Vietnam: Banking and Financial Sector

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Summary

The banking and financial sector in Vietnam, which has developed very quickly in the last few years, is playing an ever-increasing role in the country's economic growth and development. Though it does not yet fully meet international standards in all aspects, the banking industry is gradually becoming a more modern and efficient system. A growing number of private banks have emerged and equitization (partial privatization) of state-owned banks is taking place gradually. Meanwhile, the banking sector's regulatory body – the State Bank of Vietnam- continues to improve itself.

From late 2007 and throughout 2008, Vietnam experienced economic overheating characterized by high inflation, currency depression, and a high trade deficit. The government therefore reversed its economic position to give macroeconomic stability priority over rapid growth. The government's "macro plus" economic package includes tightening public expenditures, reallocating government resources out of the banking system, and stopping inefficient investment projects. These steps helped to significantly reduce inflation in the final quarter of 2008.

With the government's change in policy, commercial banks in Vietnam now focus mainly on traditional banking activities such as lending and capital mobilization. Further, investment banking activities such as brokerage, advisory, underwriting, and derivatives-related activities continue to be in high demand. The International Monetary Fund, the World Bank, and other international donors- including the United States- are assisting Vietnam to implement financial reforms to ensure stability and promote efficiency within the banking system and the financial sector. Donor funded projects continue to create selling opportunities for U.S. banks and for IT and consulting firms doing business in the retail and investment banking arena. Services companies specializing in auditing, restructuring and IT, and providers of bank equipment will also find ample opportunities to bid on ODA projects.

At present, eight U.S. banks and financial institutions are operating in Vietnam. Citibank and Far East National Bank operate branches; American Express, Wachovia and Visa International have representative offices; and JP Morgan Chase operates both a representative office and a branch. Financial institutions and consulting firms such as Morgan Stanley, GE Money, and Boston Credit Swiss also have representative offices in country.

Vietnam has changed its banking and financial law to comply with its WTO commitments. Since 2007, Vietnam has officially permitted the establishment of 100% foreign-invested banks. However, banking continues to be heavily regulated by the government. Therefore establishing a new bank is still difficult and requires patience, commitment and continuous in-country presence to navigate the process.

Vietnam Banking System Overview

The opening of Vietnam's economy has placed new demands on a financial sector that until the early 1990s operated largely in isolation from international standards and practices. Vietnam is currently making progress in developing the basic infrastructure to support a modern banking system and financial markets.

The State Bank of Vietnam (SBV) is the main financial regulatory agency. As of November 2008, the SBV supervised two policy banks (the Social Policy Bank of Vietnam and the Vietnam

Development Bank), four state-owned commercial banks (SOCBs) (Vietinbank, BIDV, Agribank and the Housing Bank of Mekong Delta), 36 joint-stock banks, five joint-venture banks, 54 representative offices of foreign banks, 37 branches of foreign banks, 15 financial companies and 13 financial leasing companies.

The SBV is not an independent body like the U.S. Federal Reserve, and it continues to operate under government oversight. In some key areas of operation, such as the provision of liquidity support; monetary policy; the management of foreign currency reserves and foreign exchange rates; and issuance of banking licenses, the SBV's actions are subject to prime ministerial approval.

The Government of Vietnam (GVN) intends to partially privatize ("equitize") all SOCBs by 2010. The bank equitization process will allow foreigners to buy shares, but will cap foreign equity at 30 percent. These restrictions will be lifted in 2012 (five years after WTO accession). The first pilot initial public offering (IPO), Vietcombank's, took place in December 2007 after years of delays. In this IPO Vietcombank sold 97.5 million shares, 6.5 percent of the bank, at an average price of 107,800 dong ($6.69) each, above a starting price of 100,000 dong. The percentage owned by small foreign investors was about 25% of total shares issued. Until now Vietcombak still has no strategic foreign partner though it has been discussing this acquisition possibility with some major foreign banks.

Joint-stock banks have been more successful at raising private capital, selling part of their equity to foreign investors (mainly investment funds or financial institutions) and issuing convertible bonds or additional shares. The joint-stock banks (JSB) are on average much smaller than the SOCBs, but they are more efficiently operated and professionally managed. The non-performing loans of these banks are widely believed to be lower than those of SOCBs.

Overheating Economy 2007 -2008

In the second half of 2007, global macroeconomic conditions became increasingly difficult. Growth forecasts around the world were revised downward, and are expected to be lower for 2008 than for 2007. Credit markets have tightened, as the effects of the U.S. financial crisis continued to broaden and intensify.

World inflation and an informally pegged exchange rate explain a large portion of the acceleration in inflation in Vietnam. Additionally, increases in non-food prices, the surge in imports, and the burst of the real estate bubble at the end-2007 are linked in one way or another to rapid credit growth. Massive purchases of foreign currency by the SBV resulted in an equally large increase in Vietnamese Dong liquidity. The volume of bank deposits increased rapidly, and with it the volume of bank credit.

Breakdowns of credit growth reveal the channels through which SBV interventions led to an overheated economy, and it appears that credit to State-Owned Enterprises (SOEs) grew at almost the same pace as credit to the private sector. However, there is a sharp contrast between the relatively modest growth in lending by State-Owned Commercial Banks (SOCBs) and the extraordinary growth by Joint-Stock Banks.

This expansion of JSBs reflects their attempt to rapidly gain market share.
However, the competence of these banks' risk management capability varies. Some are supported by credible foreign partners, but it is fair to say that the pace of credit growth of several JSBs is not consistent with prudent lending practices, which raises concerns about credit quality. Many of the smaller JSBs invested heavily in stock and real estate markets. In fact, it is estimated that 10 percent of outstanding bank loans were for real estate in early 2008, compared to 3 percent in early 2007.

Another potential reason for the overheating of the Vietnamese economy in late 2007 is the diversification of large SOEs out of their core businesses, especially in the case of Economic Groups (EGs) and General Corporations (GCs). EGs are groups of enterprises each with a distinct legal status, which are

bound together through mutual investments, capital contributions or other forms of affiliation. They share common long-term economic interests and are organized under the holding company model. All subsidiaries of economic groups are equitized or otherwise restructured, whereas GCs are corporate entities consisting of a wholly state-owned parent or holding company and a group of subsidiary companies, which may be wholly state-owned or in which the state holds a controlling interest.

Investments by Economic Groups and General Corporations

Outside Investments (as of December 31, 2007)	Number of EGs and GCs	Amount (billion dong)	Percent of equity	Percent of assets
Investment funds and stocks	13	1,061	0.31	0.13
Stock trading companies	13	420	0,12	0.05
Joint stock commercial banks	19	4,426	1.30	0.55
Real estate	18	1,463	0.43	0.18
Total		7,370		

Source: Prime Minister's report to the National Assembly, May 31, 2008.

The combined EGs and GCs investments in the financial and real estate sectors reached about $500 million, which is not negligible, but is much less than the volume of resources channeled by the banking sector.

However, this diversification of EGs and GCs still raises serious concerns. The combination of commercial and financial interests under the same entity could result in an inefficient allocation of resources. Such combination could also lead to related-party transactions escaping supervision and entailing risks for financial sector stability.

Credit Policy

By the end of 2007, it was clear that inflation was accelerating, the trade deficit was widening and real estate prices were soaring. Yet, rapid economic growth was still seen as the top priority for Vietnam, and this required both a competitive exchange rate and massive public investment in infrastructure.

During this time the SBV tried to restrain credit growth by other means. Successively, it sold SBV bills, raised the reserve requirement and policy interest rate, and stopped buying foreign currency, to take money out of circulation while widening the trading band for the exchange rate. Some of these measures generated anxiety among businesses and financial institutions, but they did not succeed at lowering the growth rate of credit.

In February 2008, the government decided to give priority to macroeconomic stability over rapid growth, with some of the practical implications of this change still being worked out. The government thus chose a “macro plus” economic package that relies on monetary and exchange rate policy (though not exclusively) as well as on action on other fronts. The range of measures include tightening public expenditures, reallocating government resources out of the banking system, and stopping inefficient investment projects.

Other government measures related to credit policy. The sale of 20.3 trillion Dong in compulsory bonds was announced for March 17, 2008. In practice, this was equivalent to raising reserve requirements, except that the interest paid was higher. The total value of the bonds each commercial bank had to purchase was also modulated, taking into account its specific circumstances and introducing more flexibility than an increase in the reserve ratio would have allowed. Subsequently, authorities announced that the target was to bring credit growth down to 30 percent in 2008. On May 19, the benchmark interest

rate was increased from 8.75 to 12 percent, thus lifting the maximum lending rate to 18 percent (or 150 percent of the benchmark rate under current regulations.)

Other recent measures relate to fiscal policy. The central government mandated line ministries, provincial governments and SOEs to review their public investment projects for 2008, with a view of cutting down those with insufficient funding or outdated objectives. In the case of SOEs, a comparison of costs and benefits was also requested.

By the end of May, 28 ministries and central agencies, 43 provinces and eight EGs had reportedly decided to postpone, delay or stop 995 projects, equaling 280 million USD in state funding, equivalent to 7.8 percent of the total investment budget. The decision was also made to reduce investment spending funded through the issuance of government bonds by 630 million USD, equivalent to 25 percent of the original plan. In relation to recurrent expenditures, a 10 percent cut in non-salary items was mandated for the last eight months of 2008. It is expected that this measure will result in 190 million USD in savings.

In addition, the government has urged ministries, provinces and SOEs to take measures to strengthen the efficiency of their spending by improving the quality of project planning and appraisal, holding project owners and investment decision makers accountable for their investment decisions, and enhancing the inspection and supervision of projects. Whether these other measures will make a substantial difference in the level of public spending remains to be seen. It is clear that this change in policy priorities will lead to a slowdown in economic activity. The government announced that its new target for GDP growth in 2008 is 7 percent, down from the 8.5 to 9 percent range announced at the beginning of the year.

Foreign Exchange Controls

Conversion of Vietnamese Dong into hard currency no longer requires foreign exchange approval and Vietnam has not had a foreign exchange surrender requirement since 2003. The Law on Foreign Direct Investment allows foreign investors to purchase foreign currency at authorized banks to finance current and capital transactions and other permitted transactions. The supply of hard currency, which was a problem in the past, was significantly eased in 2007 with high inflows of foreign direct and portfolio investments.

Foreign businesses are allowed to remit in hard currency all profits, shared revenues from joint ventures, and income from legally-owned capital, properties, services and technology transfers. Foreigners also are allowed to remit abroad royalties and fees paid for the supply of technologies and services, principal and interest on loans obtained for business operations, investment capital and other money and assets under their legitimate ownership.

In principle, most foreign investors are expected to be ‘self-sufficient’ for their foreign exchange requirements, although this sometimes proves impractical. The GVN guarantees foreign currency for certain types of foreign investors in the event that banks permitted to trade foreign currency are unable to fully satisfy their foreign currency demand.

During most of 2008, the exchange rate remained stable at roughly 16,000 dong for one U.S. dollar due to market interventions by SBV. The apparent stability of the nominal exchange rate hides a sizeable real appreciation of the dong in recent months.

The SBV currently uses a crawling-peg foreign exchange control mechanism. In November 2008, the SBV expanded the trading band for U.S. dollar and Vietnamese dong transactions to 3 percent (from the previous 2 percent (June 2008), 1 percent (Mach 2008), 0.75 percent (December 2007) and 0.5 percent rate before that) and allowed commercial banks to set the differential between currency, selling and buying prices. This decision has given more autonomy and flexibility to commercial banks in providing foreign exchange services and has made it easier for foreign investors to secure hard currency. This will also help the economy cope better if capital flows increase.

In June 2008, the State Bank decided to allow the prime interest rate to be set at 13%. At the end of 2008, the world financial crisis started to show its effects and hard currency demand in Vietnam declined; SBV has therefore loosened its foreign currency control. It recently lowered the prime interest rate of the Dong to 12%.

Below are the most recent interest rates in Vietnam as of December 2008:

Types of interest rate	Value	Document No.	Effective date
Prime interest rate	12%/year	2559/QĐ-NHNN dated November 3, 2008	November 5, 2008
Re-financing rate	13%/ year	2561/QĐ-NHNN dated November 3, 2008	November 5, 2008
Discount rate	11%/year	2561/QĐ-NHNN dated November 3, 2008	November 5, 2008

(*Source : State Bank of Vietnam)*

Market Demand

Although the banking sector remains small (only eight million bank accounts and less than one million credit cards in a country of over 85 million people), banking networks and services have been expanding rapidly and the trend is likely to continue in 2008. In 2008, the GVN began paying its Hanoi and Ho Chi Minh City employees by direct bank deposit only, and will include all government employees nationwide (including provincial staff) by January 2009.

In the recent past, the banking industry achieved rapid growth in terms of both quantity and operation scale. The number of banks increased from 9 in 1991 to 80 in 2007 and 85 in 2008. The increasing number of JS Commercial Banks and Foreign Bank Branches explains the attractiveness of Vietnam Banking industry to domestic investors as well as international financial organizations.

Besides the increase in quantity, the scale of the banks' operations has also expanded considerably. In 2007, total assets of the banking system reached over VND 1,500 trillion, comprising 130% of GDP. The growth has concentrated on two traditional activities - lending and mobilization. Credit and deposit mobilization swelled rapidly at an average rate of 35% per year during 2002-2007. As noted above credit growth became too "hot" in 2007, with the rate of 54% due to the high credit demand of the economy including credit demands for securities and real estate investment

Despite facing many difficulties in 2008, it is predicted that the Vietnamese economy will sustain a substantial growth rate in the coming years. According to Business Monitor International's (BMI) forecast, GDP growth rate in 2008 will be 7%, and will reach an average rate of 8% in 2008-2012. This is an important factor for the development of the banking system.

Commercial banks in Vietnam are now focusing mainly on traditional banking activities such as lending and capital mobilizing. Investment banking activities such as brokerage, advisory, underwriting, and derivatives-related activities are mostly executed at securities firms.
However, some big banks with are promoting these operations by establishing securities firms owned by banks. In the future, investment banking will bring many development opportunities for banks, but it is recognized that this sector is highly competitive.

The International Monetary Fund, the World Bank, and other international donors- including the United States- are assisting Vietnam to implement financial reforms to ensure stability and promote efficiency within the banking system and the financial sector. The reform program focuses on three main areas: restructuring of joint stock banks, restructuring and commercialization of the SOCBs, and improving the

regulatory framework and enhancing transparency. Other ongoing projects aim to modernize the inter-bank market, create an international accounting system, and allow outside audits of major Vietnamese banks. The SBV is also in the process of strengthening its own internal processes and enhancing the level of inspection and supervision of the banks within its jurisdiction. It is further preparing regulations to implement the Basel capital accord in calculating risk-adjusted assets and risk-adjusted capital ratios.

Increasingly, more SOCBs are audited by independent auditing firms. The government requires all banks to establish controlling committees and institute internal audit functions. In reality, prudent banking practices are not always adhered to. The actual level of non-performing and under-performing loans is difficult to gauge, as there is a very low level of transparency and disclosure in Vietnam's banking sector. Secrecy laws cover much of the banking industry's data, and meaningful information on individual financial institutions is not readily available. In 2007, the SBV introduced rules for classification of non-performing loans, which conform to international standards. It also allowed banks to accelerate loan terms and gave them more discretion in setting penalty interest rates on overdue debts. By June 2008, all financial institutions are expected to institute internal credit rating and risk assessment mechanisms.

Donor funded projects continue to create selling opportunities for U.S. banks and for IT and consulting firms doing business in the retail and investment banking arena. Services companies specializing in auditing, restructuring and IT, and providers of bank equipment will also find ample opportunities to bid on ODA projects.

Market Data

State-owned commercial banks have lost a large proportion of market share to joint-stock commercial banks in recent years, especially in 2006 and 2007. Joint-stock commercial banks' rapid expansion of market share demonstrated an appetite for fast development and a stronger competitive advantage of this group in the market. Foreign and joint-venture banks have also increased in number. The market share of this group remains stable because they are restricted to mobilizing capital in VND from individual customers, thus market share expansion has been limited considerably.

Table 5: Lending market share in 2003 – 2007

	2003	**2004**	**2005**	**2006**	**2007**
Stated owned commercial Bank	79%	77%	73%	65%	55%
Joint Stock Bank	11%	12%	15%	21%	29%
Foreign and Joint Venture banks	9%	9%	10%	9%	9%
Other financial org.	2%	2%	2%	5%	7%

Source: ADB

Table 6: Deposit market share in 2003 – 2007

	2003	**2004**	**2005**	**2006**	**2007**
Stated owned commercial Bank	78%	75%	75%	69%	59%
Joint Stock Bank	11%	13%	16%	22%	30%
Foreign and Joint Venture banks	9%	10%	8%	8%	9%

Other financial org.	1%	2%	2%	1%	2%

Source: ADB

On October 30, 2008, the World Bank approved a new loan of US$60 million to assist the State Bank of Vietnam, the Credit Information Center, and the Deposit Insurance of Vietnam to improve the delivery of their main functions in accordance with relevant international standards for the banking sector. This loan focused on developing a centralized and integrated system of advanced business processes and a modern information technology architecture, as well as strengthening institutional capacity in carrying out operations. This project should open up significant opportunities to US firms. More information on the project can be found at this website:http://web.worldbank.org/external/default/main?menuPK=387598&pagePK=141143&piPK=141103&theSitePK=387565

Prospective Buyers

At present, eight U.S. banks and financial institutions are operating in Vietnam. Citibank and Far East National Bank operate branches; American Express, Wachovia and Visa International have representative offices; and JP Morgan Chase operates both a representative office and a branch. Financial institutions and consulting firms such as Morgan Stanley, GE Money, and Boston Credit Swiss also have representative offices in country.

Of the state-owned banks, Vietcombank, Vietinbank, the Bank for Agriculture, and the Bank for Investment and Development, currently have the most active correspondent relationships with U.S. banks. Several joint-stock banks also have correspondent relationships, such as the Asian Commercial Bank (ACB), East Asia Bank (EAB), Vietnam Export-Import Bank (EXIM Bank), the Maritime Bank, Saigon Commercial and Industrial Bank, Saigon Thuong Tin Commercial Bank (Sacombank), Vietnam Technological and Commercial Joint Stock Bank (Techcombank), and the Vietnam Commercial Joint-Stock Bank for Private Enterprise (VP Bank).

Market Access Issues & Obstacles

Since April 2007, in compliance with its WTO commitments, Vietnam has officially permitted the establishment of 100% foreign-invested banks. Because banking is heavily regulated by the government and is highly competitive, establishing a new bank is difficult. Newly established banks must have a minimum-chartered capital of VND 1000 billion and reach VND 3000 billion by 2010. The foreign ownership ratio is still limited at 30% and foreign strategic shareholders can only hold a maximum of 20% chartered capital and have total assets of at least USD 20 billion. Despite these restrictions, the attractiveness of potential growth and profitability of the banking industry has motivated many domestic and foreign institutions to establish new banks. By the end of 2007, the State Bank of Vietnam has received 5 applications for establishing 100% foreign invested subsidiary banks and 19 for setting up foreign bank branches in Vietnam. Three applications for setting up branches have been approved in principle and include the Commonwealth Bank (Australia), IBK (Korea) and Fubon (Taiwan). There are also 30 applications for local banks licenses.

Despite the high barriers to entry, the banking industry is attractive to a large number of big organizations, especially foreign organizations with strong financial potential, modern banking technology, and international exposure. Hence, competition in the banking market will be more intense in the coming years. Mergers and acquisitions within the industry are expected, decreasing the number of small and medium banks significantly. Mergers and acquisitions will assist banks to improve operations and efficiency; maintain profitability, and mitigate competition within the industry.

For More Information

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