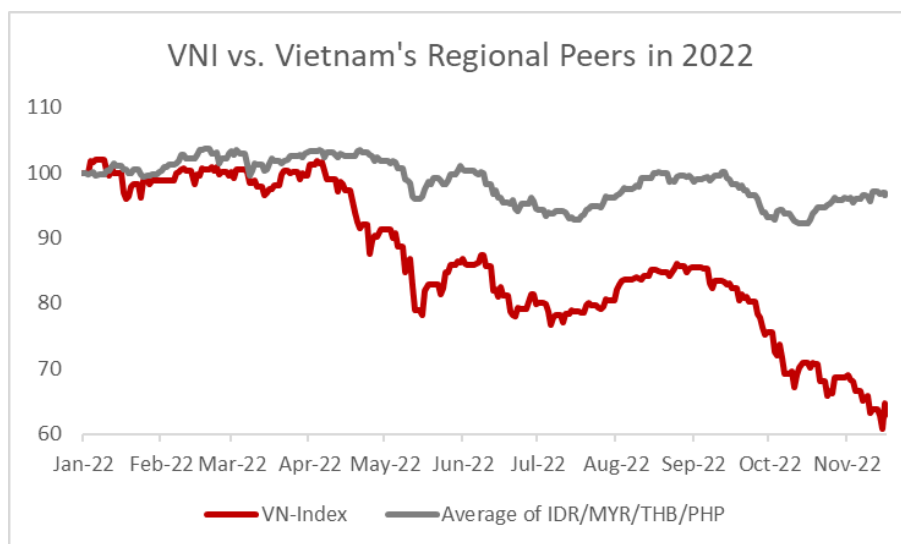


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## **“CREDIT CRUNCH” CONCERNS AFFECTING VIETNAMESE STOCKS COULD EASE SOON**

Last Wednesday, November 16<sup>th</sup> was a dramatic day for the Vietnamese stock market. The VN-Index (VNI) plunged by more than 4% soon after opening, but ended the day up over 3% on hopes that the “credit crunch” concerns that made Vietnam one of the worst performing markets in the world this year could be abating. In short, the country’s real estate developers have been facing increasing difficulties accessing credit this year and concerns that this “credit crunch” among developers could spread to other sectors of the economy helped push the VNI down as much as 42% YTD, early last week.

The plunge has been driven by a circa 50% YTD sell-off in real estate stocks and 40% sell-off in bank stocks, given that the combined weighting of these two sectors accounts for 55% of the VN-Index. The VN-Index dramatically underperformed the average of its regional peers’ stock markets (Indonesia / Malaysia / Thailand / Philippines), as can be seen below, owing in part to concerns about the ability of real estate developers to refinance over USD5 billion of maturing debts in 2023.



We believe Vietnam’s stock market is now overestimating the impact of recent tightening of credit conditions for the country’s real estate developers to the rest of the economy. It is important to note that real estate development contributes less than 10% of Vietnam’s GDP, in contrast to nearly 30% in China. VinaCapital’s analysts directly canvassed several industrial companies and

concluded that the current credit crunch primarily impacts real estate developers and *some* smaller companies. Large industrial companies (i.e., non-real estate developers) appear to continue to have access to credit – albeit at higher interest rates.

We also believe investors are overestimating how long this situation is likely to persist, and expect the Government to take action to alleviate the liquidity issues that are depressing Vietnamese stock prices well in advance of the Lunar New Year holiday (at the end of January), when both economic activity and the demand for liquidity in Vietnam are elevated. These issues are relatively straightforward for policy makers to address, so hints from Government officials about the steps they could take to alleviate the situation sent stocks soaring last Wednesday 16<sup>th</sup> and that informal guidance was followed up by the formation of a task force to address issues in the real estate sector by Vietnam's Prime Minister later in the week.

Finally, Vietnam's GDP is on-track to grow by 8% in 2022 and by nearly 6% in 2023, while corporate earnings are on track to grow by 17% this year and next. The combination of falling stock prices and growing earnings caused the FY22 P/E multiple for the VNI to plunge from above 17x at the beginning of 2022 to 9x now, and the market's 8x FY23 P/E is 40% below the forward P/E valuation of Vietnam's regional peers.

### **Vietnam's "Credit Crunch" is Not Endemic**

Our canvass of companies in a variety of industries leads us to believe that large, high-quality companies outside the real estate sector are not facing difficulties rolling over their outstanding debts. That said, local banks have become more selective in their lending, and the SBV's recent tightening of monetary conditions in Vietnam (it hiked policy rates by 200bps YTD to 6%), plus its use of its FX reserves to support the value of the VN Dong are both also constricting overall credit conditions. Further to that last point, Vietnam's outstanding credit grew by 11.4% YTD as of October 20<sup>th</sup>, far outpacing system-wide bank deposit growth of 4.8% YTD, but we estimate that bank deposit growth would have been around 9% YTD were it not for the SBV expending an estimated USD20 billion of its FX reserves to support the value of the VN Dong.<sup>1</sup>

Note also that the SBV assigns Vietnamese banks annual credit quotas, which equates to about 14% system-wide credit growth in 2022. The rumors that sent the market surging last Wednesday included speculation that the SBV will increase banks' credit quotas by another 2%pts (the 2022 credit growth quota was lifted by about 1%pts in October), and that the Government could set up a new asset management company (AMC) to provide liquidity to the corporate bond market – which is dominated by real estate developers.

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<sup>1</sup> The SBV purchased VN Dong and sold US Dollars to commercial banks, which removed VND from circulation in the local economy.



**Understanding Real Estate Developers' Credit Crunch**

Vietnamese real estate developers do not have access to sufficient long-term funding to support their “land banking” activities. From the time that a developer purchases a plot of raw land to the time that land has been rezoned for residential use and the final apartment building/housing units constructed generally takes five years. The raw land plot does not become “bankable” until the land has been rezoned for residential usage and project approvals have been secured.

Until proper project approvals have been secured, developers cannot use land as collateral to secure bank loans, and even when the appropriate legal documentation has been secured, 1) banks generally only want to loan money out for a relatively short-time horizon (e.g., for the ~2 years it takes to construct an apartment building), and 2) the SBV recently started encouraging banks to lend directly to home purchasers (i.e., mortgage lending) rather than to real estate developers. In addition, Vietnamese property developers are limited in their use of “pre-sales” funding, and can only collect payments from home buyers after the building’s foundation is laid.

The net result of all of the above, is that developers began funding their land banking via the corporate bond market in recent years, causing issuances to skyrocket from USD12 billion in 2019 to USD32 billion in 2021. Developers faced less restrictive covenants on bonds they issued, or they essentially disregarded the covenants (which has been the main thrust of the Government’s recent regulatory crackdown on the country’s nascent bond market), primarily because many corporate bonds were sold to retail investors. Note that the bonds that retail investors bought typically have a 2–3-year maturity and pay 10-12% coupons versus ~7% interest rates on 18-month bank deposits in 2021.

The first problem with this situation is that developers now face a major “Asset Liability Mismatch (ALM)” because they essentially need to re-pay / roll-over their outstanding debts every two years, but the raw land they purchased will not generate cashflows until well into the future; the history of finance is littered with examples of a modest credit tightening causing solvency problems for companies & financial institutions with ALM issues. The second problem is that the time it takes to rezone raw land has been getting longer in recent years due to various bottlenecks in the approvals process, limiting developers’ ability to refinance their maturing corporate bonds with bank loans in a timely manner.

Finally, there are three very important points investors need to understand: 1) the Government could easily resolve the situation by encouraging banks to lend to real estate developers (by reducing the capital charge on loans to developers, for example), 2) the Government can expedite the approval process for new projects to alleviate developers’ ALM issues, and 3) demand for new housing units continues to be very strong and those units are still affordable to a wide range of middle-class buyers. In other words, Vietnam’s real estate market is still fundamentally healthy (in stark contrast to China’s, for example), despite facing immediate liquidity issues.



## Conclusions

Concerns about the ability of Vietnamese companies to access credit have been severely weighing on the VN-Index, but we believe Vietnam's "credit crunch" issues are primarily contained to the real estate sector. The demand for new housing units in Vietnam is still strong and prices are still affordable, so the prices of real estate stocks are likely to recover if-and-when the Government takes action to ease credit conditions to the sector. The market recent got the first inkling that such an easing could be in the works, which sent stock prices soaring.

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