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Special Report

Consumer Financing – Opening Door for Credit Growth

Vietnam's financial risk-warning indicators are close to the red line after exploiting the monetary policy to push the economy up in decades. We estimate the amount of total credit to non-financial sectors would reach USD290 billion, equivalent to 133.8% of normal GDP in 2017. This is similar to emerging markets' but higher than that of Greece which is in crisis. Another indicator, the credit-to-GDP gap, approaches the warning point of 10% again, which threatens a high possibility of financial crisis in the next 3 years according to BIS's recommendation.*

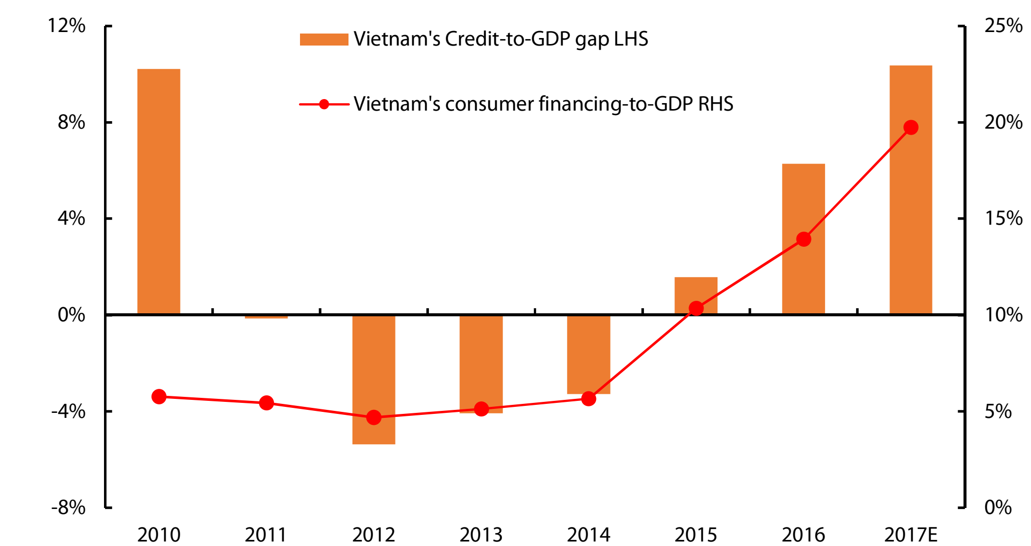
However, it is essential for policymakers to maintain a high credit growth and control the money flow in the economy when the "fiscal wheel" is wearing out. Consumption, which contributes 70% to GDP, becomes a sweet fruit as the credit to non-financial corporation is stuck and NPLs solve are still a nightmare. Five years ago, consumer financing growth was impressive and we forecasted the average growth at nearly 30% per year.

On one hand, credit financing has been opening the door for credit growth. In the mid-term, there is a bright prospect as the scale of consumer financing is estimated to be nearly 19% of GDP in 2017. Moreover, we bet on a significant push-up on the momentum of the economy in the coming years. As a result, real estate and stock markets are likely to benefit from such changes.

On the other hand, financial risks are getting more serious as consumers are too confident and ready to call for debts although the savings ratio is lower than other nations in ASEAN. Besides, there is a significant correlation between asset prices and household debts. The high-credit-growth environment is likely to activate speculators and push asset prices up. In contrast, household credit ranking may be over assessed as the overvalued assets are being used for collaterals.

Overall, we believe that credit flow will drive up asset prices such as property and stocks. However, there are potential risks and it is essential for policymakers to control them.

Financial risk and consumer financing scale



Source: NFSC, RongViet Research

Note: The credit-to-GDP gap is defined as the difference between the credit-to-GDP ratio and its long-run trend and warns about potential financial risk in the next 3 years.

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THE TREND OF CREDIT FLOW INTO HOUSEHOLD SECTOR

- Vietnam's financial risks getting higher and the buffer wearing out
- Trend of credit flowing into household sector
- Vietnamese consumers becoming more confident

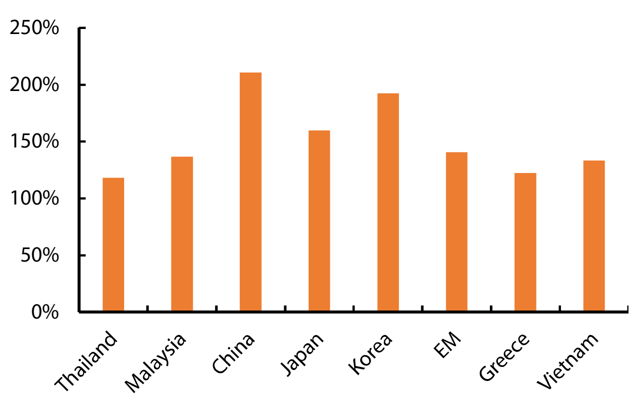
Financial risks getting more serious

There are more and more concerns about Vietnam's financial risks after exploiting the monetary tool to push the economy up in decades. Currently, we estimate total amount of credit to non-financial sector reaches USD290 billion, equivalent to 133.8% of Vietnam's normal GDP. This is similar to emerging markets' and higher than that of Greece (122.3% of GDP).

Another financial risk warning indicator, credit-to-GDP gap, threatens a possible nightmare because credit growth remains high. Up to the first quarter of 2017, Vietnam's credit-to-GDP gap stood at 10.4%, approaching the peak for 2010. According to the recommendation of the Bank for International Settlements (BIS), the possibility of the next 3-year financial crisis gets higher whenever the indicator overcomes the threshold of 10%. We intend to emphasize two important points:

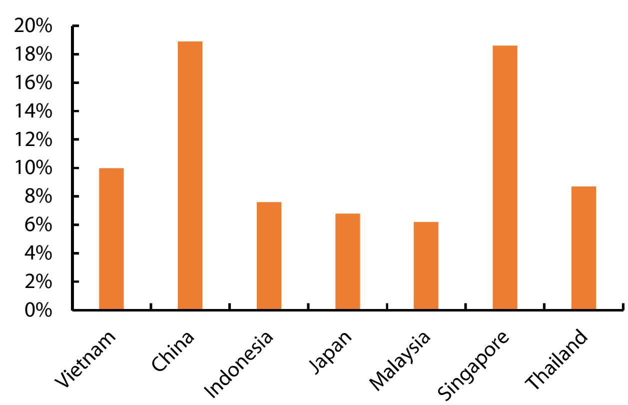
1) Vietnam's credit-to-GDP gap is significantly higher than others' and just ranks below China (18.9%) and Singapore (18.6%). In addition, Vietnam's country risk is at the top of ASEAN due to CDS indicator's denomination in compared with other countries such as Thailand (49.8 points), Philippines (65.9 points) and Indonesia (98.6 points), despite gradual drop to 130.3 points in November 2017. Those have been keeping investors from pouring money into the market.
2) There is a high possibility of a trade-off game between high credit growth and financial risks. After tightening strongly the monetary policy in 2011-2012 due to hyperinflation, credit's rising period has resumed since 2013. However, we see a step-by-step increase of credit-to-GDP gap and a larger amount of bad debts. Currently, we stand pats on that as the scale of bad debts surged 10.44% YTD in September 2017 although the published level of NPLs is lower than the requirement of 3%.

Figure 1: Total credit to non-financial sectors (% GDP)



Source: BIS, RongViet Research

Figure 2: The Credit-to-GDP gap



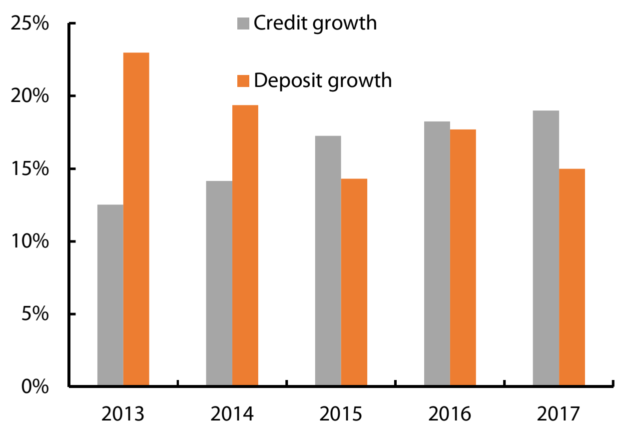
Source: NFSC, RongViet Research

The buffer is likely to wear out

Up to 2017, credit growth is estimated at 19% YoY while deposit growth is in a range of 15-16% YoY, which is similar to what happened 5 years ago. The gap between credit and deposit growth has been raising concerns about the banking system's liquidity risk. According to SBV statistics, the overall LDR is at 88.74% in August 2017 while that of the state-owned banks has reached 94.57%, well above the mark of 90% based on Circular No.36/2014/TT-NHNN.

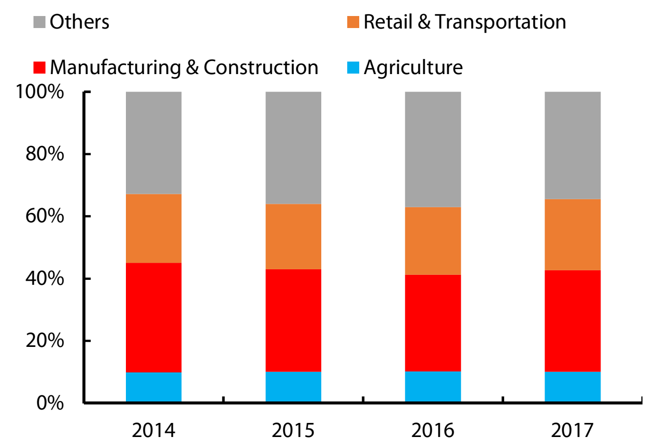
On the other side, we see no significant changes in the credit structure as a third of loans lies in other sectors, including highly risky sectors like the real estate. Meanwhile, there are obstacles on the way of credit to prioritize sectors like agriculture, hi-tech businesses, supporting businesses, and exports.

Figure 3: Credit and deposit growth



Source: SBV, RongViet Research

Figure 4: Credit structure

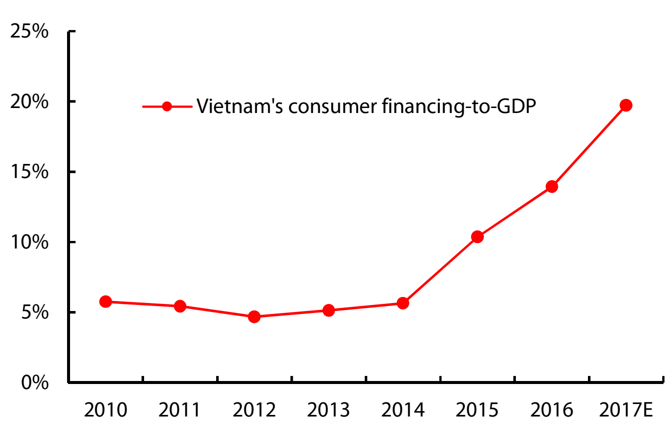


Source: SBV, RongViet Research

Credit flows into household sector

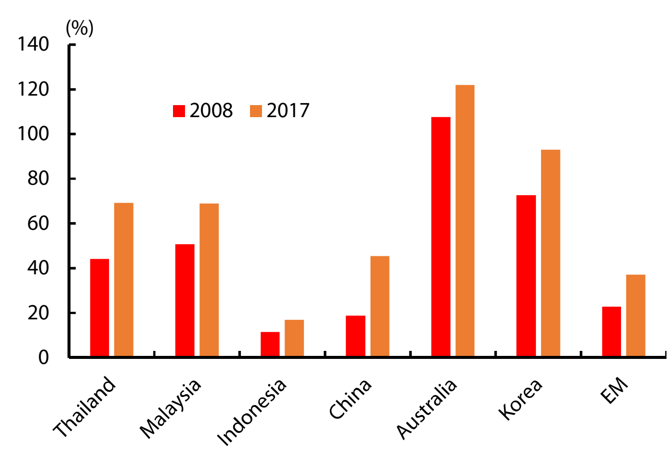
Under the circumstance of corporation's silent capital absorption, redirecting credit flow into the household sector is a good response to what the economy's momentum is in the mid-term. According to our calculation, consumer financing grows at an annual pace of 60% in 2017 and will increase by 30% YoY on average in the next 3 years. In 2017, the scale of consumer financing accounted for 19% of GDP.

Figure 5: Credit-to-GDP gap



Source: RongViet Research

Figure 6: Household debt-to-GDP ratio



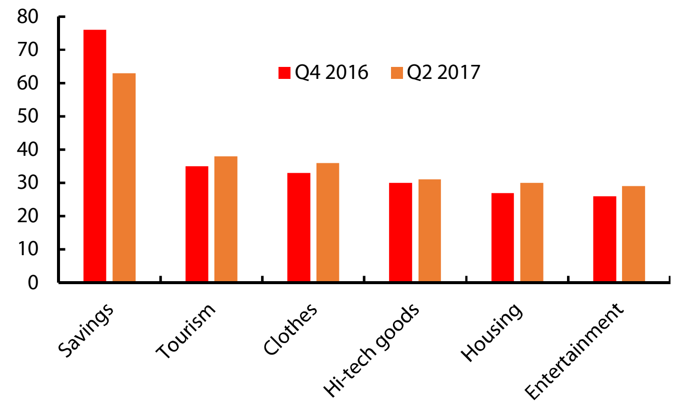
Source: Bloomberg, RongViet Research

In compared with other nations in Asia we see a similar trend as such countries intending to take advantages of the internal force. For example, China, whose policymakers have prolonged headache related to state-owned corporation's debt and bad debts, redirects a part of credit flow to household debts. Currently, its household debt-to-GDP ratio is 2.4 times higher than it was 10 years ago.

Vietnamese consumers becoming more confident and open-minded

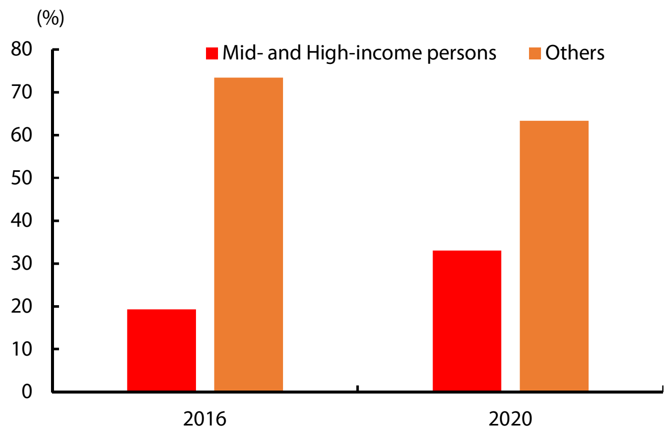
According to Nielsen's market research, Vietnam's consumer confidence level climbed to 117 points in the second quarter of 2017, reaching a 5-year high. Vietnamese optimism is ranked at the fifth position. Notably, the Vietnam is ready to pay for tourism, entertainment, and healthcare, after spending for basic demand.

Figure 7: Consumer behavior



Source: Nielsen, RongViet Research

Figure 8: Mid- and high-income persons



Source: Bloomberg, RongViet Research

POSITIVE EFFECTS ON ECONOMY IN MIDTERM

- Positive effects on GDP growth in midterm
- A door for financial institutions' growth
- Benefit for manufacturers and servicers

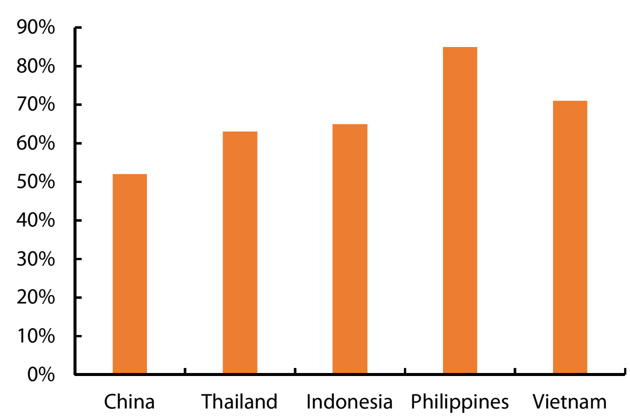
Positive effects on GDP growth in midterm

On the macro front, the benefits of credit flow into the household sector consist of 1) pushing the economy up in midterm and 2) spreading the risk out. In details, consumption contribution to GDP was 71% in 2016, which was higher than most of other Asian nations. Thanks to the golden population structure, Vietnam's consumer market becomes a sweet fruit for financial institutions. According to IMF's recommendation, a higher household debt positively affects the economy whenever the ratio of household debt to GDP stands below 30%.

In addition, a better access to credit indirectly reduces the scale of underground credit business in the economy. At the Financial Marker Reform Conference in 2013, in Vietnam's plan of economic restructuring, the scale of underground credit business was USD50 billion, equivalent to that of the 30% of the total official credit to non-financial sectors. In Vietnam, there is no doubt that the underground credit business is parallel to the official system and plays a role in pumping capital to private sectors despite lack of diversified services. In addition to small-scale loans among individuals, SMEs, which are facing obstacles in asking for bank loans, also become such business's clients.

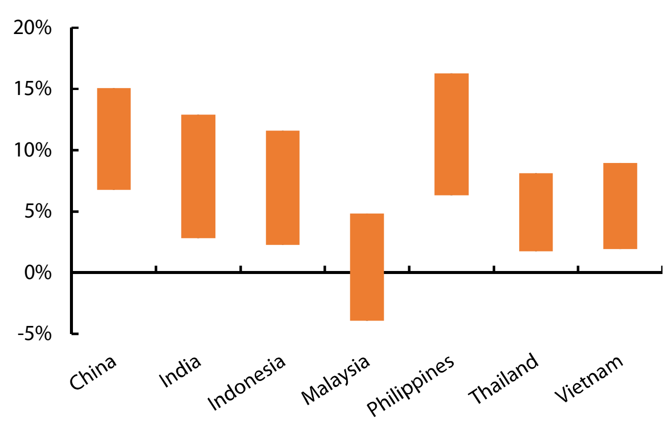
Furthermore, Global Financial Integrity (GDI) reported that Vietnam received nearly USD33-150 billion of net illicit financial inflows, equivalent to 2-9% of total trading value, in 10 years from 2005 to 2014.

Figure 9: Consumption contribution to GDP



Source: Bloomberg, RongViet Research

Figure 10: Illicit financial inflow (% of total trading value) in 2005-2014



Source: Bloomberg, RongViet Research

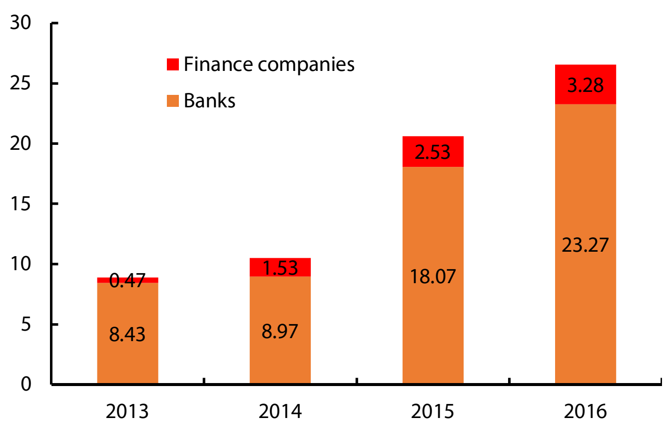
A door for financial institutions' growth

According to statistics, consumer financing stems mostly from banking systems, around USD23.27 billion, accounting for 87.6% of total amount in 2016. Currently, commercial banks such as VPBank, Techcombank, HDBank,etc set the retail-focusing strategy and own their financial companies. Higher participation of financial companies in the market provided 12.4% of total consumer financing.

As mentioned previously, we think that consumer financing's development creates a good meal for financial institutions. Regarding banks, the net interest rate margin dropped significantly and remains under the mark of 3%, well below those of other regional countries in ASEAN such as Thailand (3.07%), Indonesia (5.82%) and Philippines (3.58%). Therefore, more and more banks and financial companies are investing in consumer financing business in order to maintain the upward momentum.

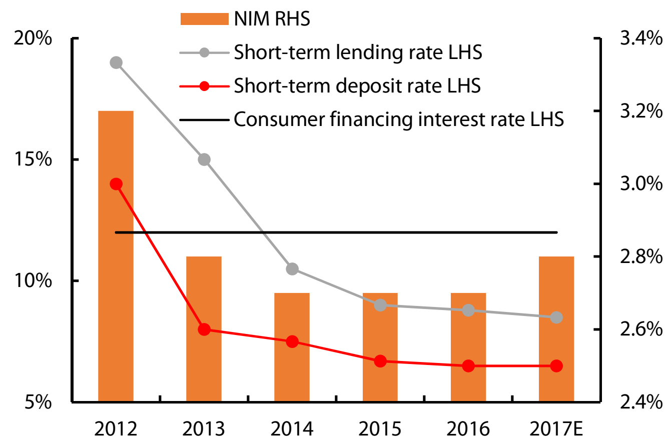
Regarding of the prospect, if we exclude the amount of loans for buying/repairing houses (based on international roles), the scale of consumer financing is only 9% of GDP. Besides, there are only 30% of total clients who are served.

Figure 11: Consumer financing structure



Source: Stoxplus, RongViet Research

Figure 12: Lending rates



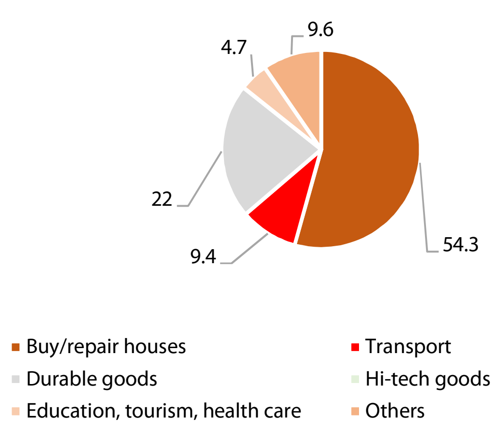
Source: RongViet Research

Benefits for manufacturers and servicers

Based on consumer loan classification, banks' consumer financing concentrates on large-scale loans used for buying/repairing houses (54.3%) and transportation (9.4%). In the context of SBV's strict control put on credit flow into the real estate market, such changes are expected to push the demand up, especially in terms of mid-class property.

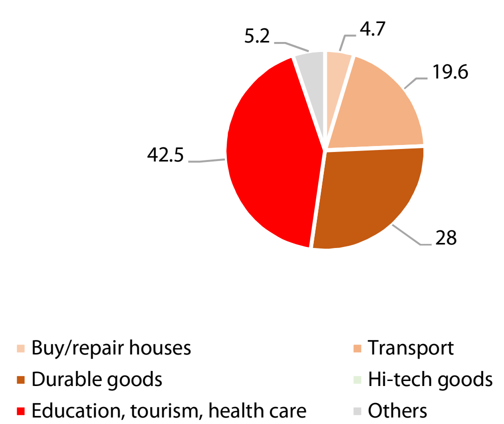
Looking on the other side, we appreciate the role and prospect of financial companies which contribute to Vietnam's retail market although such companies prefer subprime and low-value loans. Durable goods like television, refrigerator, etc. took 28% of total loans coming from financial companies as Vietnamese consumers are ready to get indebted and pay for diversified demand such as education, tourism, healthcare, etc.

Figure 13: Banks' consumer loan structure



Source: Stockplus, RongViet Research

Figure 14: Financial companies' consumer loan structure



Source: Stockplus, RongViet Research

POTENTIAL RISKS

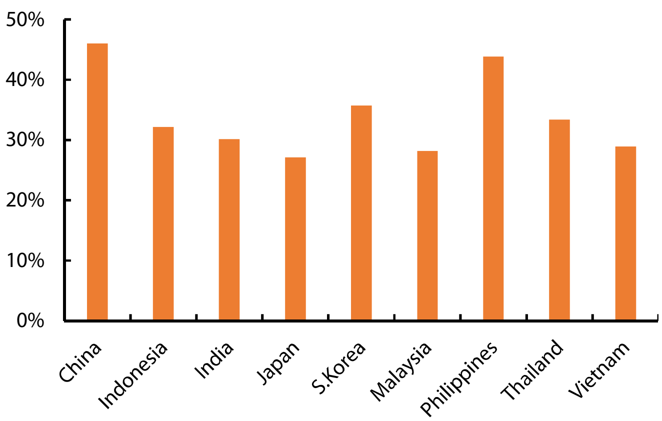
- Household indebtedness amid low level of savings
- Credit inflow to highly speculative assets
- Better credit ranking of consumers due to higher price of collateral

Household indebtedness

The most important risk is household indebtedness. According to statistics, Vietnam's consumer financing soared 60% YoY in 2017 and is expected to grow at an annual pace of 29-30% on average in the next 3 years.

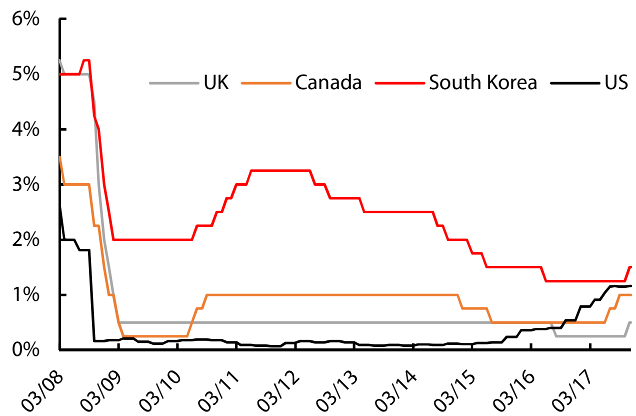
Up to 2016, Vietnam's savings-to-GDP ratio was only 29% of GDP, below other countries in ASEAN. Based on the analysis of consumer behavior, there is an over-optimism sentiment about future income and readiness to make a trade-off between present and future consumption. All of them pose questions on the ability to repay debts. Moreover, the economy will weaken significantly in the case of lack of connection between higher consumption and healthier country.

Figure 15: Savings-to-GDP ratio



Source: Bloomberg, RongViet Research

Figure 16: Big central banks' policy interest rates



Source: Bloomberg, RongViet Research

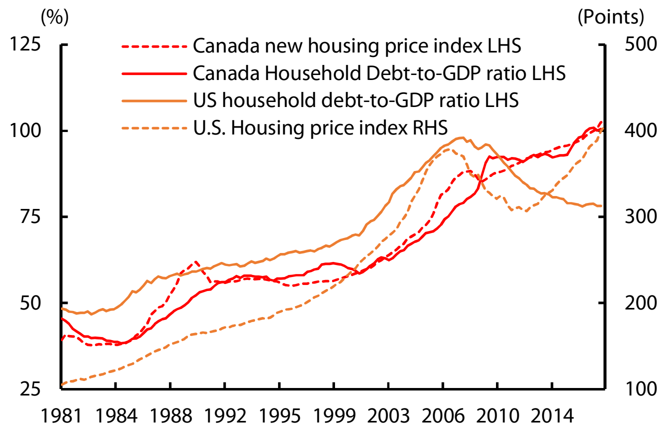
The scale of debt will increase globally as the cycle starts to tighten. After FED takes specific actions to realize its normalization plan, the effect stretches out. According to the US Department of Education, nearly 5 million Americans have defaulted on federal student loans in the third quarter of 2017, twice as high as what happened 4 years ago. Recently, the Bank of Korea (BOK) decided to increase its policy interest rate by 25 bps to 1.5% per year while PBOC hiked OMO tools' and MLFs' interest rates. Learning lessons from Korea, which recorded a USD1.3 trillion household debt in September 2017, a 25 bps increase in policy interest rate will put more debt burden, an additional USD325 billion on the household sector, to mention the negative effects on consumer confidence.

Recently, the Bank of England (BOE) and the Bank of Canada (BOC) also raised their interest rates after a prolonged period of no change. One of the important reason is related to the huge amount of household debts, 87.2% of GDP in U.K. and 100.5% of GDP in Canada. BOE advises its commercial banks to make 11 billion pound of capital as a provision because of its concerns about banks' over assessment of household credit profile.

Risk of higher asset prices

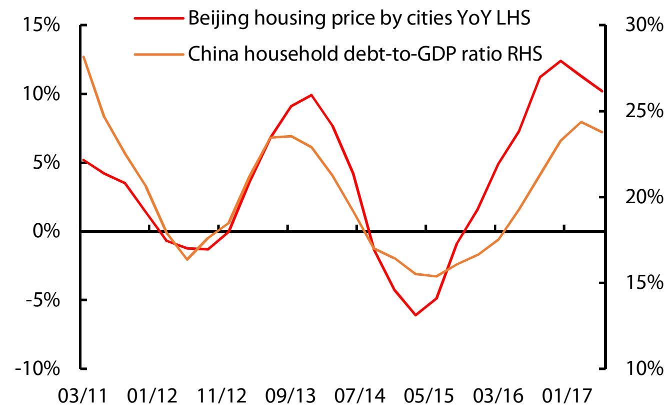
In addition, there are proofs of highly positive correlation between household debts and asset price, thanks to the historic lessons. The housing prices' movement in Canada and the US have shown significant differences since global financial crisis in 2008. While the US housing price index dropped by 25% in compared with 2008's peak, that of Canada has kept the uptrend. One of the most important reasons was the divergence of household debt trend. On the other side, property prices increase and become collaterals, resulting in a better credit profile for the household sector. This encourages them to exploit personal financial leverage.

Figure 17: Housing prices in the US and Canada



Source: Bloomberg, RongViet Research

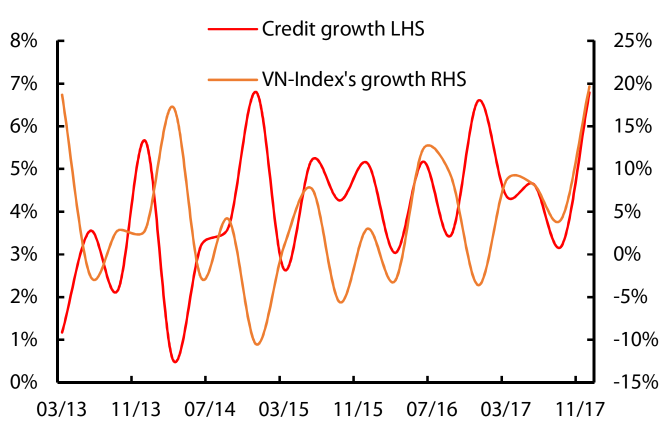
Figure 18: Housing prices in Beijing



Source: Savills, RongViet Research

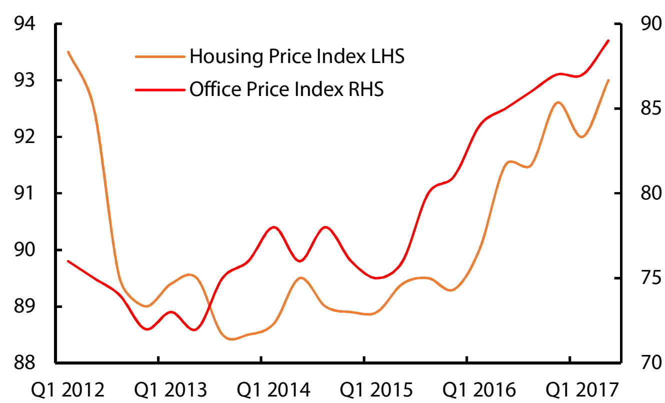
We also saw a valuable experience from Vietnam's neighborhood, China, which experts fear for price bubble. There is also a highly positive correlation between big cities' house prices and household debts. In addition to the government's strict control, PBOC has actively reduced the growth rate of household debt since 2017. As a result, Beijing's house price is growing at a slower pace.

Figure 19: Stock market movement



Source: SBV, RongViet Research

Figure 20: Real estate market in Ho Chi Minh city



Source: Savills, RongViet Research

In Vietnam, housing price and office price have rebounded strongly in 5 years. In Ho Chi Minh city, the housing price index reached 93 points in the second quarter of 2017, up 5.1% in compared with 2014's bottom while the office price index rose 89 points, up 23.1% in compared with 2013's. Despite lots of reasons, we bet on a strong effect of credit growth.

In addition to the real estate market, the stock market is likely to benefit from a part of credit flow. Based on our calculation, credit growth often affects the stock market's results after 3 months. In 2017, the VNIndex increased by 42% YTD and its PE climbed to 18.6 times. The VNIndex has shown an impressive performance in ASEAN.

CONCLUSION

- Consumer financing growth is bright and affects positively on the economy in midterm
- SBV needs to control the growth and destination of credit flow
- Banks should be careful on collateral in the context of higher asset prices

We assess that consumer financing is a door for credit growth of banks. In the midterm, there is a bright prospect of growth as its scale is equivalent to 19% of GDP in 2017. Moreover, we bet on a better economic growth in 1-2 years. While the "fiscal wheel" is wearing out significantly and debt repayment is getting more serious in the next 3 years because 60% of VGBs will reach maturity, the monetary policy keeps the driving the upswing. However, the fast growth of consumer financing (30% per year) is likely to create a difference compared with the initial plan. It should strengthen the economy's aggregate demand and push the domestic manufacturing sectors up. Currently, Vietnam's per capital is nearly USD2,400 per year, up 8.3% YoY. However, Vietnam's productivity growth remains low, around 4.4% per year, in 2004-2015, compared with China's productivity, 9.1% YoY increase.

Regarding of highly speculative sectors such as real estate and stock markets, such changes are drawing a beautiful picture. However, there are potential risks as over 50% of the credit pours into the real estate market and becomes an important pillar of the rallying period. This creates different calculation of credit and increases financial risks for the real estate sector, as assets are used for collateral and banks over assess borrowers' credit profile.

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