Mumbai, November 2012

# VIETNAM
# COUNTRY REPORT


**TRINH HOAI GIANG**

**Vice Chairman**

**VIETNAM BOND MARKET ASSOCIATION**

# 1. THE ECONOMY

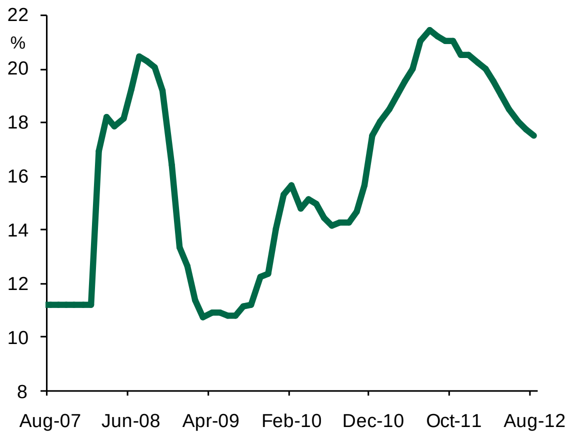
# OVERVIEW

- After two years of painful monetary and fiscal discipline, Vietnam has broken the boom/bust cycle and put its economy on a sound footing for "growth with stability"
- Inflation has been whipped, external accounts rationalized and the currency restored – and there has also been progress on reining in SEOs
- The Government deserves full credit, but policy discipline has also brought decelerating growth, and this is a challenge because reform has two phases
- *Phase I*, sorting out macro indicators, may have been the easier part
- *Phase II*, curbing the vested interests and the bank / SOE nexus, has proven more difficult – but recent events mark a beginning, albeit a hard-fought one
- The deeper reform campaign is underway, and its ongoing progress will help the economy push through its growth slump, with a bottom seen in 1Q13
- Meanwhile the market is by far Asia's cheapest, at 8.5x PER on +14% EPS growth, and it is primed to motor at the first sign of renewed reform momentum

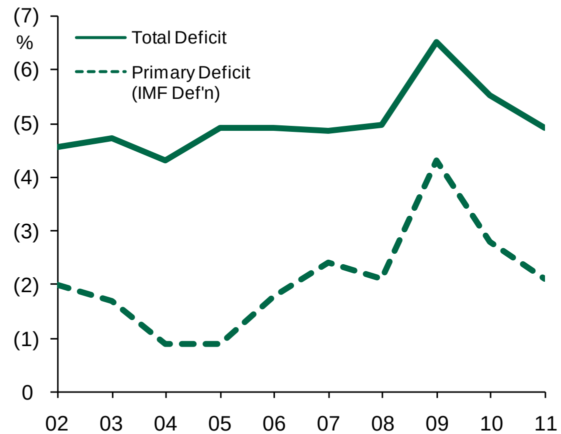
# PHASE I REFORM: LEAD INDICATORS

Monetary/fiscal tightness has seen key macro numbers all move the right way in past year

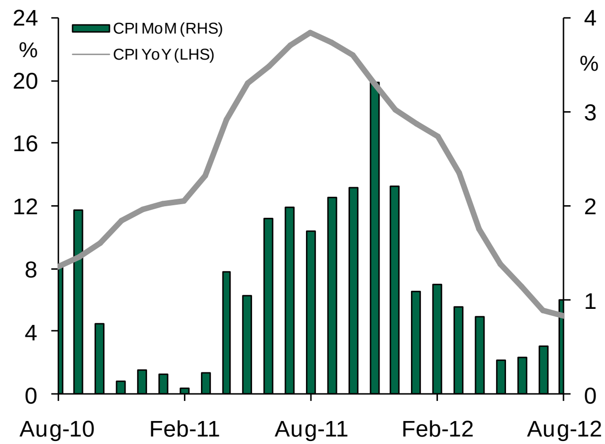
### MONETARY: CAUTIOUS RATE CUTS



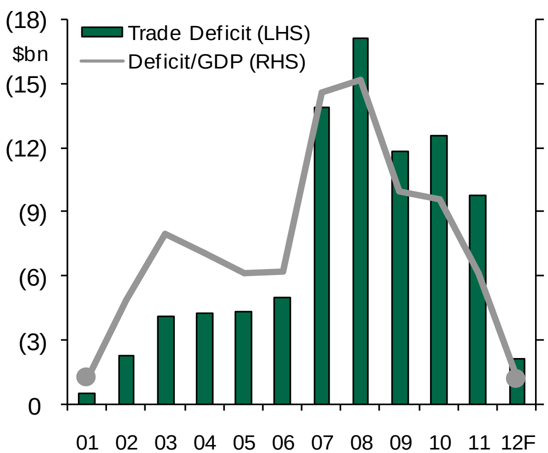

### FISCAL: DOWNTREND BEGINS



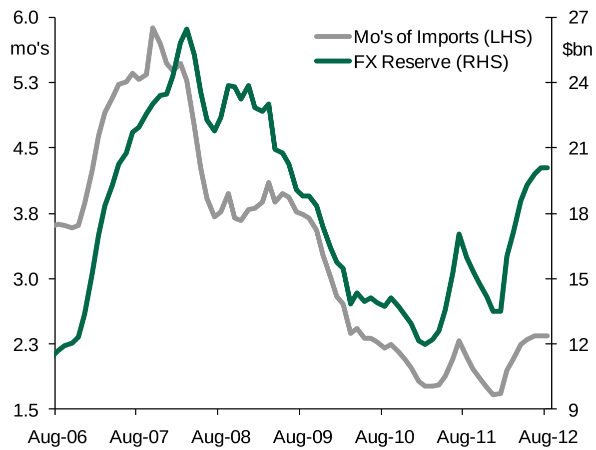

### INFLATION: PEAKED AND FALLING



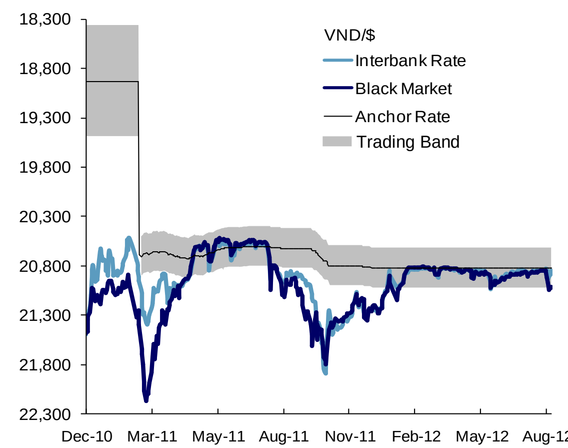

### TRADE DEFICIT: DOUBLY DECLINING




### FX RESERVES: REBUILDING




### CURRENCY: CA 21000 SINCE 2011



# PHASE I REFORM: GROWTH MODEL

Government has moved from forced high growth to "growth with stability", and has made good progress in implementing the new strategy

| ITEM | 2006-10 | NOW |
|---|---|---|
| Macro Strategy | Growth via aggressive fiscal / monetary stimulus, channeled thru SOEs that are designated as chaebol-type growth drivers, with license to do anything | "Growth with stability": fiscal / monetary restraint, prioritization of inflation and currency management, roll-back of SOEs to core businesses |
| Loan Policy | No targets for credit, with result of 31% average growth | Target of 15% pa for credit growth |
| Monetary Policy | No targets for M2, with result of 35% average growth | Target of 15% pa for M2 growth |
| Fiscal Policy | Official deficit > 5%, and unrestricted SOE investment creates off-budget spending that adds massively to final shortfall | Official deficit targeted at 3% for 2015, while strict limits on SOE investment greatly reduce final budget gap |

# PHASE I REFORM: SOE CONTAINMENT

Since Vinashin, Government has halted the expansion of SOEs, and many former high-ranking executives have been dismissed, jailed or investigated

| ITEM | 2006-10 | NOW |
|---|---|---|
| Economic Role | Enthroned as all-powerful growth champions, with control of strategic industries and mandate to lead development | Recognized as Frankensteins, with exec's from Vinashin, Vinalines, EVN and Agribank removed from their posts and disgraced |
| Corporate Status | Implicit Gov't guarantee for all loans and losses | Demoted to limited-liability companies, with no more automatic subsidies |
| Borrowing Terms | Better than Triple-A as market priced in nil risk | Cost of funds is 200-300bps above private sector and 300-500 bps above VGBs |
| Investments | 19.5% of GDP in 2010 | 11.2% of GDP in 1H12 |
| Non-Core Businesses | No restriction, with result of massive debt-funded expansion into speculative ventures, led by property and financial enterprises | Target of maximum 15% of paid-in cap and anecdotally there is ample evidence that divestment has started |
| Transparency | All data a "State secret" | Plans to publish key financial results |

# PHASE I REFORM: BANK CONTAINMENT

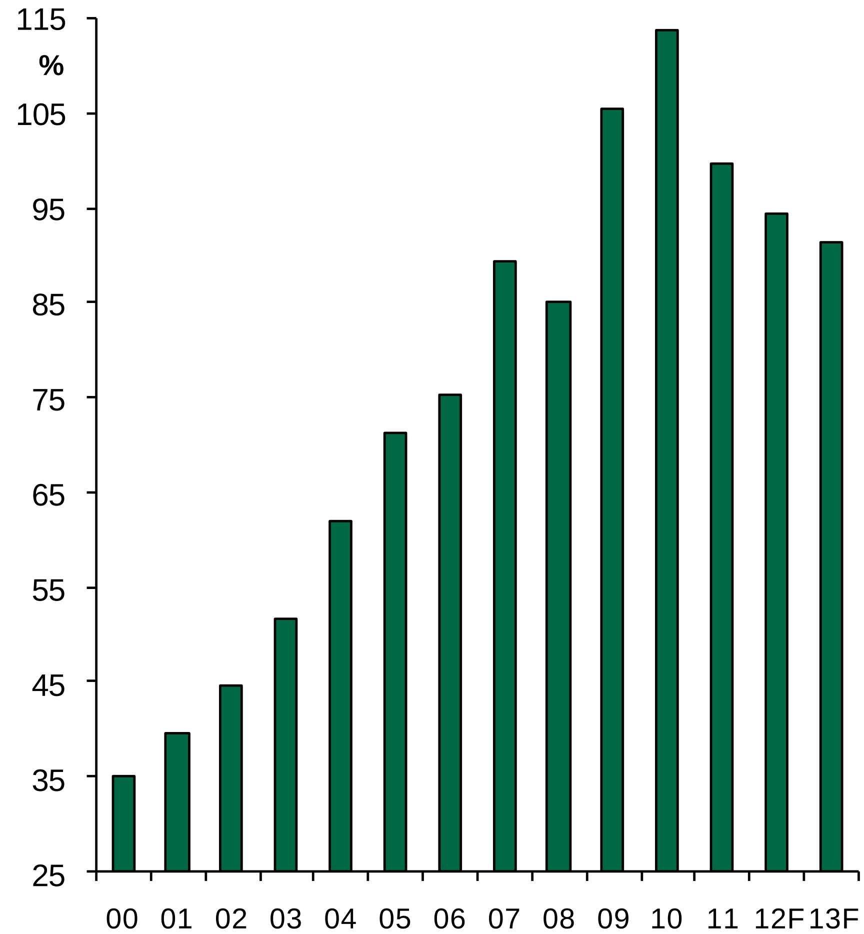
Much tougher prudential regulation is being imposed on banks with Vietnam's own Basel III, raising risk-management standards while controlling quantity and quality of loan growth

| ITEM | 2006-10 | NOW |
| --- | --- | --- |
| General Status | Pell-mell expansion of banks is officially encouraged to fuel growth, but with no serious regulation or oversight | Government has greatly expanded regulations, while evolving plans to break State Bank / SOE nexus |
| Loan Growth | No restrictions; State and crony banks lend indiscriminately to SOEs for their get-rich diversification schemes | New credit targets, high rates and risk aversion see loans at just +3.5% yoy as of Aug: part over-kill, but also part shake-out |
| NPLs | Fiction of 2-3% | Recent SBV estimate of 8-10% |
| Paid-In Capital | No requirement | $150m now; proposed $500m by 2015 |
| CAR Calculation | 8% - cum general provision, ex RPLs | 9% - ex general provision, cum RPLs |
| Branch Expansion | No rules | $10m capital per branch |

# PHASE I REFORM: BANK RESTRUCTURING

- As loan growth slows, loans/GDP have plunged, putting Vietnam in deleveraging mode
- But NPLs still loom large at a consensus 8-12% of loans – say $13bn on the current book of $125bn
- With collateral at about 1.35x, and discounts calculated at 50%, uncovered NPLs may be $4bn
- That is 30-35% of banks' net equity, and a couple years of earnings - but it's not Thailand 1997
- The SBV has a good work-out program involving consolidations, re-caps, bad banks or AMCs, etc.
- Over a two- or three-year period, with good admin and timely asset sales, the SBV could probably find the funds to make its program work
- The SBV tried to merge a few small banks in 2011-12, with limited success, but it showed it had a plan
- And ability to resist its plan may be dwindling

**LOANS / GDP, 2000-12F**



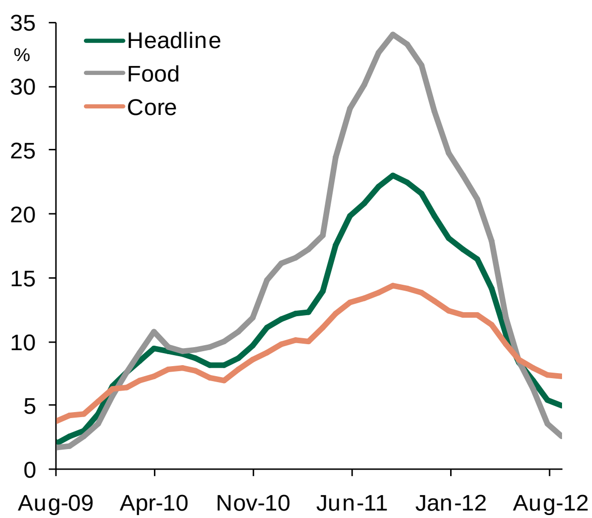
# PHASE II REFORM

- The Government has made significant headway in containing banks and SOEs, but that is not enough - the former must be fully restructured, and the latter privatized
- The extraordinary resolve the Government showed in Phase I reform is still there for Phase II, but it first needs to clear away opposition from the vested interests
- Earlier this year the Communist Party issued Resolution Three, to upgrade and accelerate the anti-corruption effort
- This was followed by Resolution Four, requiring self-criticism by all members – the first such procedure since 1968 – and prompting internal realignments
- Recent actions against bankers show Vietnam’s reform elements going actively on the offensive – and they are likely to increase their momentum
- In the end, bank overhauls may simply be unavoidable: low growth from non-lending banks is politically unacceptable, but scope for fiscal / monetary stimulus is limited
- Progress on banks would pave the way for a re-start of SOE privatization

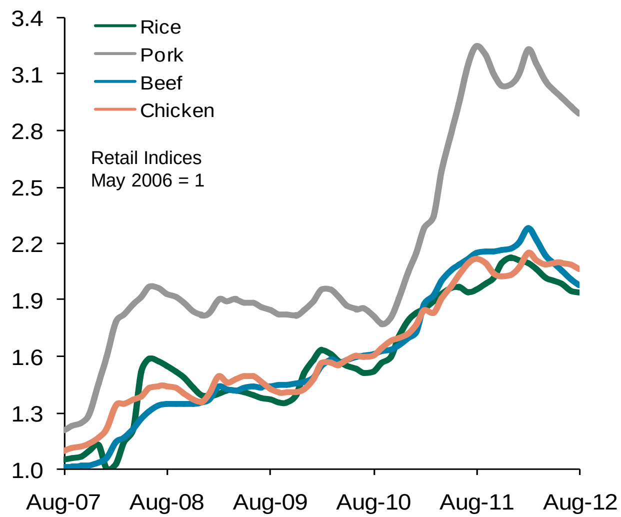
# INFLATION

- Lax fiscal /monetary policy has historically been main inflation motor, but not the only one
- In the past 18 months, numerous other forces have imposed themselves: subsidy cuts on public goods, the agri-commodity boom, Chinese pork-buying, floods – and devaluation itself
- But inflation has been trending rapidly lower as fiscal / monetary looseness is corrected and one-offs price hikes drop out of the base
- 2012 CPI is likely to be 6%, with subsidies on petrol, water and other key staples terminated
- 2013 CPI is expected at 7-8%, on a view that food and foodstuff prices may tick up

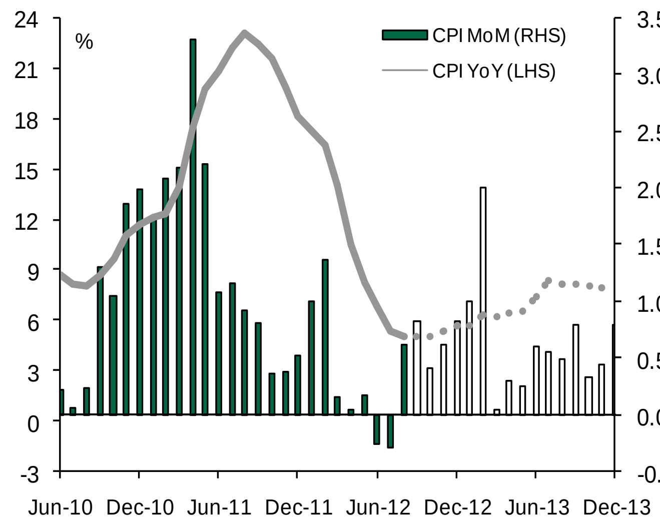
**INFLATION, 2009-12**




**FOOD PRICE INDICES, 2007-12**



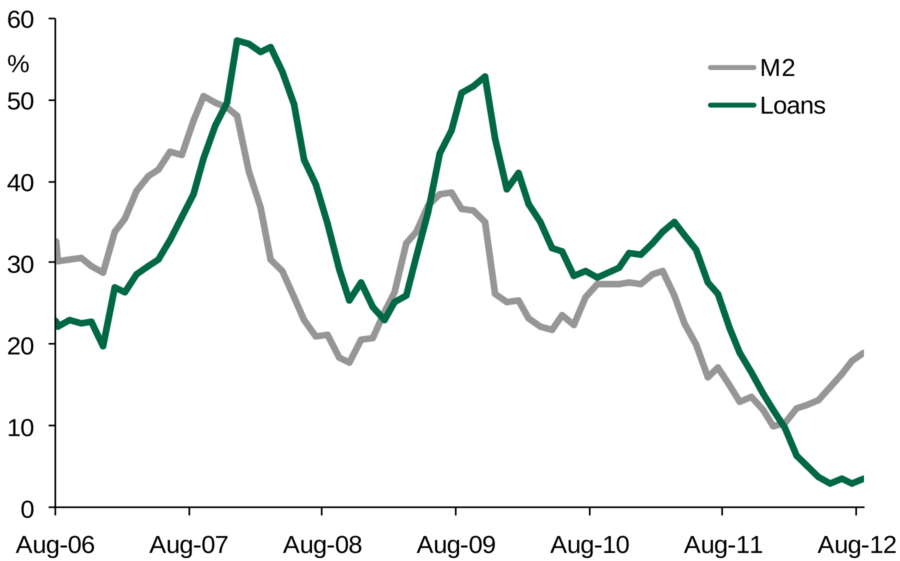

**INFLATION 2010-13F**



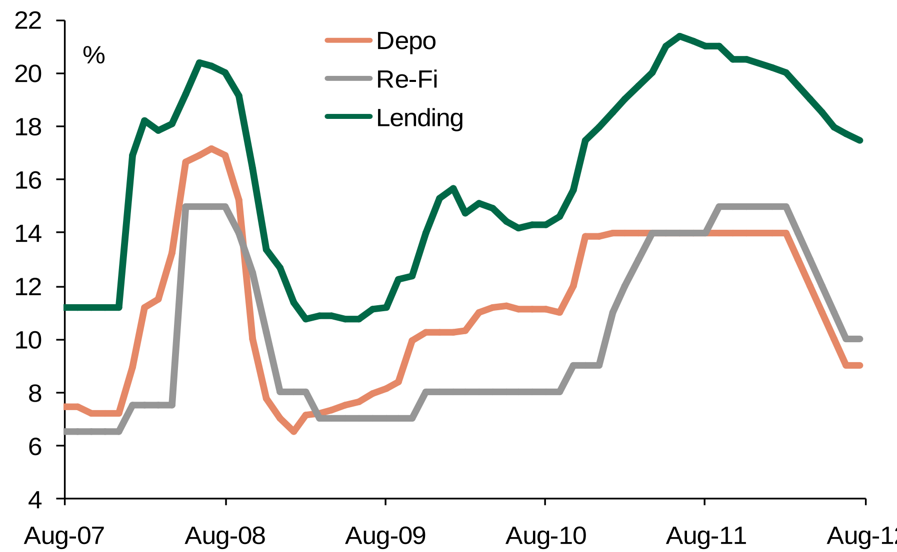
# MONETARY POLICY

- Government put policy rates up to a peak of 15% by early 2012, but has cut them to 8-9% now
- Unhappily, the decline in lending rates, from 21% to 16%, has been much less, while loan growth remains moribund at +3% yoy
- This is despite a resurgence of M2, and reflecting several factors - banks' risk aversion, their upper hand with businesses and their effort to bolster NIMs while raising NPL provisions
- Lending will pick up as NPLs are sorted out and bank restructuring accelerates, but the process is likely to be a slow one – loan growth may not be much more than +10% in 2013

**LOAN AND M2 GROWTH, 2006-12**



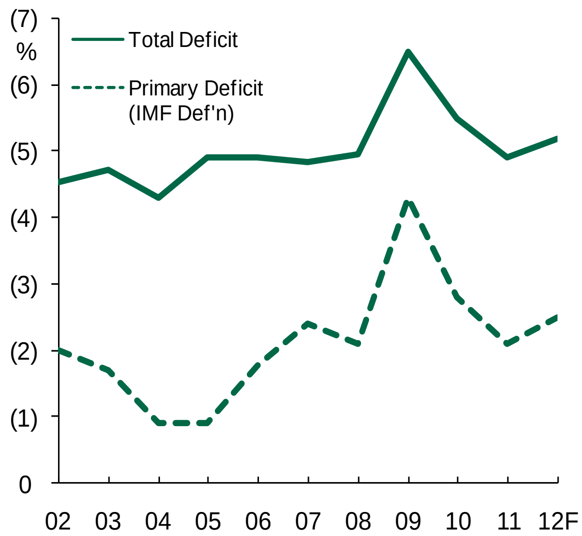

**INTEREST RATES, 2007-12**



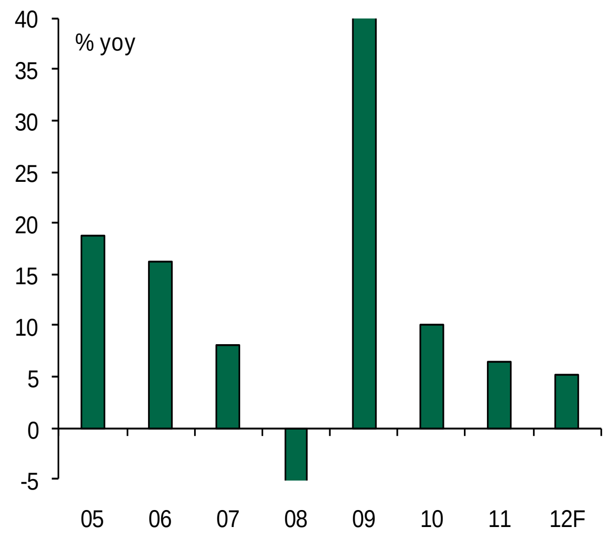
# FISCAL POLICY

- Official budget deficit fell sharply in 2010-11 as investment spending was controlled
- The gap is ticking up in 2012 as wage hikes become unavoidable, while revenue is under pressure
- But expenditures are under careful management – public investment has plunged from 43% of GDP in 2010 to 34% in 1H12, with SOEs moving from 19% to 12%
- Off-budget spending on SOEs is also known to have contracted dramatically – this is significant, and if it were added to the official deficit, the combined total would show a healthy decline
- Meanwhile the Government is working hard on revenue enhancements, per the development of PIT

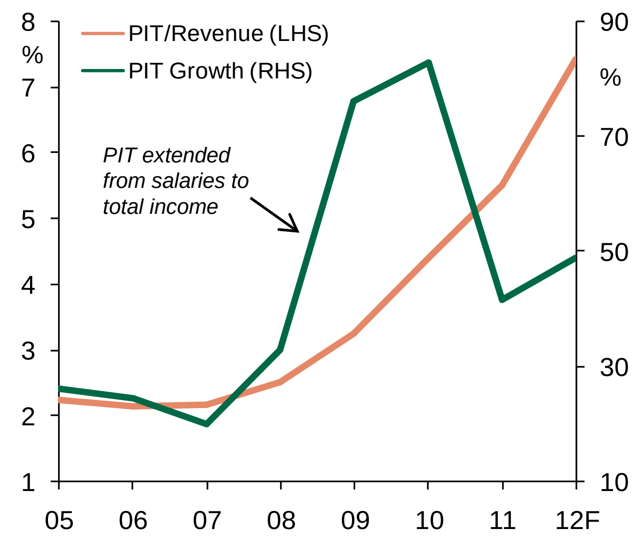
## DEFICIT / GDP




## GOV'T AND SOE INVESTMENT



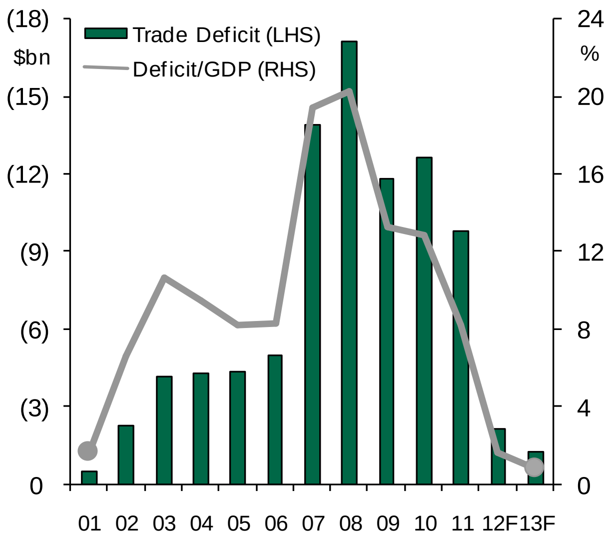

## PERSONAL INCOME TAX



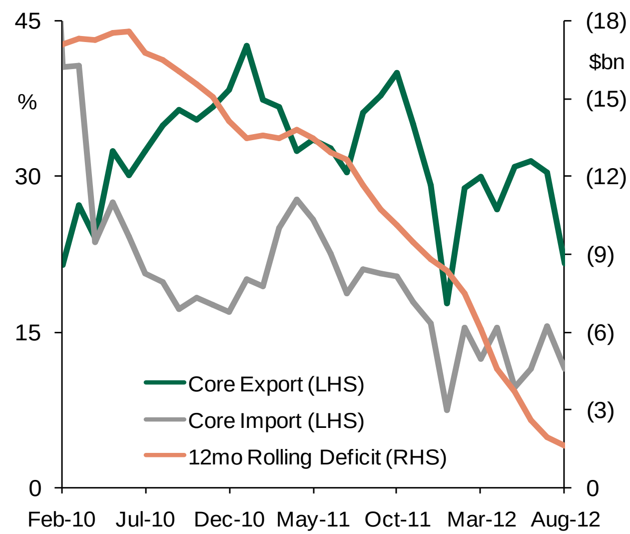
# TRADE ACCOUNT

- As a percentage of GDP, the trade deficit (c.i.f.) peaked in 2008 and has rapidly declined
- Core trade deficit (eliminating oil and gold) has plunged after topping out in Jun 2010, with exports have consistently outpacing imports
- At present there is substantial export growth coming from FDI projects launched in 2009-10, and generally, Vietnam's lower-end goods are expected to hold up well in a recession
- Credit contraction helped to tame the trade deficit, but with a huge structural decline in non-essential imports, normalized lending will not blow the gap back out

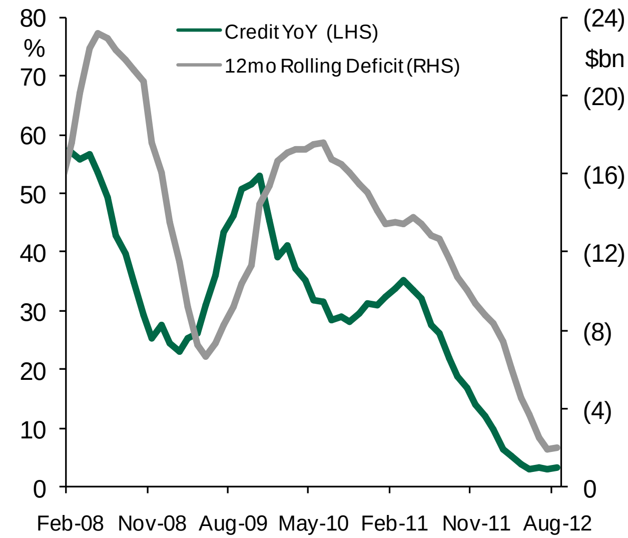
## TRADE DEFICIT / GDP




## CORE TRADE DEFICIT, 3M/3M

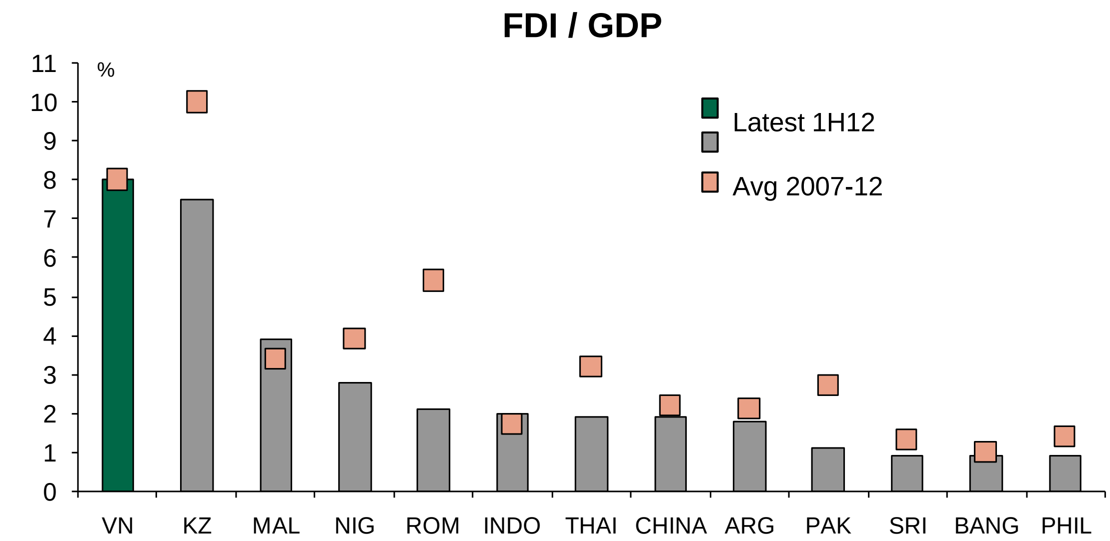


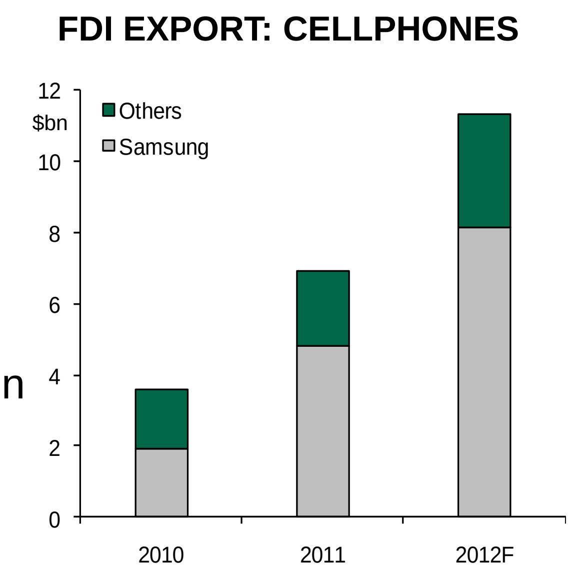

## CREDIT & TRADE DEFICIT

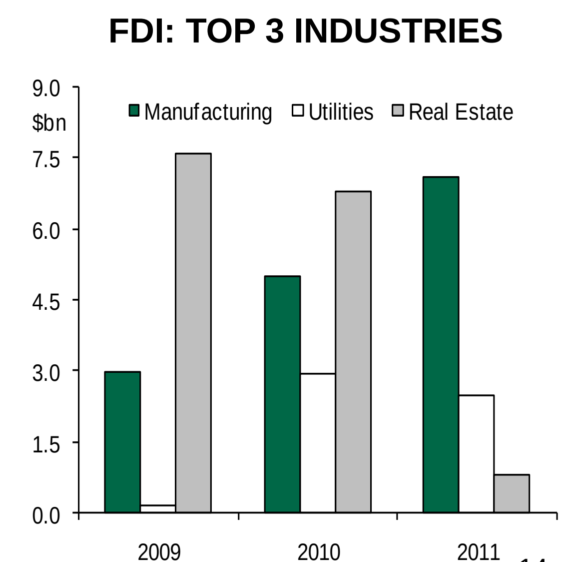


# FDI

- Despite its oft-proclaimed demise, FDI has remained steady at $7-8bn pa throughout 2009-12
- This is a bigger number vs GDP than for virtually all peers
- Wages remain competitive, even with inflationary pressures, thanks to well-known demographic trends
- Property FDI heavily contributed to trade deficit up in 2009-10
- But FDI is now back to focusing on productive sectors, i.e., utilities and manufacturing
- FDI players confirm they are bringing in or attracting support industries, particularly in electronics



# EXTERNAL ACCOUNTS

- BOP risk has never really been about the trade deficit – this has always been well offset by net capital flows
- BOP risk does not come from hot money (long gone) or from sovereign debt (40% of GDP and mostly concessional)
- Historically, the BOP has been in surplus
- Problem is internal capital flight, via "errors and omissions" that eat reserves
- This blows out when locals lose faith in currency and dump VND for USD / gold
- Ending inflationary policies ends internal capital flight – as is now happening
- Hence reserves are rapidly rebuilding

**BALANCE OF PAYMENTS**

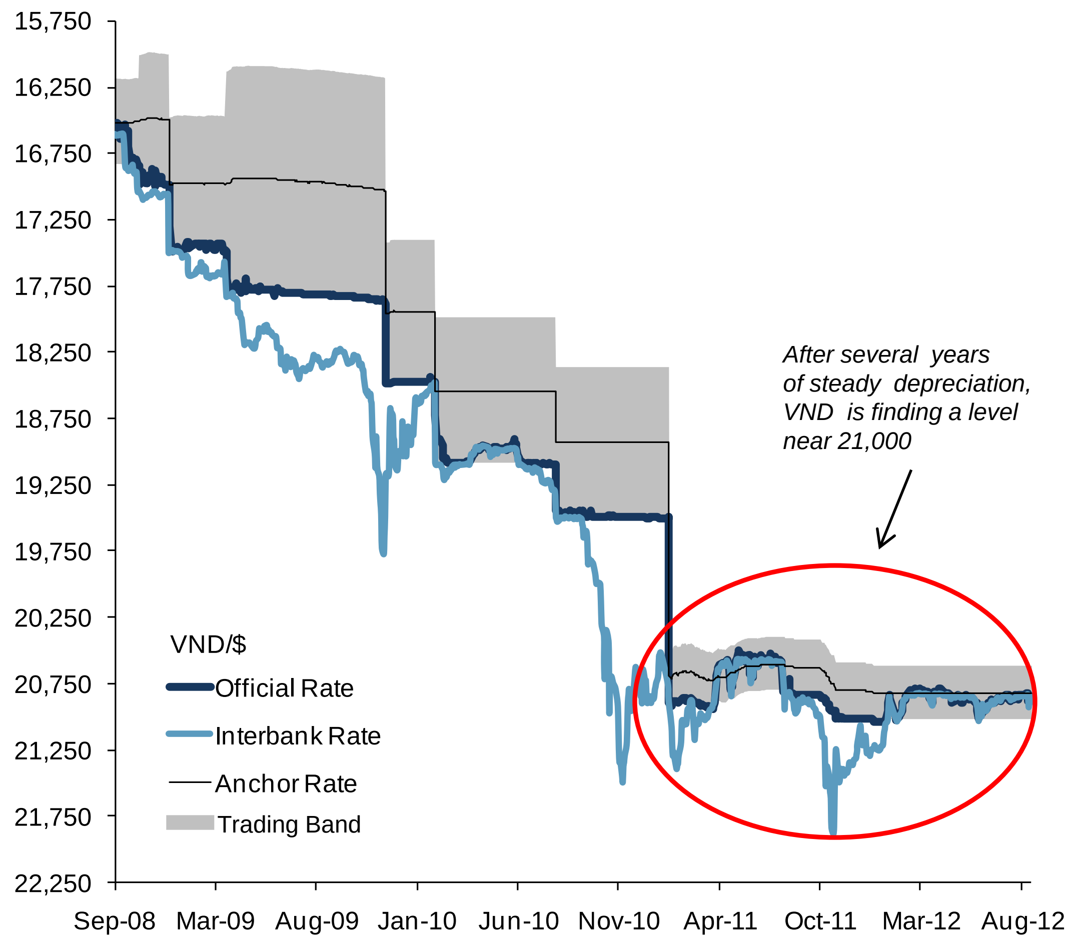
| ($bn) | 2008 | 2009 | 2010 | 2011E | 2012F | 2013F |
|---|---|---|---|---|---|---|
| Trade Account (fob) | (12.8) | (8.3) | (5.1) | (0.5) | 8.2 | 10.4 |
| Net Services | (0.9) | (1.2) | (2.5) | (3.0) | (4.2) | (5.3) |
| Net Investment Income | (4.4) | (3.0) | (4.5) | (5.1) | (5.6) | (6.5) |
| Remittances | 7.3 | 6.4 | 7.9 | 7.9 | 7.3 | 7.3 |
| **Current Account** | **(10.8)** | **(6.1)** | **(4.3)** | **(0.7)** | **5.8** | **5.9** |
| ODA Loans | 1.7 | 5.2 | 4.2 | 3.3 | 3.3 | 3.1 |
| Other Net Loans | (0.7) | (0.7) | (0.8) | (1.4) | (1.9) | (1.9) |
| Net Financial | 2.0 | (0.1) | (3.6) | (3.8) | (4.4) | (4.2) |
| Net FDI | 9.3 | 6.9 | 7.1 | 7.3 | 6.9 | 6.6 |
| **Capital Account** | **12.4** | **11.3** | **6.9** | **5.4** | **3.9** | **3.6** |
| **Sub-Total** | **1.6** | **5.2** | **2.6** | **4.7** | **9.7** | **9.5** |
| **Errors & Omissions** | **(1.1)** | **(14.1)** | **(4.3)** | **(3.6)** | **(2.8)** | **(3.0)** |
| **Ch in Reserves = BOP** | **0.5** | **(8.9)** | **(1.7)** | **1.1** | **6.9** | **6.5** |
| RESERVES | 23.0 | 14.1 | 12.4 | 13.5 | 20.4 | 26.9 |
| Months of Imports | 3.7 | 2.6 | 1.9 | 1.7 | 2.3 | 2.7 |
| Debt/GDP - % | 29.8 | 39.0 | 39.0 | 42.4 | 45.0 | 44.0 |

Sources: World Bank for historic, Dragon Capital for forecasts

# CURRENCY

- Currency is the acid test of reform
- VND has been stable near 21,000 since Feb 2011 de-valuation
- Official and interbank rates (and black-market rates) have long since converged
- The gold-US$-VND nexus has been broken
- If policy discipline is maintained, downward adjustments in VND can remain minimal
- Macro reforms will make it possible to continue rate cuts without undermining the currency

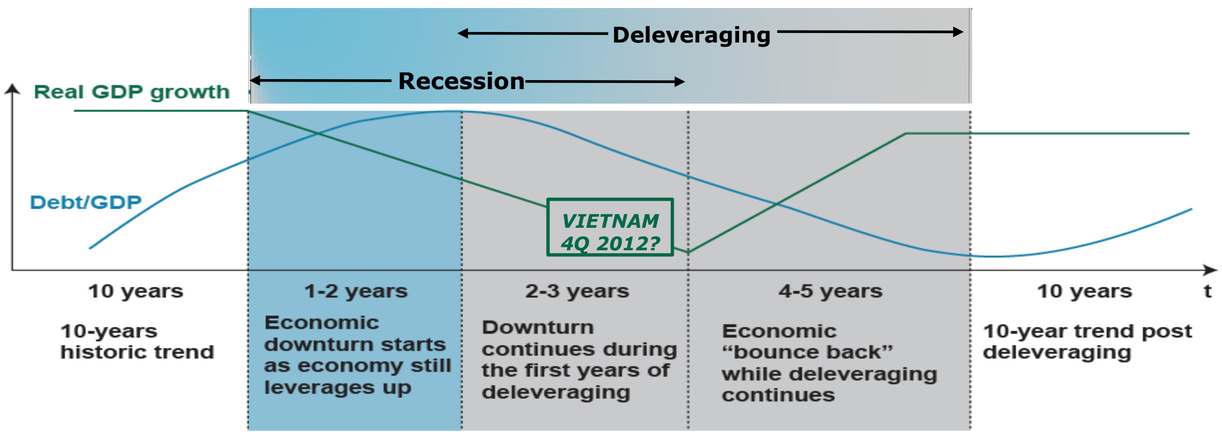
**VND/$ RATES, 2008-12**



# GROWTH

- Policy discipline is heroic but it has put Vietnam in a classic post-bubble deleveraging slump
- The +4.4% GDP estimate for 1H12 is widely viewed as high, given no loan growth, but there was a push from public investment at ca +5% and resilient retail sales at +7%
- A recent McKinsey study of 45 countries in 1930-2010 suggests that the low-growth phase of deleveraging typically lasts 2-3 years; if so, Vietnam has put in some good time at 18 months
- This model might see the economy bottoming in 2013 given underlying plus factors that do exist
- These are falling rates, the beginnings of renewed lending, residual consumer spending, low household debt, minimal foreign debt, a recent upturn in 3Q12 PMI, the ongoing FDI/export story
- Phase II reform, if it happens, would be a powerful catalyst for the growth re-start

**MCKINSEY DELEVERAGING STUDY, 1930-2010**



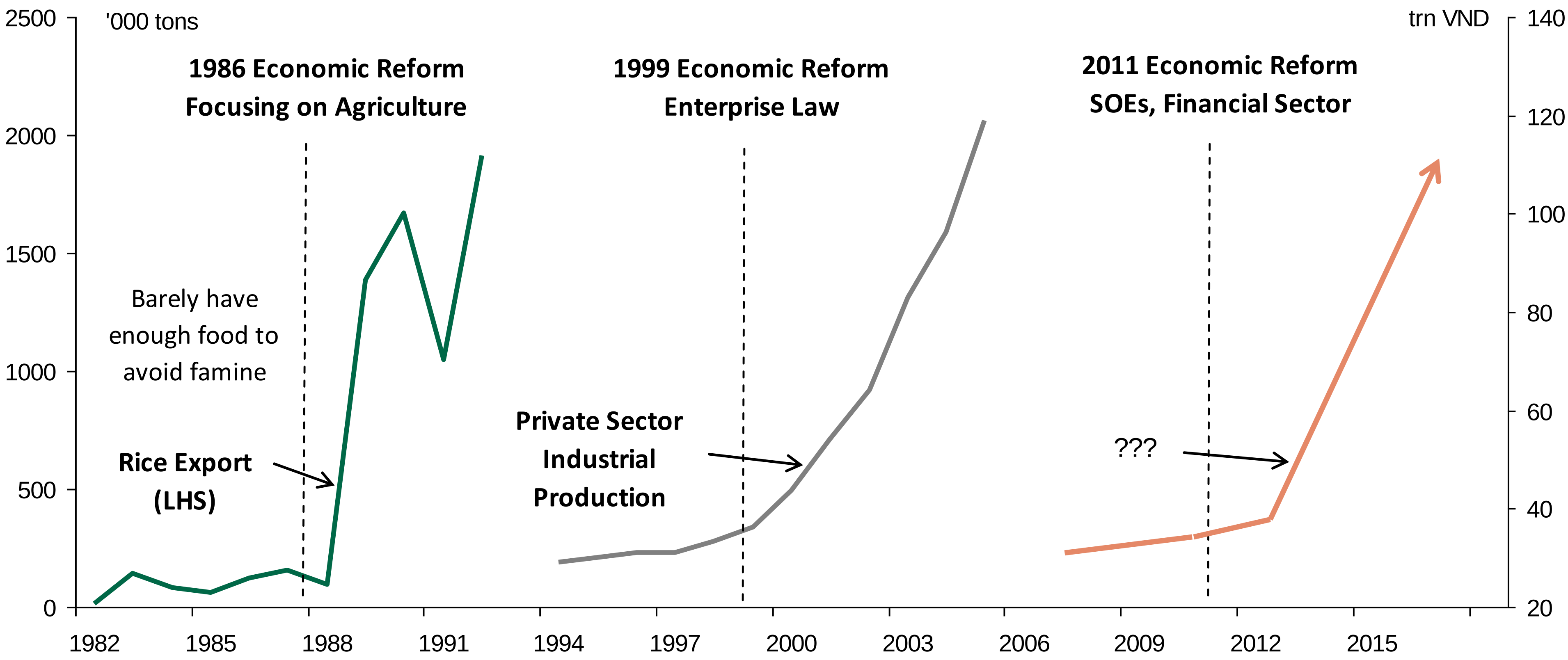
# MACRO FORECASTS

| | unit | 2009 | 2010 | 2011 | 2012F | 2013F |
|---|---|---|---|---|---|---|
| Real GDP Growth | % | 5.2 | 6.8 | 5.9 | 5.0 | 5.5 |
| Nominal GDP | $bn | 88.9 | 95.7 | 119.6 | 135.2 | 150.7 |
| CPI | % | 6.5 | 11.8 | 18.1 | 6.1 | 7.9 |
| Exports | $bn | 57.1 | 72.2 | 96.9 | 116.3 | 131.4 |
| Imports (cif) | $bn | 68.9 | 84.8 | 106.7 | 118.4 | 132.6 |
| Trade Balance (cif) | $bn | (11.8) | (12.6) | (9.8) | (2.2) | (1.3) |
| FDI Approvals | $bn | 12.0 | 19.0 | 14.0 | 12.0 | 11.5 |
| FDI Disbursed | $bn | 7.6 | 8.0 | 8.0 | 7.6 | 7.2 |
| IP Growth | % | 7.1 | 9.4 | 6.8 | 4.5 | 4.9 |
| VND (interbank) | $1 | 18,500 | 20,700 | 21,200 | 21,000 | 21,400 |

- Government now fully understands that pumping GDP is more trouble that it’s worth
- It will stick to the new program of “growth with stability” and the fiscal / monetary discipline it entails
- Trade deficit will stay at a modest level of GDP, reinforcing hidden BOP surplus
- CPI and VND will stabilize as more professional macro management is institutionalized
- 2012-13 growth prospects are underwhelming, but performance from 2014 should be more exciting
- Meanwhile the Government is likely to be stepping up bank and SOE reforms

# REFORMS AND ITS IMPACT

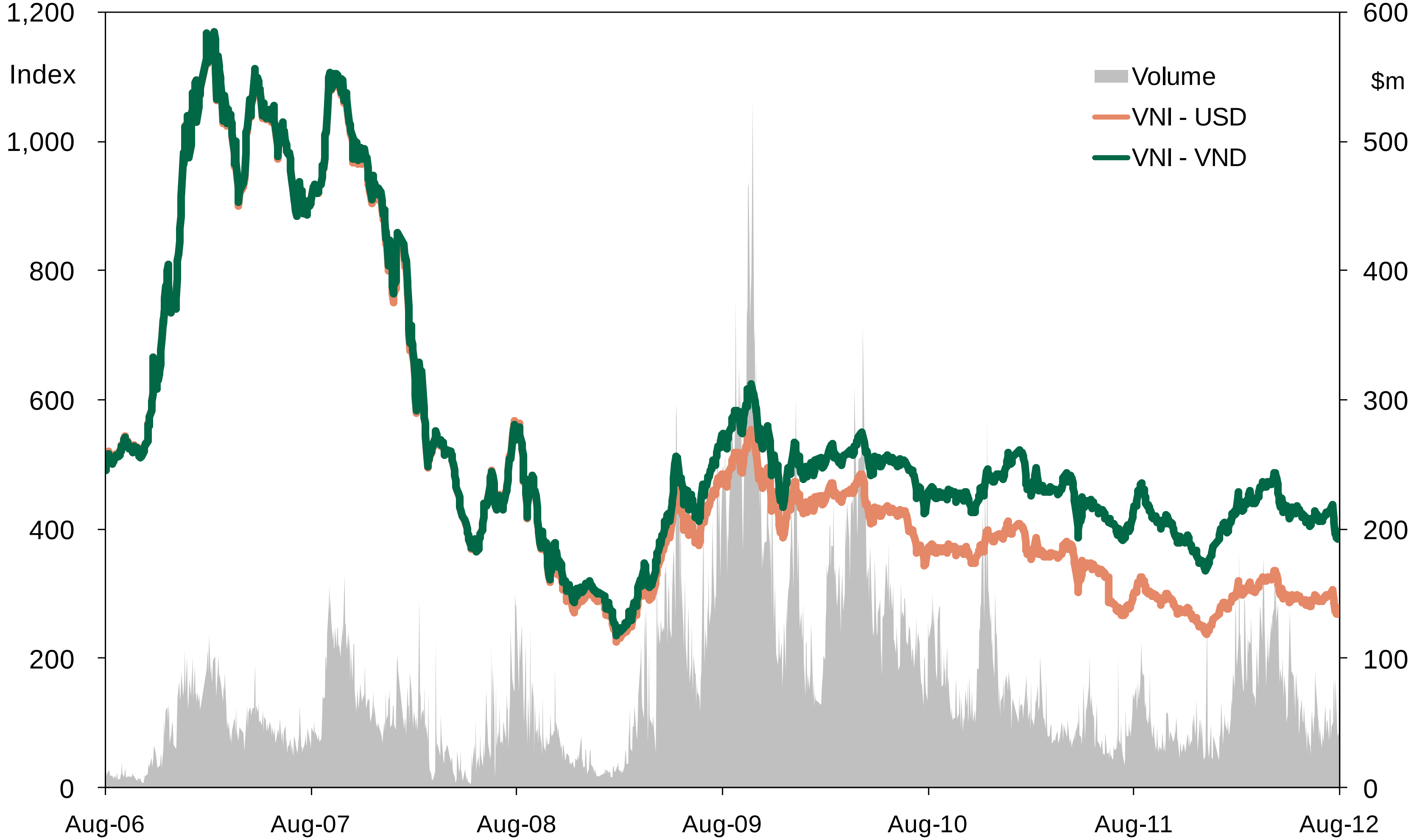
## VIETNAM'S ECONOMIC REFORMS: WILL HISTORY REPEAT ITSELF?



# 2. THE EQUITY MARKET

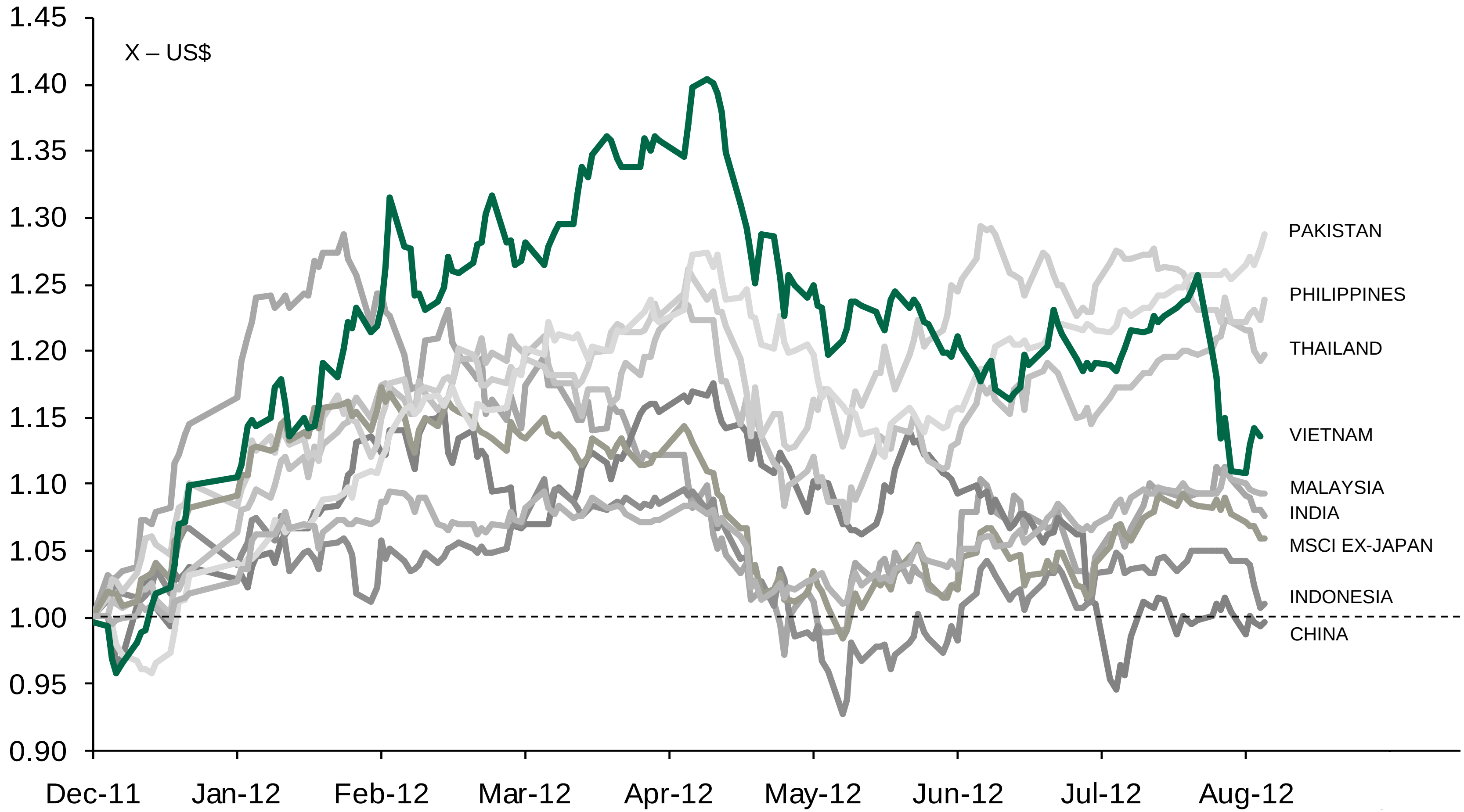
# MARKET PERFORMANCE: LONG TERM

Not a pretty long-term historical chart but…



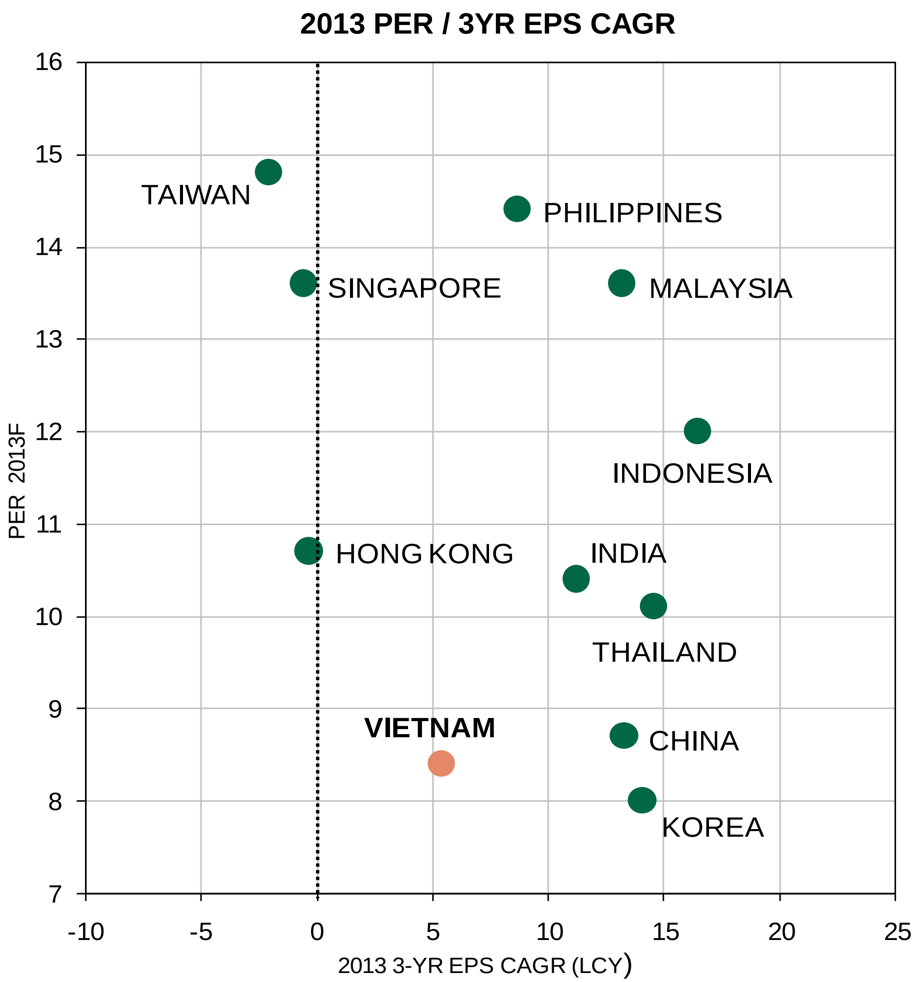
# MARKET PERFORMANCE: YTD

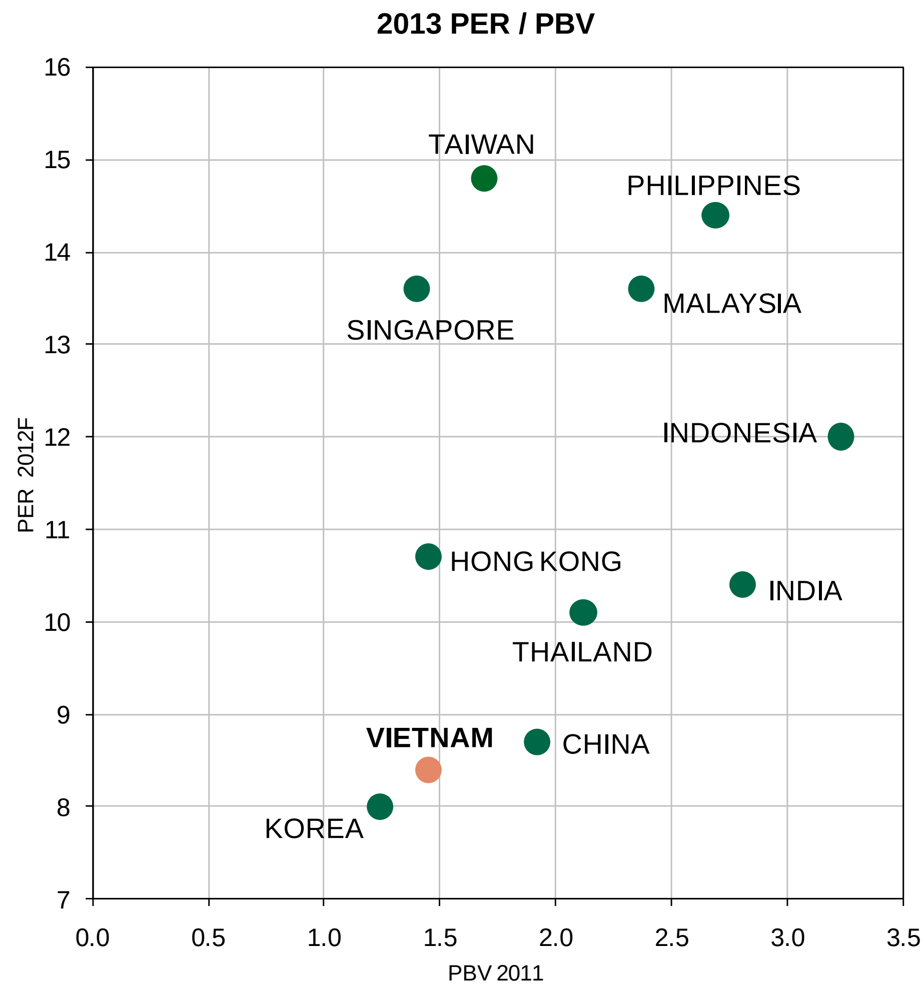
…thanks to the macro policy turnaround, comparative performance YTD has been quite encouraging, even with the correction for recent political events



# MARKET VALUATION

Market is cheap – admittedly for a reason, but the Government is working on the reason




*Source: Dragon Capital Top 50 for Vietnam; CLSA all others*

# FORECASTS AND VALUATIONS

After a tough 2011, earnings will surge in 2012 on margin gains, even as the top line decelerates and in 2013 NPAT will follow sales

| 31 Aug - VNI 396 | 2010 | 2011 | 2012F | 2013F |
|---|---|---|---|---|
| P/E (x) | 9.8 | 10.8 | 9.2 | 8.4 |
| EPS Growth (%) | 17.7 | -9.4 | 13.7 | 13.7 |
| PEG (x) | 0.6 | neg | 0.7 | 0.6 |
| Sales Growth (%) | 34.5 | 19.5 | 9.7 | 13.4 |
| EBIT Growth (%) | 20.5 | 7.5 | 27.5 | 12.7 |
| PBT Growth (%) | 29.6 | -3.3 | 24.3 | 11.0 |
| NPAT Growth (%) | 25.9 | -3.5 | 20.1 | 14.5 |
| Net DER (x) | 0.4 | 0.4 | 0.4 | 0.3 |
| ROE (%) | 20.2 | 15.6 | 18.5 | 18.1 |
| Yield (%) | 5.0 | 4.0 | 4.6 | 4.5 |
| PBV (x) | 1.69 | 1.61 | 1.54 | 1.45 |

# FORECASTS AND VALUATIONS

***2012***

- *Sales:* Will slow sharply on the downturn in GDP growth
- *EBIT:* Lower cost inputs, especially from raw materials and marketing expenses (after big jumps in 2011) will see EBIT margins motor
- *PBT:* Rate cuts may have a negative effect by constraining non-interest income at banks, and financial income at net-cash companies – and these players are 60% of market earnings
- *NPAT:* The winding-down of tax breaks from earlier years will be a further hit, but ultimately bottom-line gains will still be very healthy
- *EPS:* Hit by dilution from late 2011, early 2012

***2013***

- Sales growth will pick up a bit but another round of margin gains is not foreseen, and certainly large companies that had explosive growth in 2012 will not repeat the experience
- Hence the bottom line will be more inclined to follow the top line

# PLAN FOR 2013-1015

- Tighten regulations on securities companies
- Merge Hochiminh City Stock Exchange and Hanoi Securities Exchange
- Launch ETFs
- Allow local open-ended funds
- Launch the new trading platform
- Have a central counterparty system
- Have securities lending and borrowing system and allow short-selling
- Have stock index futures

Mumbai, November 2012

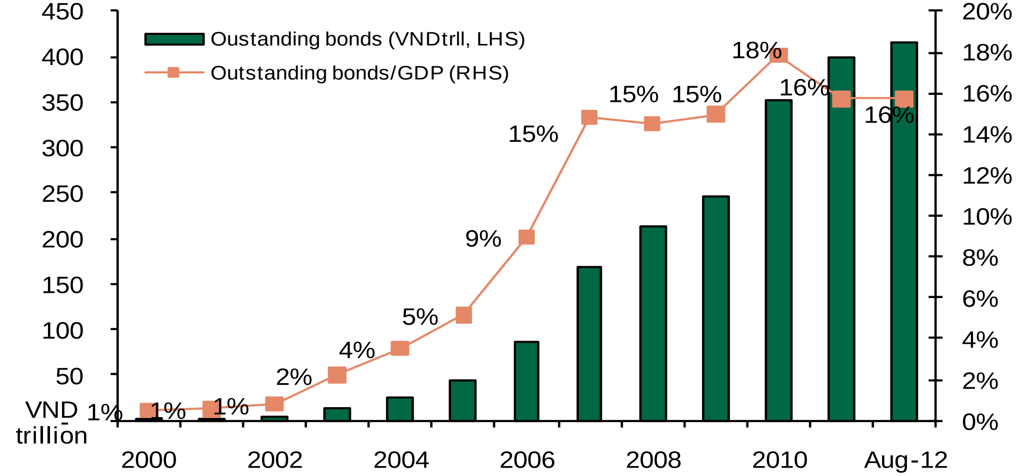
# 3. THE BOND MARKET

# VIETNAM BOND MARKET – HISTORY

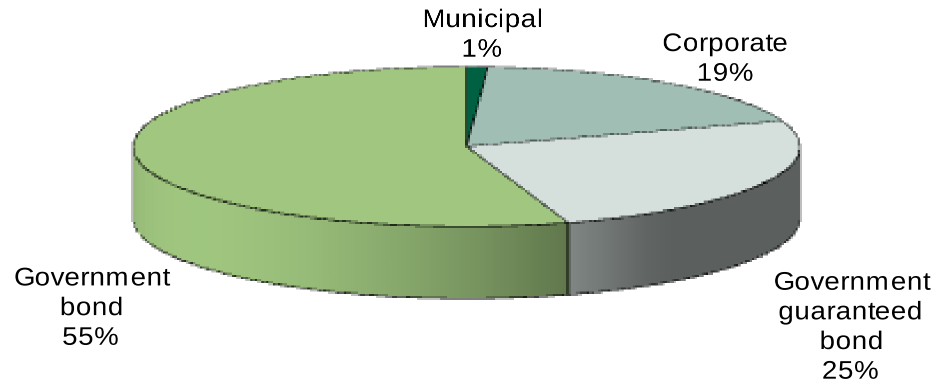
**Milestones:**

- **Before 2006**: Very small issuance, limited transaction.
- **From 2006-2008**:
  - The Vietnamese market in reality born when Vietnam entered WTO.
  - Bonds as % of nominal GDP now about the same as Thailand and Philippines in mid-90's.
  - New issuance was 2x-3x the outstanding before, in all kind of bonds.
  - Secondary market activities: clearly picked up to some U$80-100m per day at the end of 2008. Yield was bottom out at 6.5% and peaked at 20+% mid-2008.
- **2008 - today**:
  - is primarily Vietnamese.
  - Trading volume has been around US$20-30m per day for both repo and outright transactions.
  - Yields is at 9.5-10% for 5yrs.

**BOND MARKET GROWTH ( 2001-2010)**



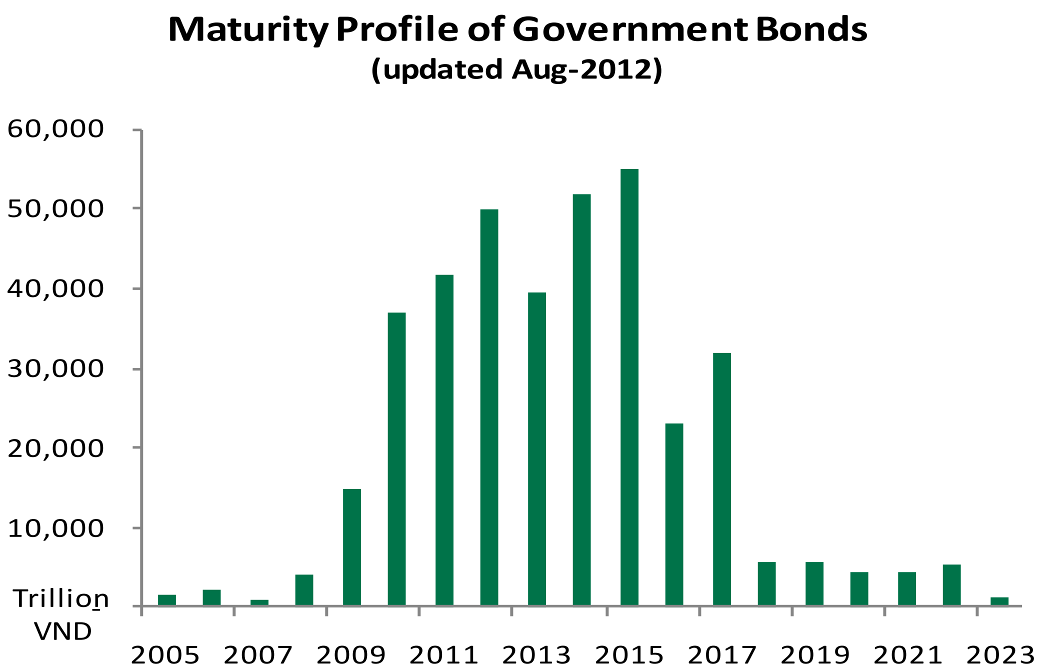

**BOND MARKET BREAKDOWN**
**(as end of Aug-2012)**



# VIETNAM BOND MARKET – INFRASTRUCTURES

- **Investor base:** In the absence of mutual funds/pension funds, the domestic banks make up one giant investor. Very few institutions (if any) do mark-to market.
- **Product range**: extremely narrow, basically only straight bonds.

  - Government bonds: US$10.5bn; 90% will matured within the next 5 years.




  - Government guaranteed bonds: From 2007, total more than US$ 5bn.
  - Municipal bonds: extremely small. No new issuance since 2010.
  - Corporate bonds: Issuers are SOE's and property companies.
  - Derivative and hybrid products: in reality doesn't exist.

    Equity linked notes have been issued in 2009-2011 as convertible bonds, bonds with warrants, exchangeable bonds, mandatory to convert debt.

# VIETNAM BOND MARKET – INFRASTRUCTURES

- **Market Regulation Improvements**:
  - State Treasury issuance policies:
    - From 2011, has used the reopening method to enlarge the size of new bonds and testing the buying-back program. The size of each bond is now 2.5 times comparing to 2007 ($37m vs $14m).
  - The electronic auction and trading system from Aug-2012.
  - Coupon tax on foreign investors: 5% from March-2012 (before:10%), transaction tax 10bps.
  - Changes in related laws

- **Rating agencies:** No domestic rating agency contributes to opaque corporate pricing. Although:
  - SBV has the credit information center which rates listed companies but too generous results.
  - Private Credit Bureau JSC (PCB ), has just submitted application for license to the State Bank of Vietnam.
  - Credit Rating Vietnam Joint Stock Company (CRV) has rated listed companies and commercial banks.

- **Market participants:** The VBMA (Vietnam Bond Market Association) officially operated from May-2009, now has around 60 members( banks, fund managers and insurers)

# VIETNAM BOND MARKET – Challenges

**Illiquidity and very limited product range**

- Limited transaction: Government bond turnover is USD 10-30m per day.
- Practically, no market makers.
- Market is very binary
- Not possible to shorten the curve.

→ Exit strategy is essential.

**Limited market access and taxes for offshore institutions**

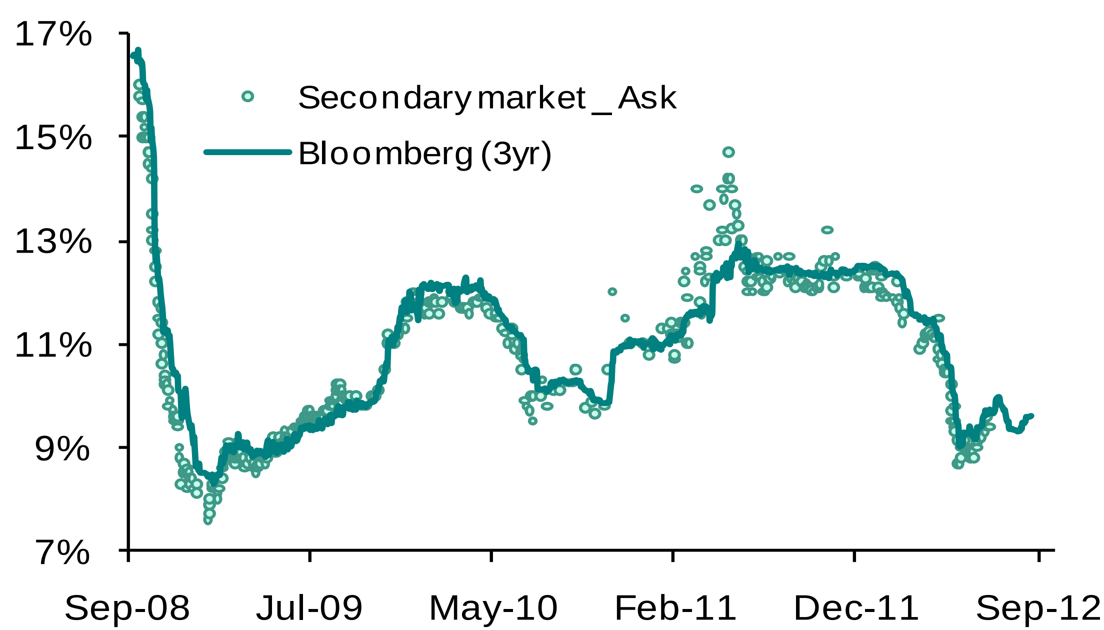
- They do not have access to interbank market
- They pay 10 bps transaction tax and 5% coupon tax.

→ Major focus is on minimizing tax costs.

**Frequent discrepancy (at times >100 bps) between screen rates and true market rates**

- Screen rates tend to be too high when rates are falling and vice versa.
- Performance can be distorted.
- Distorts strategy.

**3yrs Screen rates vs Seconday market**



# PLAN FOR 2013-2016

- Improving legal system,
  - Improve issuing government bonds, municipal bonds, and corporate bonds
  - Allow fixed-income derivatives
  - Allow pension funds
  - Establish credit rating agency
- Developing market
  - Building the primary dealer system
  - Buiding government bond yield curve
  - Developing inter-dealer market
- Improving infrastructure
  - Adopting custody standards by IOSCO
  - Aiming to unify the custody houses, the clearing and settlement systems

Mumbai, November 2012

# THANK YOU!

**Vietnam Bond Market Association**
14th Floor, Vincom Tower A, 191 Ba Trieu Str.,
Hai Ba Trung District, Hanoi, Vietnam
Tel: +84 4 3974 8781
Fax: +84 4 3974 8782
Email: info@vbma.org.vn