAGR



[a] Weighted average
Source: Fitch Ratings, banks

Loan Composition
Aggregate of top 11 banks



Source: Fitch Ratings, banks

We believe consumer loans' generally higher yields and more favourable risk-weighting treatment for mortgages compared with corporate lending, under the local Basel II standards (Circular 41) scheduled to be implemented in January 2020, have incentivised banks to continue to focus on expanding their consumer portfolios.

Circular 41 Risk Weighting

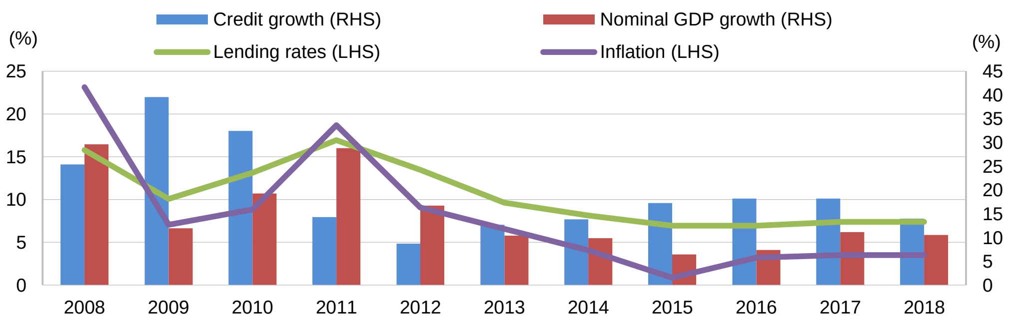
Loan type	Risk weights
Mortgages	25%-100%
Corporates	50%-250%

Source: Fitch Ratings, SBV

High and Rising System Leverage Poses Risks

Rapid credit expansion, however, raises the risk of a repeat of the country's double-digit inflation in 2011 and asset-quality problems following years of fast loan growth. Bank lending expanded by an average 38% per year during 2007-2010. The authorities aggressively raised lending rates to combat the overheating economy, which dented the real-estate market and raised borrowers' debt burden. This, along with a sharp depreciation in the Vietnamese dong, triggered a spike in non-performing loans.

Comparing Credit Expansion, GDP Growth, Inflation and Lending Rates



Source: Fitch Ratings, Fitch Solutions, World Bank

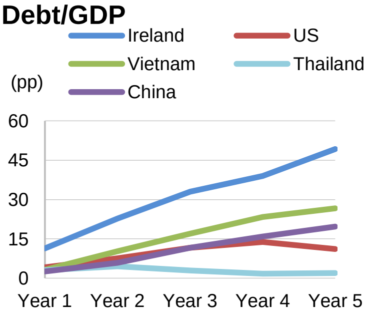
Related Criteria

Bank Rating Criteria (October 2018)
Short-Term Ratings Criteria (May 2019)

[1] Four Fitch-rated Vietnamese banks listed on the first page, Vietnam Bank for Agriculture and Rural Development, Bank for Investment and Development of Vietnam, Saigon Thuong Tin Commercial Joint Stock Bank, Vietnam Technological and Commercial Joint Stock Bank, Vietnam Prosperity Joint Stock Commercial Bank, Saigon Joint Stock Commercial Bank and Saigon Hanoi Commercial Joint Stock Bank

Credit growth over the last four years may have slowed but it has been outpacing nominal GDP growth. The system already has a large number of problem loans and credit leverage is high, as indicated by the total bank credit/GDP ratio of 134%, which is significantly higher than the 'BB' median of around 60% and 'BBB' median of 55%. We expect this ratio to edge higher, propelled by sustained high system loan growth, led by consumer loans. The banks' ability to navigate asset-quality risks emanating from a fallout in the consumer sector remains untested.

Increase in Household Debt/GDP

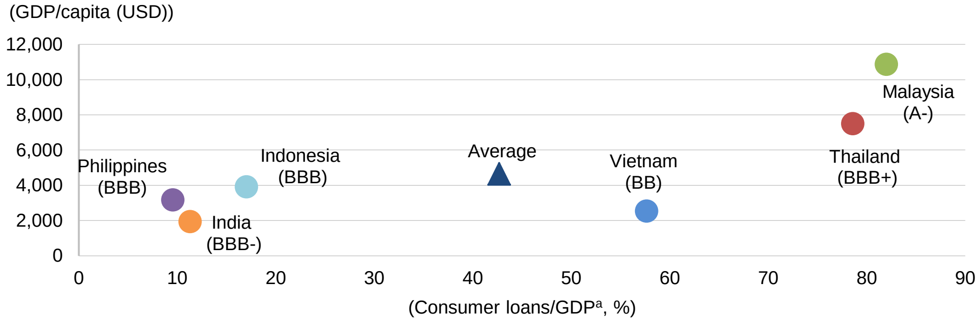


2003-2008 for US, Ireland
2013-2018 for Vietnam, China, Thailand
Source: Fitch Ratings, BIS

A Comparative Look

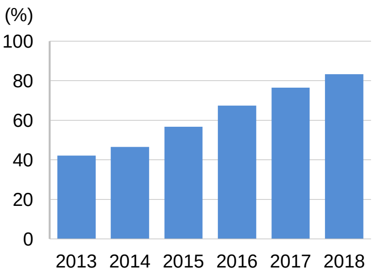
The Vietnamese banking system's consumer loans accounted for 58% of GDP at end-2018, based on our estimates, representing a sharp increase from 31% at end-2013. This is much higher than the emerging-market average of 39%[2] and the difference is greater when compared with that of many south and south-east Asian countries whose economies are more developed. System credit leverage would likely be higher if informal micro-consumer finance loans were included.

GDP Per Capita vs. Consumer Loans/GDP



[a] Data at-end 2018 except for Indonesia and India, which are as at 3Q18. Average is simple average
Source: Fitch Ratings, Fitch Solutions, Bank of International Settlements, central banks

Consumer Debt/Annual Workers' Wage
Per labour force



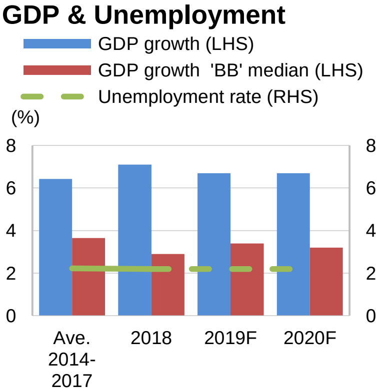
Fitch estimates
Source: Fitch Ratings, GSO

The rate of increase in Vietnam's household debt/GDP over the last five years has remained well below that of Ireland in the run-up to the country's domestic property crisis and the global financial crisis in 2008, but it has outpaced that of the US (before the crisis), China and Thailand. However, Vietnam's property price increase has been largely steady over the last three years, and mortgage credit standards for Fitch-rated banks do not appear excessive with maximum loan-to-value ratios capped at 80%.

Reduced Debt-Servicing Capability

We think it is equally important to evaluate the sustainability of a country's consumer indebtedness with respect to its income levels. To assess overall debt sustainability in the absence of official household-income data, we have used salaried workers' wage data from the General Statistics Office as a proxy for income, which we have compared with outstanding consumer loans per labour force.

GDP & Unemployment

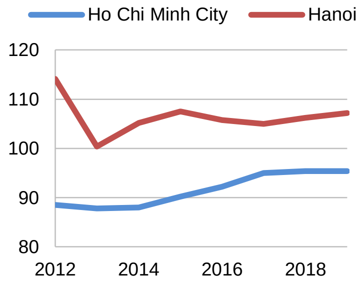


Source: Fitch Ratings, Fitch Solutions

Fitch estimates that Vietnam's consumer debt per labour force reached around 83% of the mean national annual income of workers by end-2018, up from 42% at end-2013. We believe the ratio could be overstated as the income component does not take into account remittances from Vietnamese who work abroad. Annual remittances constituted 6%-7% of GDP over the past 10 years, based on data from the World Bank. Nevertheless, the rising trend suggests an erosion in consumer debt-servicing capacity and we expect this to persist as consumer loan growth is likely to continue to outpace income growth in the near term.

[2] Based on Bank of International Settlement data at 3Q18

Residential Property Price Index
1Q09 = 100



Source: Fitch Ratings, Savills

Near-Term Stress Unlikely

The longer rapid consumer-loan growth is sustained, the more vulnerable the banking system could become to shocks and asset-quality deterioration. The banks' growing exposure to the residential property market also makes them susceptible to a shift in real-estate market sentiment. Vietnam's relatively open economy also exposes the country to external risks. A shock to domestic interest and exchange rates, possibly through undue tightening in global liquidity, is likely to have repercussions for the financial system as the household debt-servicing burden increases.

Nevertheless, a consumer-debt crisis in the near term is less likely in light of the relatively benign economy. Fitch expects Vietnam's GDP to grow 6.7% a year in 2019 and 2020 (2018: 7.1%) – ranking it one of the fastest-growing countries in the Asia-Pacific – while the unemployment rate continues to be low at 2.2% and inflationary pressures remain subdued (an average 2.6% yoy in 1H19).

In addition, Savills' house price index for major cities (Vietnam does not have a national property index) shows that property price increases have been modest, suggesting current demand is likely to be more fundamentally driven than in previous cycles.

The SBV has also demonstrated some level of readiness to ensure the real-estate sector remains healthy, as indicated by some of the macro-prudential measures it has introduced. For example, the central bank increased risk weights on loans for real-estate investments to 200% from 150% in 2016 and recently proposed an increase in the risk weight on housing loans worth more than VND1.5 billion (USD60,000) to 100%-150% from 50%. This should ensure the banks maintain some level of discipline in underwriting new housing loans.

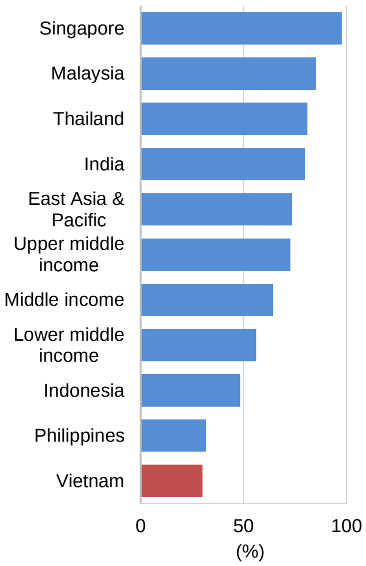
The Fitch-rated banks' VRs in the 'b' category already reflect, to a certain extent, the risks they face from the rapid growth in consumer lending, and we believe they are among the strongest banks in the country. Any change in their ratings would depend on the pervasiveness of a fallout and the degree to which consumer and business confidence are hurt, as well as the extent to which it becomes a binding constraint on the banks.

Appendix: Micro-Consumer Loan Landscape in Vietnam

Expansion into Vietnam's micro-consumer lending sector has been very aggressive as players have been drawn by the segment's highly lucrative business potential, with interest rates that could exceed 50% per year, and the country's favourable demographics, driven by rising consumerism and a large underserved and unbanked population. Only 30% of Vietnam's population has bank accounts compared with East Asia and the Pacific's average of 73% and Indonesia's 48% at end-2017, according to the World Bank's Global Findex.

Micro-consumer loans are inherently of higher risk relative to traditional mortgages or household personal-business loans in light of the unsecured nature of these loans and the borrowers' profiles, which are traditionally outside the banking system's target customer. The majority of these customers are therefore served by the black market and consumer-finance companies.

Banking Accounts
% of population



Note: At end-2017
Source: Fitch Ratings, World Bank

Some banks, however, have ramped up or established a presence in the sector, in particular smaller private commercial banks such as VP Bank, Orient Commercial Bank, HD Bank and Southeast Asia Commercial Bank. Foreign investors such as Japan's Credit Saison, and South Korea's Lotte Group and Shinhan Financial Group have also taken an interest in the market by partnering with local consumer-finance companies.

Fitch-rated state-owned banks, on the other hand, have been wary of the segment so far, citing the lack of know-how in developing risk and operational processes to monitor these high-risk consumers. As such, we believe their foray into this market is likely to include foreign investor participation.

We believe loan growth in this segment is likely to continue to moderate slightly in the near term, after having grown rapidly over the last five years. This is premised on the introduction of regulatory caps of VND100 million per customer in 2017 and recently proposed changes, which will limit consumer-finance companies' unsecured cash loan exposure to 30% of their total loans.

Nevertheless, credit expansion in the micro-consumer sector is likely to remain high relative to GDP and income growth over the next few years. We do not expect a crisis scenario in the near term, but a continued increase in the interlinkages between the sector and the banking system would make the banks, even Fitch-rated ones, more vulnerable in the event of an economic downturn.