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# **An “Evergrande Crisis” Could Not Happen in Vietnam**

Chinese real estate developer Evergrande has dominated international business headlines in recent weeks, and we have been asked by several investors, reporters, and analysts whether such a crisis could happen in Vietnam. The simple answer is “no,” for a number of reasons. First, Chinese real estate developers engage in business practices that were outlawed long ago in Vietnam, including pre-selling apartments to homebuyers *years in advance* of construction. Also, Evergrande’s true debt-to-equity ratio is nearly 5x versus 0.7x for Vietnam’s largest property developers.

Evergrande happened because Chinese policy makers explicitly target urbanization as an economic development strategy — and not because the country’s regulators are ineffectual. In contrast, Vietnam’s leaders target industrialization, and not urbanization. The growth of Vietnam’s cities is a by-product of the country’s industrialization, but it is not a goal in and of itself, which explains why the contribution of property development to Vietnam’s economy is much lower than it is in China:

### **Direct Contribution of Real Estate to GDP**

*(Graph showing real estate contribution to GDP: China ~14%, Vietnam ~5%)* *Sources: TS Lombard, Vietnam Real Estate Association*

China’s overreliance on real estate construction to propel the country’s economic growth explains why over 20% of the country’s apartments are empty[1]. In contrast, there is huge, unmet demand for new homes from owner-occupier buyers in Vietnam, although this demand also stems from the fact that less than 40% of Vietnam’s citizens live in cities, versus over 60% in China (Vietnam’s cities are growing ~2-3% per year, while two-thirds of China’s cities are shrinking). Furthermore, home prices in Vietnam are still relatively affordable, unlike in China where homes cost over 40x median household income[2].

### **Why Evergrande Can’t Happen in Vietnam**

There are two main reasons why China’s regulations on real estate development are much looser than those in Vietnam. First, China’s central government sets economic growth targets for the country’s individual provinces, and local officials achieve those targets by ramping up real estate development activity whenever the province’s “genuine economic growth” falls short[3]. Second, local governments finance about a third of their spending by selling land to real estate developers[4]. For these reasons, it was not in the Chinese government’s own interest to impose stricter regulations on the sector.

Next, Chinese developers borrowed enormous amounts of money from unregulated “shadow banks” with very loose lending standards; Gavekal estimated that just 25% of Evergrande’s interest bearing liabilities are owed to traditional banks while 45% are owed to shadow banks. Chinese savers poured money into shadow banking products that promised 7–12% annual returns because local banks paid artificially low deposit rates for years, for reasons that are outside the scope of this report.

This could never happen in Vietnam. The State Bank of Vietnam forbids such “shadow banking” products and has strict regulations in place to protect savers. Also, the demand for such products is low in Vietnam because Vietnamese banks pay savers market-level interest rates, which are usually at least 2%pts above the prevailing inflation rate.

**References**

1. <https://scholar.harvard.edu/rogoff/publications/peak-china-housing>
2. https://www.globaltimes.cn/content/1121946.shtml
3. About ⅓ of China’s recent GDP growth was generated by local provinces boosting their growth with real estate development.
4. https://www.adb.org/sites/default/files/publication/396826/adbi-wp800.pdf

Finally, the following business practices and conditions in China’s real estate market do not exist in Vietnam:

* **Excessive prepayments from buyers**: About 1.5m people are waiting for Evergrande to finish constructing apartments that they already paid for in whole or in part, and over half of the company’s USD300 billion liabilities are pre-payments from homebuyers. In Vietnam, regulations were enacted in the aftermath of a property bubble that peaked around 2009 that stipulate that developers are not allowed to collect down payments from homebuyers towards the purchase of an apartment until that building’s foundation is completed.⁵
* **Off-balance sheet liabilities**: Evergrande’s reported debt-to-equity (D/E) ratio is 3x, but the company’s “true” D/E ratio is closer to 5x when all of its off-balance sheet liabilities are properly accounted for.⁶ Those off-balance sheet liabilities include money the company borrowed via shadow banking products,⁷ as well as nearly USD100 billion of mortgage guarantees that Evergrande extended on behalf of the buyers of its apartments.
* **Government bailout**: Evergrande was able to accumulate enormous debts because of the tacit, widespread assumption among lenders that the firm is “too big to fail” and would get bailed out by the government if it encountered financial distress. Vietnamese investors are under no such illusions, partly because of the default of an SOE shipbuilding company in 2010 that lenders had assumed would be bailed out by Vietnam’s Government.

Further to that last point, there are ten more large property groups in China in equally precarious positions as Evergrande, according to UBS. The cumulative debts of these firms equate to another 2-3 Evergrandes, making it inevitable that the Chinese government will orchestrate some form of bailout because of the systemic risk posed to the country’s economy. We expect China’s government to inflict some pain on Evergrande’s creditors in order to prevent similar problems from amassing in the future, although home buyers are likely to be protected by the government.

**Negligible Contagion Risk in Vietnam**

There are concerns that Evergrande’s imminent collapse could be a “Lehman Moment,” with contagion effects that trigger sharp selloffs in other markets. In 2015, the unexpected and abrupt 4-5% depreciation of the Chinese Yuan caused Vietnam’s stock market to plunge 14%, and the VN Dong to depreciate by 4% in just 12 days, so it is understandable that investors are concerned about the potential impact of a disorderly deflation of China’s real estate market on Vietnam.

We are not overly worried about the possibility of a major impact on Vietnam, based on our research. We believe Chinese officials can prevent an episodic selloff in the country’s financial markets and will do so to maintain social harmony in the country. Furthermore, the Chinese government spent USD1 trillion of its FX reserves to stabilize the country’s economy after the 2015 Yuan devaluation mentioned above. Government officials do not want a repeat of this, and will act decisively to prevent disorderly conditions in the country’s capital markets from unfolding.

Chinese policy makers are likely to spread the negative economic consequences of Evergrande over several years, just as Japanese policy makers did following the collapse of that country’s real estate bubble. China’s GDP growth will be slower going forward, but this will not have a major impact on Vietnam, partly because Vietnam has a 15%/GDP trade deficit with China. Furthermore, China’s slower growth could encourage investment inflows into Vietnam that would have otherwise flowed into China.

Finally, it is possible that the Chinese Yuan may depreciate somewhat, but China’s policy makers probably won’t permit a major depreciation. This would benefit Vietnam (due to its trade deficit with China) but would not reduce Vietnam’s export competitiveness vis-à-vis China, because factory wages in Vietnam are two-thirds lower.

**Summary**

Evergrande’s troubles unveiled systemic issues in China’s real estate industry that do not exist in Vietnam, including: the sale of apartments years before construction commences and the reckless financing of projects via shadow banks. China’s government permitted all of this because it targeted urbanization as a goal in and of itself. Consequently, only about half the country’s GDP growth in recent years is attributable to what Xi Jinping calls “genuine growth” (the remainder is from real estate construction). In contrast, Vietnam targets industrialization, rather than urbanization as an explicit goal. As such, we are not concerned about a similar crisis happening here.

⁵ Some developers circumvent this and collect a ~10% “commitment fee” before signing a proper sales-purchase contract with the buyer.  
 ⁶ https://carnegieendowment.org/chinafinancialmarkets/85391  
 ⁷ It was widely reported that Evergrande missed payments on ~USD6 billion of wealth management products (WMPs), but the company’s total shadow banking liabilities (including WMPs & trusts) are probably over USD100 billion, according to Standard Chartered and others.

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