**VinaCapital** **Economist’s Note** *April 1, 2021*

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# **Vietnam’s Bank Stocks are Leading the Market Higher**

Vietnam’s bank share prices are up nearly 15% this year, versus a 10% YTD increase in the VN-Index (VNI), after having surged by more than 30% last year (vs a 15% increase of the VNI in 2020). Since banks account for nearly one-quarter of the total market cap of Vietnam’s stock market, the outperformance of Vietnamese bank share prices is helping to boost the whole stock market.

Three factors are likely to drive Vietnam’s bank stock prices higher in 2021, and beyond:

1. **Consumer and small business lending** is raising local banks’ profitability and should propel loan growth for years to come
2. **25–30% earnings growth in 2021**, as the receding impact of COVID is improving Vietnam’s economic outlook, increasing margins, and alleviating asset quality concerns
3. **Windfall gains** from the IPOs of consumer finance subsidiaries and bancassurance deals, as well as from the restructurings of certain banks, all of which should boost the stock prices of those banks¹

In addition to the points above, the valuation of Vietnam's bank shares is quite reasonable at a 1.9X sector-wide, price-to-book (P/B) ratio, versus 19% expected ROE in 2021, driven by a 1.7% expected return on assets (ROA).

## **Consumer and Small Business Lending are Driving Earnings & Profitability**

Loans to consumers and small businesses accounted for 48% of Vietnam’s system-wide outstanding loans at the end of 2020,² and we expect this figure to increase to 51% by the end of this year given the faster growth rate of such lending, as can be seen in the chart below on the left. An increasing proportion of loans to consumers and small businesses boosts the profitability of the banking sector, because the net interest margins (NIMs) on these loans in Vietnam is ~6–7% versus ~3–4% for corporate loans.

### **Charts:**

**Left:** *Consumer & Small Business Loan Growth vs. Overall Credit Growth*

* Bar chart showing that Consumer & Small Business loan growth outpaced total credit growth each year from 2014–2020

**Right:** *Vietnam’s Consumer Loans/GDP*

* Line chart showing consistent increase from ~5% in 2011 to ~28% by 2019

Furthermore, we expect comparable improvements in the loan book composition of Vietnam’s banks in the years ahead because:

1. Vietnam’s consumer lending penetration rate is still just 28% versus 40–70% in its ASEAN EM peers³
2. Vietnamese banks have not yet started to aggressively lend to SMEs on the basis of the cash flows/business results of those companies. Banks in Vietnam will generally only lend against real estate or other tangible collateral, which means that those banks have yet to tap into attractive lending opportunities such as financing the working capital needs of local companies.

**¹** We expect 25% recurring earnings growth this year for Vietnam’s listed banks – or 30% growth when windfall gains are included.  
 **²** Note that Vietnamese banks aggregate loans to consumers and sole proprietor businesses into a single category called “Retail Loans”.  
 **³** Vietnam’s mortgage penetration rate is still only around 10%/GDP.

### **Strong Earnings Growth in 2021**

We expect the earnings of the 11 banks we cover⁴ to increase 25% in 2021, driven by:

* **12% system-wide credit growth** (and slightly higher growth for the banks we cover)
* **A 10bp NIM expansion**, to 3.6% system-wide NIM
* **A 10bp drop in credit costs** to 1.6% of total outstanding loans
* **A 30% surge in fee income**

Further to that last point, banks waived some fees for customers last year at the Government’s behest, so fees are surging from a low base in 2021. That said, fee income is also surging because major insurance companies including Sun Life, Manulife, and Prudential recently entered into bancassurance agreements to sell their products via local banks.

Those agreements entailed the introduction of new revenue streams, plus upfront payments from the insurance companies to local banks, which are thought to be as high as USD400 million. Speculation about the size of those payments ignited retail investor sentiment – although fee income is just over 10% of the sector’s pre-provision profits – so the other dynamics mentioned above (loan growth, NIM expansion, etc.) are more important long-term growth drivers than fee income.

Finally, COVID understandably prompted asset quality concerns, and those concerns were exacerbated by the considerable latitude that Vietnam’s banking regulators gave local banks about the level of NPLs they reported at the end of 2020, just as other regulators around the world did. The market consensus is that the true, system-wide NPL ratio in Vietnam probably increased from 4.5% at end-2019 to ~7% at end-2020, but that the receding impact of COVID, coupled with the Government’s adept handling of the COVID outbreak mean that the true NPL ratio will almost certainly be lower by the end of 2021.

Furthermore, we expect the Government to re-introduce stricter NPL reporting requirements by the end of the year, and to introduce a scheme for banks to write-down COVID-impacted loans over a 3-year time horizon starting in late-2021 – all of which is our basis to expect provision expenses as a percent of outstanding loans (aka credit costs/loans) to decline slightly this year.

### **Summary: Short-Term and Long-Term Positives**

The short-term outlook for Vietnam’s banks is supported by a re-bound in profitability as COVID-related earnings and asset quality issues recede (listed banks’ earnings are likely to surge by 50–60% yoy in Q1 led by higher margins and lower provisions). Over the long-term, we expect the earnings and share prices of Vietnam’s banks to be supported by increased lending to consumers and to a range of SMEs, including very small businesses.

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⁴ *The banks VinaCapital’s equity research team covers account for over 60% of the sector’s total outstanding loans – excluding Agribank, which is essentially a policy bank.*