

## Attracting FII to Vietnam

### Summary

- Foreign Indirect Investment (FII) – or money invested into Vietnam via equities or bonds – is another area where Vietnam has an opportunity to attract inflows in the wake of the COVID-19 outbreak.
- Many of the ideas summarized below have already been widely discussed for years - but that have not been implemented for a variety of reasons.
- With an enormous pool of money now being printed by the world's central banks, it should be fairly easy for Vietnam to attract FII by implementing the proposals discussed below.

### Now is the Time to Attract FII to Vietnam

Over the past few years, Vietnam has made progress in expanding accessibility to its capital markets. A number of ideas have been discussed that would further enhance the attractiveness of the country to foreign investors, but there has been limited movement on those ideas for any number of reasons. As Vietnam seeks to boost investment in the wake of the outbreak, the time is right to implement these and other ideas for a few compelling reasons:

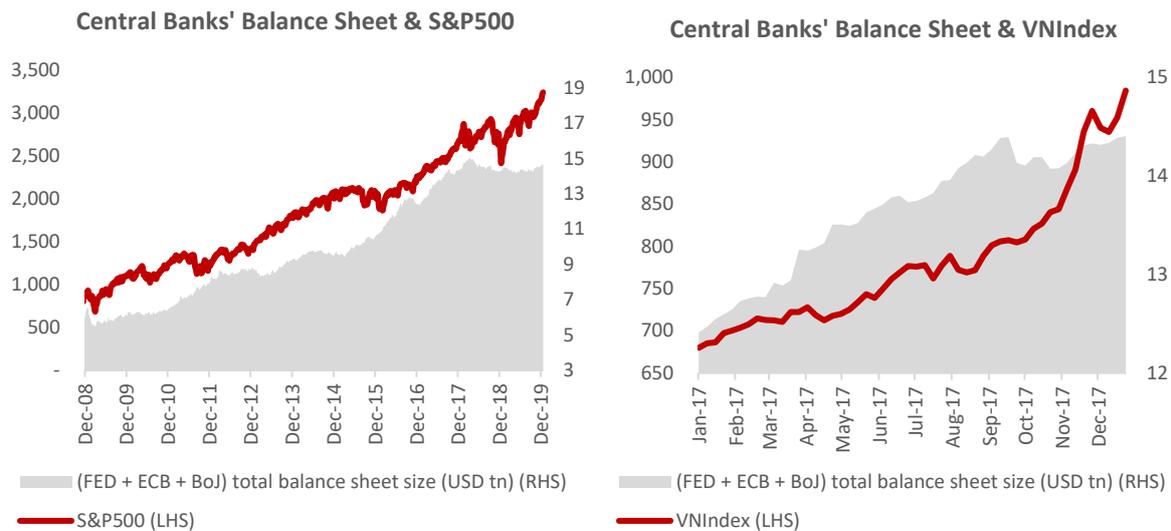
- 1) The world's central banks are likely to print USD6 trillion this year via so-called "Quantitative Easing (QE)" programs, and some of that newly created money will inevitably leak out of developed markets and into frontier and emerging markets in search of higher investment returns.
- 2) Governments around the world are responding to the COVID-19 crisis by taking dramatic actions that would not normally be feasible. Vietnam's Government can follow this example and use the crisis as a rationale to push through long-overdue reforms that could vastly increase the amount of foreign investment inflows to the country.

Further to #2 above, some specific examples of measures taken in other countries that would have previously seemed improbable include the US Federal Reserve buying "junk bonds" (i.e., bonds with a very low credit quality), and Germany's central bank participating in the European Central Bank's aggressive QE program – despite the fact the Germany's own Supreme Court has ruled that the ECB's QE program violates German law.

Next, as mentioned above, the world's central banks are currently printing an enormous amount of money in order to prevent businesses in their countries from going bankrupt (US Fed Chair Jerome Powell recently indicated that the Fed is likely to print another USD4 trillion of money before the COVID crisis ends). This is similar to what they did in the years following the 2008 Global Financial

Crisis (GFC); the huge volume of QE at that time helped support the economies of those developed countries, but much of the newly created money ended up being invested in global stock markets.

In the US, stock prices soared by about 5x over the 11 years leading up to early 2020, despite the fact that corporate earnings essentially only doubled over that time, which clearly illustrates that money printing by global central banks is now the single biggest driver of stock prices. Meanwhile in Vietnam, the VN-Index increased by nearly 50% in 2017 because the European Central Bank printed about USD1 trillion, and about half of that newly created money left Europe, with much of it ending up in frontier and emerging market stock markets, including Vietnam's.



The reasons why this topic is so important for Vietnam are because the **scale** of money printing by global central banks is currently 3x the amount of QE that was done after the GFC (this is the reason that the Nasdaq, high-tech stock market index is now **up** 4% YTD !), and because a higher proportion of the money being printed by those central banks will end up in EM stock markets compared to post-GFC for reasons that are outside the scope of this article (including the end of the US stock buyback craze).

### Attracting Foreign Investment to Vietnam's Stock Market

For years, Vietnam has been an attractive destination for foreign investors, who have been enamoured by its growth prospects and other factors. However, those investors constantly lament the limited number of large, high-quality, high-growth companies for them to invest in, especially compared to regional markets such as Thailand, Philippines, and Indonesia.

The obvious way for the Government to solve this problem is to simply privatise more of the country's premier companies, such as the telecommunications companies (e.g., Viettel, Mobifone), Electricity Vietnam, and PetroVietnam. These "national champions" are the type of companies that foreign investors would typically expect to have been already privatized in a market like Vietnam.

Furthermore, Vietnam's stock market is dominated by banking, real estate, and consumer stocks that account for about 70% of the country's stock market cap. However, foreign investors are

typically interested in diversifying their holdings to a wider range of sectors, which is another argument for privatizing companies in a greater range of industries.

Next, foreign investors prefer to buy stocks that have high liquidity, and in which a large proportion of the company's outstanding stocks are already in the hands of other investors. For that reason, those investors do not like it when a company like PetroVietnam Gas has been "privatized", but only a tiny proportion of the company's shares have been sold to private sector investors (just 4% in the case of GAS). We have long been proponents that the government should sell a far greater proportion of its ownership stakes in companies that have already been equitized – it should be a fairly simple endeavour compared to undertaking equitizations of new companies.

Notwithstanding all of the above, the biggest "market access" issue that foreign investors are unhappy with in Vietnam is Foreign Ownership Limits (FOL). The FOL law was partly liberalized in 2015, but only 82 companies (out of 1,700 listed companies) have actually raised their FOLs – an embarrassingly small number and a major red flag to foreign investors considering investing in Vietnam's stock market.

There are currently 30 Vietnamese stocks that have full FOLs, meaning that they have no shares available for foreign investors to purchase. If a foreign investor wants to buy shares in one of those companies, they must buy the shares from another foreigner at a price which will typically be 7-15% above the prevailing listed price. This creates a problem in that the new foreign investor then suffers a 7-15% mark-to-market loss on the investment because there is no way of verifying the foreign premium that the investor paid to purchase the stock.

The solution to this problem would be for Vietnam to implement a "foreign board" on which transactions between foreign investors are recognized. Thailand's stock market implemented such a scheme in order to facilitate foreign inflows to the stock market while essentially maintaining foreign ownership limits of publicly traded companies with some success. Vietnam's stock market could simply follow Thailand's precedent, as well as garner the necessary technical insights from Thailand to implement such a scheme.

Another well understood challenge to attracting foreign investors to Vietnam's stock market is that the country is still classified as a "Frontier Market" by MSCI and other stock market index companies. Vietnam urgently needs to be upgraded from the MSCI-Frontier index to the MSCI-EM index because the country primarily appeals to EM fund managers, many of whom are either unable or unwilling to risk their own jobs by investing in countries that are not included in the MSCI-EM index. The amount of investment funds in the world that is benchmarked against the MSCI-EM index is over 100 times that linked to the MSCI-Frontier index; an upgrade to the MSCI-EM index would probably push Vietnam's stock market up by at least 50% based on the experience of other countries that were upgraded in the past.

The biggest barrier to Vietnam being included in the MSCI-EM index is the above-mentioned FOL issue, which strengthens our belief that the Government should use the current COVID-19 crisis as a rationale to push forward the relevant reforms that have been stalled for over five years for no obvious, justifiable reason.

That said, there are also some other periphery topics related to MSCI-EM index inclusion such as improving corporate governance, disclosing more information in English, and implementing other measures. Addressing these issues would bring Vietnam's capital markets in-line with the international norms and standards that foreign investors expect based on their experiences in investing in other EM stock markets around the world.

Another issue that Vietnam's investment community has been pushing for action on is the establishment of a private pension program. Such a scheme would encourage locals to save for their future (thus reducing potential strain on the country's social safety net) as well as bring a degree of maturity and stability to the stock market which would in turn encourage foreign investors to invest more money into the country. We believe that foreign investors would feel more inclined to pour money into Vietnam's stock market if the economic interests of those foreign investors were more aligned with the country's savers.

The inauguration of such a scheme could entail companies paying progressively less into the mandatory national social insurance programme as the private pension scheme ramps up. For example, contribution rates to the national insurance scheme could be reduced by 10% per year over a ten-year period as this commitment is phased out.

Finally, some other measures the government could consider to further encourage foreign inflows to the stock market include:

- Slashing corporate taxes for the next 1-2 years to boost corporate profits and EPS growth
- Taking measures to encourage lower deposit rates in the banking system to encourage *domestic* investors to pour money into the stock market (which in turn would encourage foreigners to buy Vietnamese stocks)
- Encourage Vietnam's leading stockbrokers to organise investor conferences abroad, similar to those that Malaysia's stock market has been supporting to encourage foreign investment inflows
- Vehemently reiterating the Government's commitment to macroeconomic stability and to the stability of the USD-VND exchange rate.

### **Attracting Debt Market Investment Inflows**

Fund managers in developed markets have an urgent need to pour money into investments that can generate *income*. The interest rates in most of the developed world are likely to be around 0% over the next decade (investors are currently predicting that US interest rates will fall into negative territory next year). Additionally, the huge and growing number of retirees in those countries need to live off their investment income.

Pension funds in the US and Europe generally target 6-7% annual investment returns, which means that Vietnam's relatively high interest rates would be very attractive to those investors, especially because inflation in Vietnam is low, the USD-VND exchange rate is likely to remain stable going forward, and because the country is very politically stable. For that reason, it should be relatively easy to attract foreign money into Vietnam's nascent corporate bond market if companies take the steps necessary to secure a credit rating from one of the major international credit ratings agencies.

We believe the Government has a range of incentives at its disposal (including tax breaks) that it could use to encourage Vietnamese companies to get credit ratings from international ratings agencies. Alternatively, the Government could foster the development of a credible local ratings agency by encouraging foreign credit ratings agencies to partner with Vietnamese commercial banks to launch a proper, professional Vietnamese credit ratings agency. It could also make sense to enlist the help of international investment banks and/or Development Finance Institutions (DFI) such as

the International Financial Corporation (IFC) arm of the World Bank to help the country's efforts to develop its domestic corporate bond market.

One thing we do not recommend is for local companies to issue bonds that are denominated in US Dollars. While foreign investors typically prefer such "hard currency" debt issues, many Emerging Market countries encountered serious economic difficulties in the past after local companies issued too much debt denominated in USD (e.g., Turkey and Argentina).

Instead, we think it would be possible to attract foreign fixed income investors by offering those investors international, US Dollar denominated bond funds, in which the underlying bonds held by the fund are denominated in VND, but the pay out to investors is made in US Dollars (investors' investment returns would decline if the VN Dong depreciated). Since the fund would raise US Dollars from investors it would probably need to be a closed-end fund listed on a foreign stock market.

Finally, a variation on the Vietnamese bond fund for international investors would be the launch of a so-called Collateralised Loan Obligation (CLO) product that is backed with Vietnamese corporate debt. A CLO is similar to a bond fund, with some important technical differences. The important point to note here is that these products have been extremely popular with US Pension funds and Japanese investors, so we think that a CLO backed by Vietnamese borrowers would attract an enormous amount of attention by foreign investors.

Vietnam's effective handling of the COVID-19 outbreak to-date has been based on quick and decisive action. We view this as an opportunity to apply those same qualities to resolving some longstanding issues which could play a key role in helping Vietnam's economy grow in the aftermath of the pandemic.

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