April 24th, 2019

Special report

Modest pressure on low government bond yields

In 2019, the Vietnam State Treasury (VST) plans to issue VND 260 Tn (USD 11.2 Bn) worth of government bonds, up 30% YoY as bonds mature and the Treasury failed to complete its 2017 and 2018 targets.

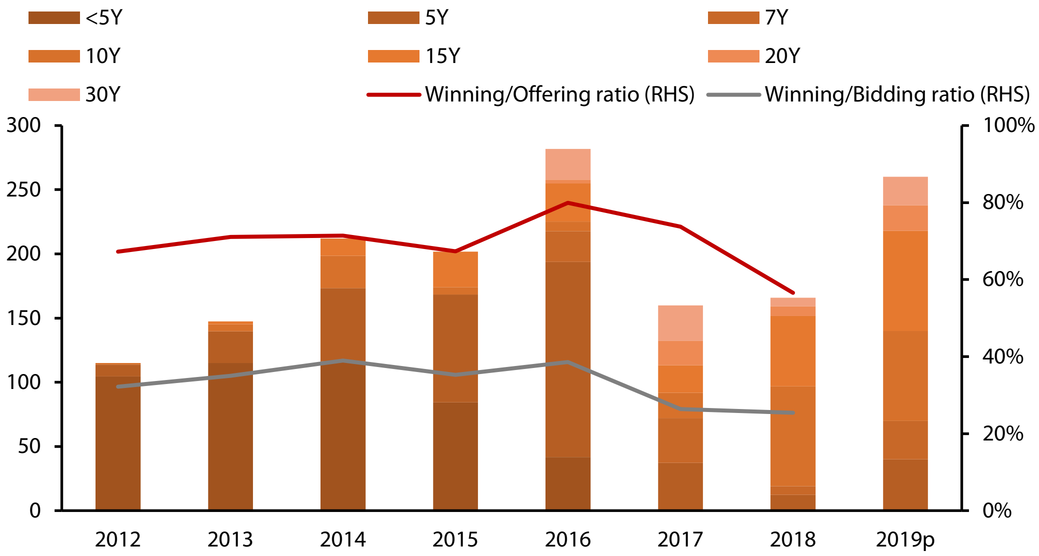
Demand for government bonds remains high while the bid-to-cover ratio continued to decline (60% of the total offer) due to declining yields. The 5-year bond yields just 3.6%, lower than our expected inflation for 2019. Besides traditional bank buying, Vietnam Social Securities purchases helped lower yields. We think yields may have to pick up in 2019 in order to meet the Treasury's plans.

Along with inflation, tightening bank liquidity will also put pressure on yields. We predict VGB yields may be flat in the second quarter and increase + 25-50 bps in 2H2019 although a possible reduction in reserve requirements may offset this somewhat. Moreover, as the Fed became dovish, other global central banks may follow.

Regarding the secondary market, we believe: 1) bank market liquidity will be tighter than in 2017-2018, 2) repos trading value will continue to rise as investors use it to mitigate risks and 3) foreign investors will net buy government bonds if the exchange rate (USD/VND) trades within a 3% range.

The corporate bond market grew strongly in 2018, reaching 8.6% of GDP and exceeding the 2020 target of 7% of GDP. We expect companies to issue more corporate bonds as bank credit tightens, especially in the real estate industry.

Figure 1: Issuance plan of Vietnam government bonds (Tn VND)



Source: MOF, Rong Viet Securities

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Content

Primary market

- VST boosts its plan for 2019
- Certain government bond yields were lower than inflation

VST boosts its plan for 2019

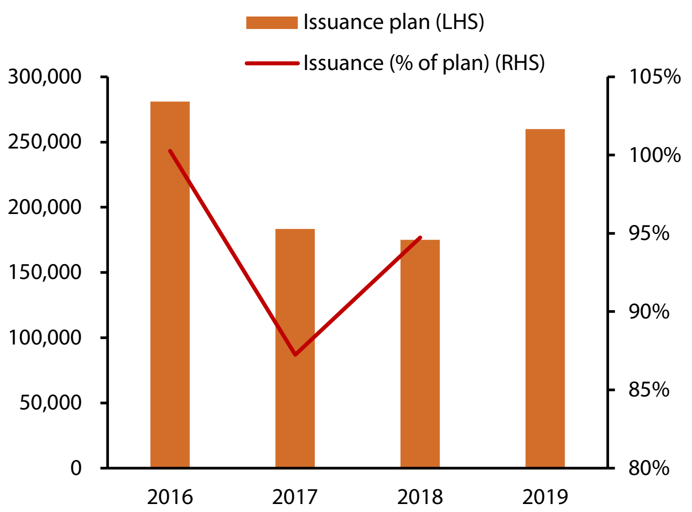
The Vietnam State Treasury (VST) increased the amount of government bonds it wishes to issue in 2019 to VND 260 Tn (USD 11.2 Bn, FX as of April 19th 2019), up 48.6% YoY. We think there are two reasons for this increase. Firstly, the value of maturing bonds this year will reach VND 119.6 Tn (USD 5.2 Bn), an increase of 87.8% YoY. A big proportion of those bonds matures in the 1H2019. Secondly, the state budget deficit will continue to rise this year to VND 222 Tn (USD 9.6 Bn) from VND 204 Tn (USD 8.8 Bn) in 2018, an increase of 8.8% YoY and the equivalent of 3.6% forecasted 2019 GDP.

The high issuance of government bonds is part of the reason why the State bank of Vietnam (SBV) plans higher money supply (M2) growth in 2019, 14% versus 11.5% in 2018. The increase of M2 will diminish the impact those issuances have on the banking system's liquidity. Usually, when the VST increases the amount of issuance, the State Bank tends not to withdraw money on interbank market.

In first quarter of this year, the VST issued more than VND 69 Tn (USD 2.9 Bn), an increase of 72% YoY; and 95% of its Q1 plan. However, the winning/offering ratio was only 76% compared to 81% in the same period last year. This ratio has continuously decreased in recent years while the bidding/offering ratio stays high. This means demand for government bonds is healthy but the market is increasingly seeking higher yields. In the next quarters of this year, we expect the VST to issue around VND 60 Tn (USD 2.6 Bn) per quarter.

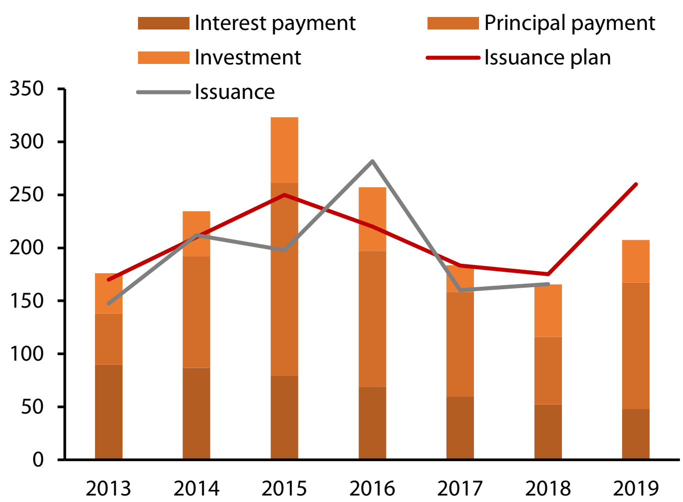
Regarding the tenors, we noticed the proportion of 5-year and 7-year bonds accounted for 15% and 12% of the yearly issuance plan, higher than in 2018 (7% and 4% respectively). However, in 2018, the VST could not complete its plan for these two tenors, raising just 41% and 19% of the intended amount. We saw no change in the first quarter of 2019 and think the VST will have to issue more 10-year and 15-year bonds to offset.

Figure 2: Issuance plan of Government Bonds (Billion VND)



Source: MOF, Rong Viet Securities

Figure 3: Expenditures from the government bonds



Source: MOF, GSO, Rong Viet Securities

5Y Government bond yields were lower than inflation

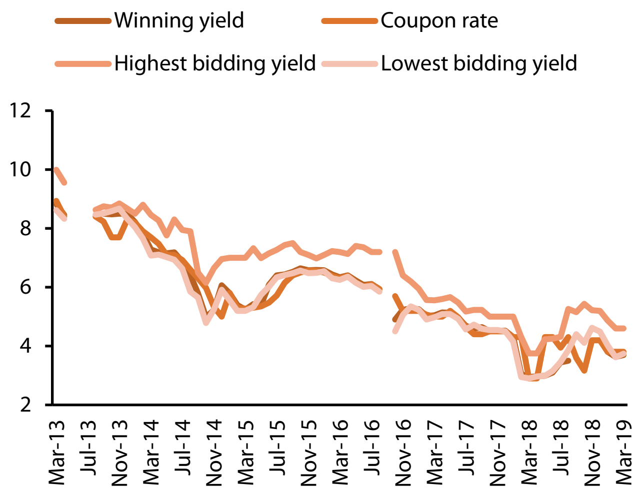
We are concerned about the 5-year bond given inflation exceeded the offered yield in 2018. We saw a similar situation post global financial crisis in the U.S., Germany and Japan. When investors believe inflation will decrease, they are willing to put more money into government bonds.

But these three developed markets have vastly different inflation expectations than most of the emerging market world. We expect Vietnam's inflation to rise further and reach 3.8% this year.

After rebounding at the end of 2018, the 5-year bond yield went down in the first quarter of 2019 and fluctuated around 3.8% since. In general, money supply growth exceeding credit growth helps stabilize yields. Also, interest rates tend to decrease slightly after the Tet holidays as commercial banks mobilize a huge amount of cash from citizens. Given the 80% credit-to-deposit ratio limit, commercial banks will invest the remainder into other investment channels, usually, government bonds.

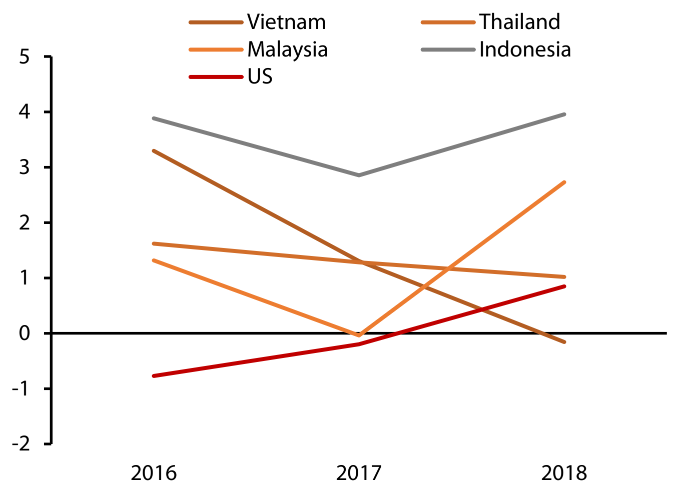
Besides inflation, the banking system's liquidity may cause yields to increase as banks are facing difficulties in raising capital to meet requirements. We expect government bond yields to be flat in the second quarter of 2019 before advancing +25-50bps in 2H2019, a proposed reduction in reserve requirement may offset this somewhat.

Figure 4: 5-year yield curve



Source: HNX,Rong Viet Securities

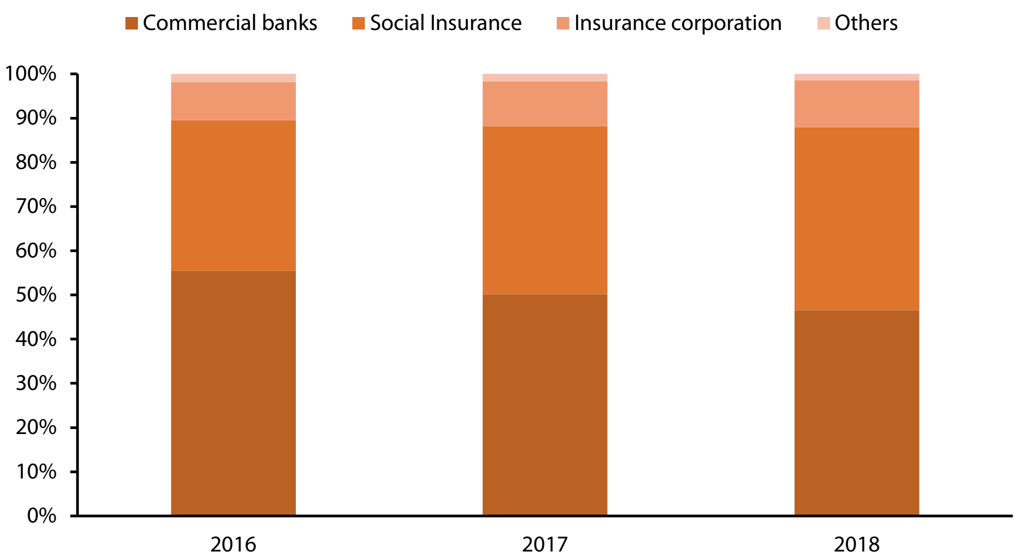
Figure 5: Gap between 5-year yield and inflation



Source: Bloomberg, HNX, Rong Viet Securities

Regarding government bond buyers, Vietnam Social Securites (VSS) plays an important role. The organization now holds over 41% of all outstanding government bonds, up from 34% a few years ago, while banks take 46.5%, down from 55.5%. The remainder is mostly held by insurance companies.

Figure 6: Owners of government bonds



Source: MOF, Rong Viet Securities

Secondary market

- Trading value declined
- Government bond yields remain low from historic perspective

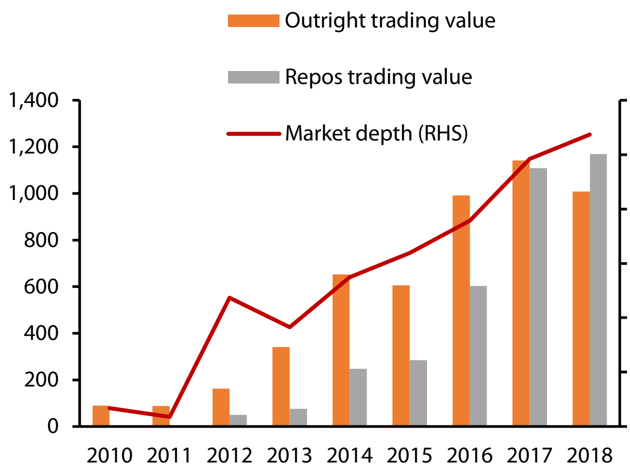
Trading value on the secondary market declined

Trading value on the secondary market, which includes outright and repos transactions, continued to decline in the first quarter of 2019, -20% YoY. While 5-years bonds usually have the highest trading value among all tenors, the proportion of above 10-year tennors trippled compared to 2017.

However, market depth increased as repos trading reached 55% of total trading value, the highest in history. Repos contracts usually mature in less than a year.

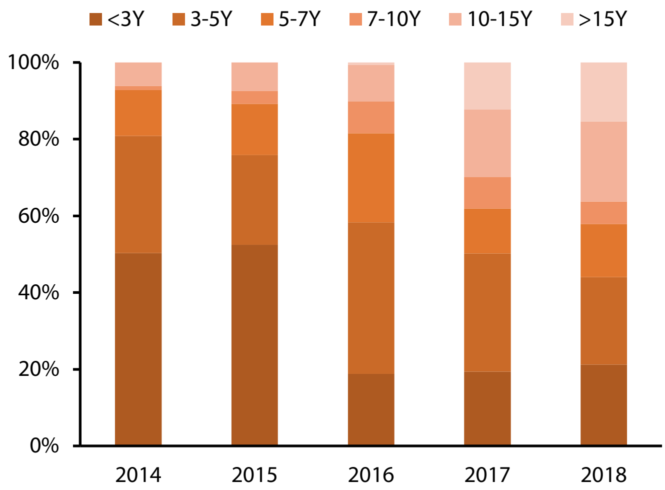
The increase in repos activity suggests 1) rising demand for short term liquidity and 2) an increase in risk prevention factor. The interbank market was active in March as the amount of short-term loans increased dramatically and reached VND 52 Tn per day (USD 2.2 Bn), the high level since 2012.

Figure 7: Trading value



Source: HNX, Rong Viet Securities

Figure 8: Structure of outright trading



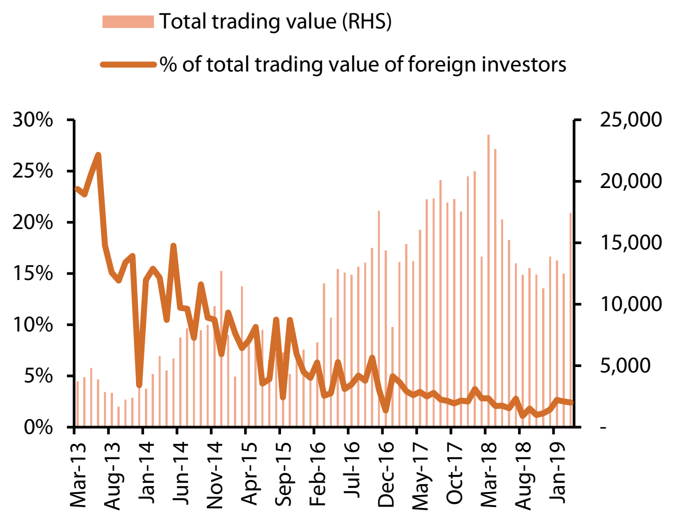
Source: HNX, Rong Viet Securities

Foreign investors net bought

Trading value of foreign investors also decreased compared to the same period last year. They mainly traded outright transactions. They net sold more than USD 45 Mn in 2018, but turned around in the first quarter of 2019 and net bought more than USD 260 Mn. Foreign capital flows into Vietnam's bond market are quite sensitive to the financial and economic changes around the world (Figure 10) and this may affect the overall macro stability. Total outstanding government bonds are equivalent to 27% of GDP 2018.

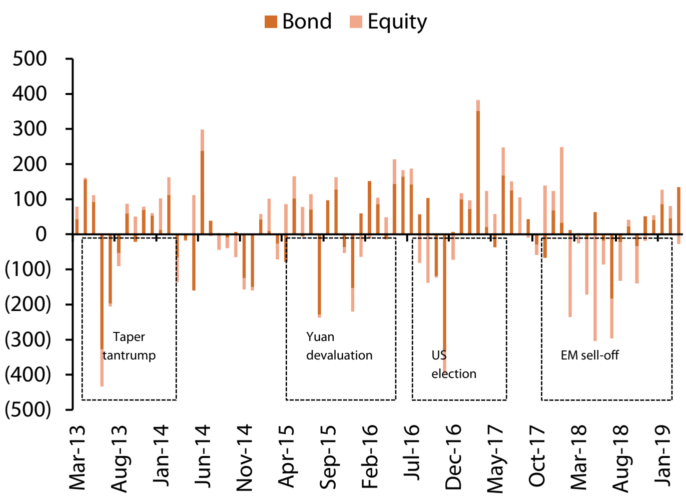
Although we are still optimistic that Vietnam will see foreign capital inflows in 2019, investors will likely target longer (than 5Y) maturities.

Figure 9: Trading value of foreign investors on secondary market (million USD)



Source: HNX, Rong Viet Securities

Figure 10: Foreign money flow (million USD)



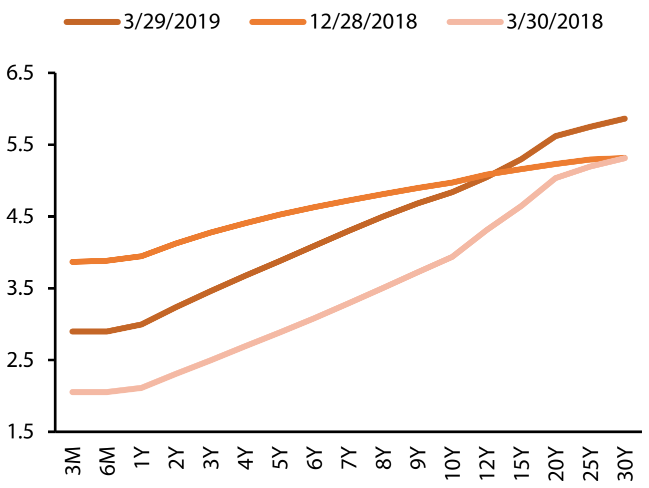
Source: HNX, Rong Viet Securities

Government bond yields remain low

Yields decreased from the end of 2018 but are still higher than in the same period last year. We believe the decrease in the interbank interest rates in the first quarter of 2019 helped lower yields, particular for the short-term tenors. Meanwhile, long-term bond yields tend to decrease only if interbank interest rates remain low for a certain period. Indeed, the spread between 10-year and 2-year yield widened in recent months. The spread between Vietnam and US 10-year bond yield also picked up after reaching a low point of 1.2% in the same period last year.

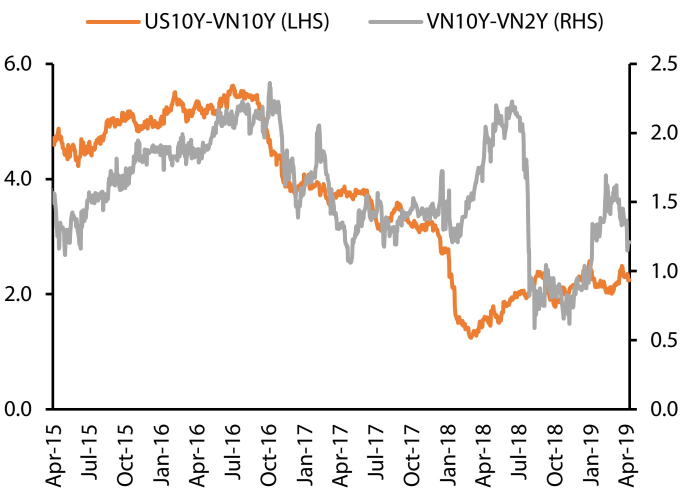
Overall, secondary trading activity was supported by the reduction of geopolitical risks in the first quarter of 2019 and volatility decreased gradually. Vietnam's 5-year CDS has fallen since the beginning of this year. A similar move was seen in countries around the region.

Figure 11: Bond yield curve



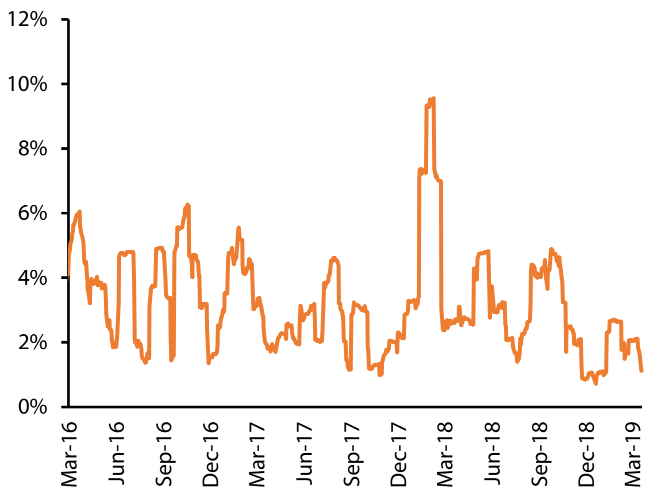
Source: Bloomberg, Rong Viet Securities

Figure 12: Vietnam's risk premium



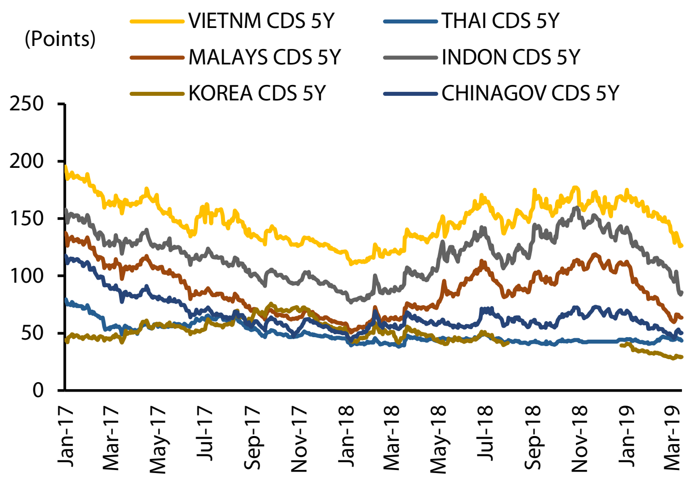
Source: Bloomberg, Rong Viet Securities

Figure 13: Bond yield volatility



Source: ADB, Rong Viet Securities

Figure 14: CDS indices



Source: Bloomberg, Rong Viet Securities

Corporate Bonds

- The size of corporate bond market increased sharply
- Corporate bond yields stablized

The size of corporate bond market increased sharply

The total amount of corporate bonds issued reached VND 224 Tn (USD 9.7 Bn) in 2018, up 94.5% YoY, according to the State Securities Commission. By the end of 2018, there was VND 474.5 Tn (USD 20.4 Bn) corporate debt outstanding, up 53% YoY and the equivalent to 8.6% of GDP.

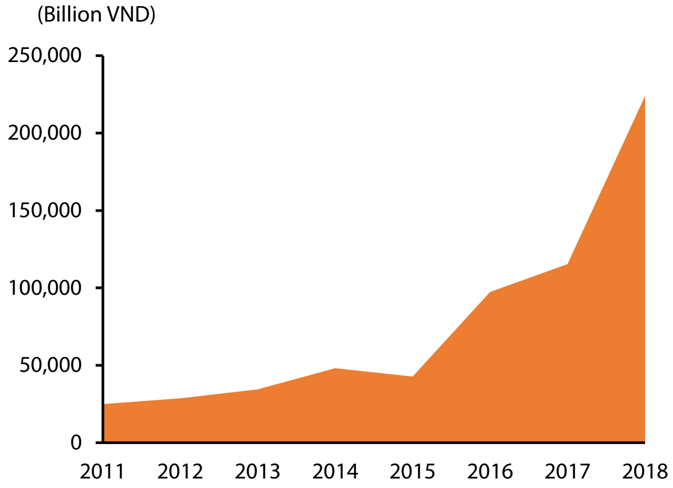
We noticed that banking, securities companies and real estate developers accounted for most of the issuances. The maturity of most corporate bonds is less than three years except for banks.

Regarding the banking sector, banks issued more in order to raise tier 2 and long term capital. The yield of banking bonds is around 7.5%. However, there are still large differences between private and state-owned commercial banks. State-owned commercial banks tend to issue longer-term bonds (above 5 years), while the others focus more on 3-years bonds.

In addition, securities companies actively issued corporate bonds with a total amount of VND 500-1,200 Bn (USD 21-51 Mn). Maturity was 2-3 year; and yields were offered in range of 8-10.5% p.a.

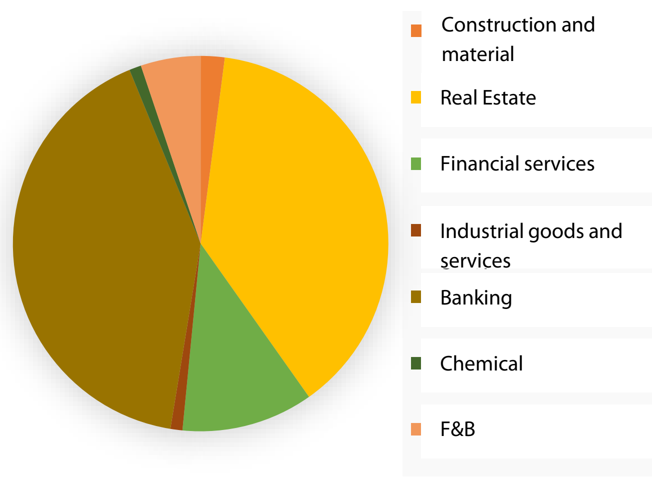
Large real estate developers such as Vingroup, Novaland and Dat Xanh actively issued bonds in 2018 as bank credit tightened. Yield on Vingroup bond was 10%/year in 2018 compared to 10.3%/year in 2017.

Figure 15: Scale of corporate bonds



Source: Rong Viet Securities

Figure 16: Structure of corporate bonds



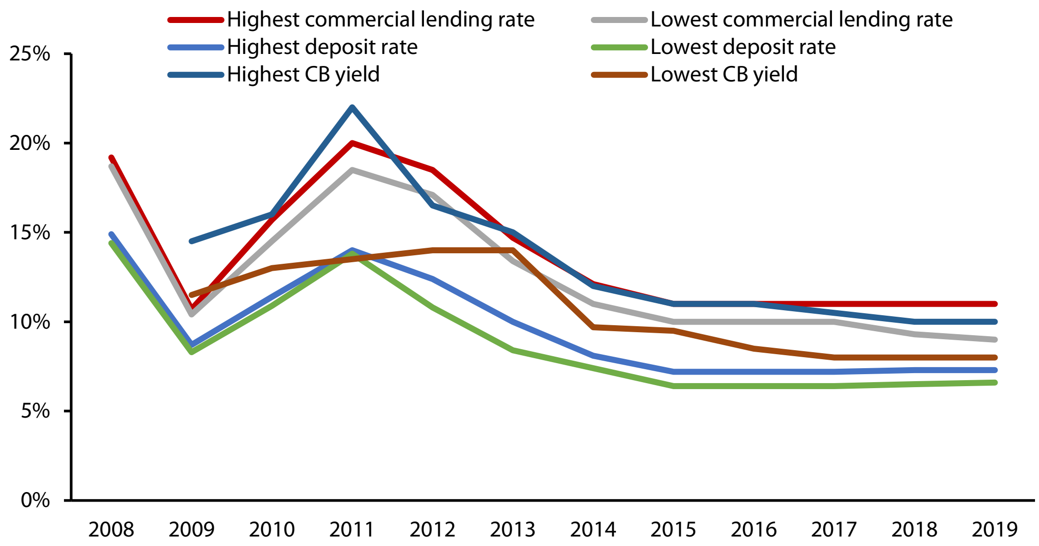
Source: FiinPro, Rong Viet Securities

Corporate bond yields stabilized

In recent years, we noticed the yield on corporate bonds have decreased then stabilized around 8-10%/year. According to the SBV, the >12M deposit rate is around 6.6% -7.3%/year while lending rates are around 9% -11%/year. Obviously, there remain large differences amongst companies.

The International Finance Company (IFC) has proposed a program to support Vietnamese enterprises to issue domestic currency bonds, the so-called Bong Sen bond. This will help local businesses to diversify capital sources as credit growth slows. However, bottlenecks such as a lack of credit rating agencies make it hard for enterprises to issue domestic bonds.

Figure 17: Corporate bond yields vs banking rates



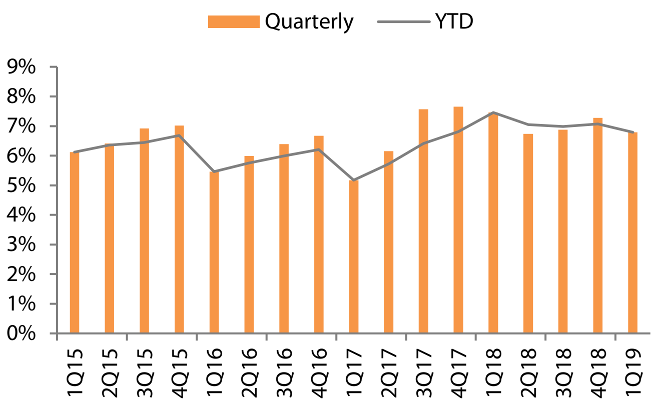
Source: Bloomberg, HNX, Rong Viet Securities

Table 1: Top 30 Issuers of Local Currency Corporate Bonds in Viet Nam

Number	Issuer	Outstanding Amount LCY Bonds (VND billion)	Outstanding Amount LCY Bonds (USD billion)	Type of industry
1	Vinhomes	12,500	0.54	Real Estate
2	Masan Consumer Holdings	11,100	0.48	Diversified Operations
3	Vingroup	9,600	0.41	Real Estate
4	Vietnam Joint Stock Commercial Bank for Industry and Trade	8,200	0.35	Banking
5	Asia Commercial Joint Stock Bank	6,800	0.29	Banking
6	Hoang Anh Gia Lai	4,000	0.17	Real Estate
7	No Va Land Investment Group	3,300	0.14	Real Estate
8	Masan Group	3,000	0.13	Finance
9	Vietnam Technological and Commercial Joint Stock Bank	3,000	0.13	Banking
10	Vietnam Prosperity Joint Stock Commercial Bank	3,000	0.13	Banking
11	Bank for Investment and Development of Vietnam	2,700	0.12	Banking
12	Sai Dong Urban Investment and Development	2,600	0.11	Real Estate
13	Ho Chi Minh City Infrastructure Investment	2,410	0.10	Infrastructure
14	Hoan My Medical	2,330	0.10	Healthcare Services
15	Hoang Anh Gia Lai International Agriculture	2,271	0.10	Agriculture
16	Vietnam International Commercial Bank	2,208	0.10	Agriculture
17	Agro Nutrition International	2,000	0.09	Agriculture
18	Joint Stock Commercial Bank for Foreign Trade of Vietnam	2,000	0.09	Banking
19	Vietnam Electrical Equipment	1,800	0.08	Manufacturing
20	Nui Phao Mining	1,500	0.06	Mining
21	Saigon Securities	1,450	0.06	Finance
22	Saigon-Hanoi Securities	1,150	0.05	Finance
23	Mobile World Investment	1,135	0.05	Manufacturing
24	Pan Group	1,135	0.05	Consumer Services
25	DIC corporation	1,000	0.04	Chemicals
26	TTC Education Joint Stock Company	951	0.04	Education Services
27	Vietnam Bank for Agriculture and Rural Development	760	0.03	Banking
28	Nam Long Investment	660	0.03	Real Estate
29	KinhBac City Development Holding	600	0.03	Real Estate
30	Khang Dien House Trading and Investment	534	0.02	Building and Construction
Total Top 30 LCY Corporate Issuers		95,635.3	4,13	
Total LCY Corporate Bonds		99,328.3	4,29	

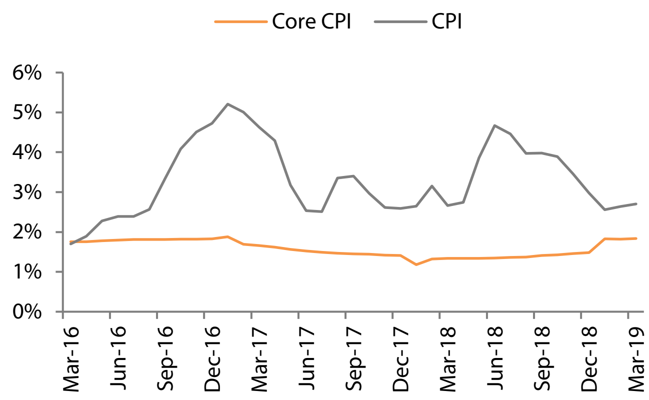
Source: ADB, FiinPro, Rong Viet Securities

GDP growth YoY



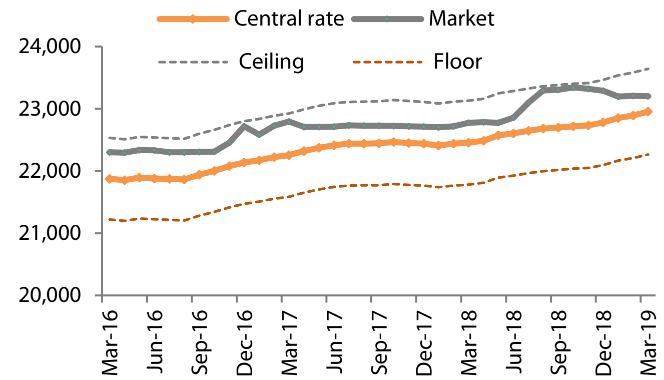
Source: GSO, Rong Viet Securites

CPI YoY



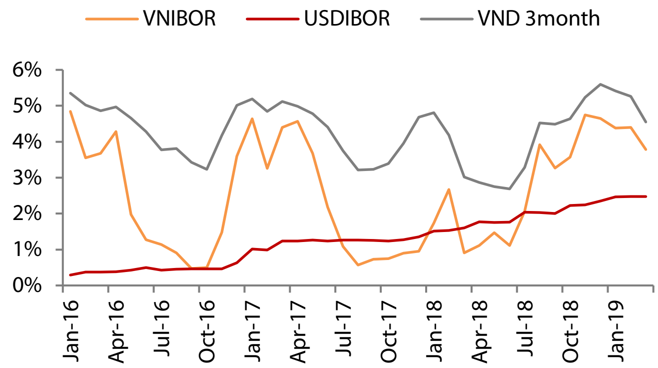
Source: GSO, Rong Viet Securites

Exchange rate (USD/VND)



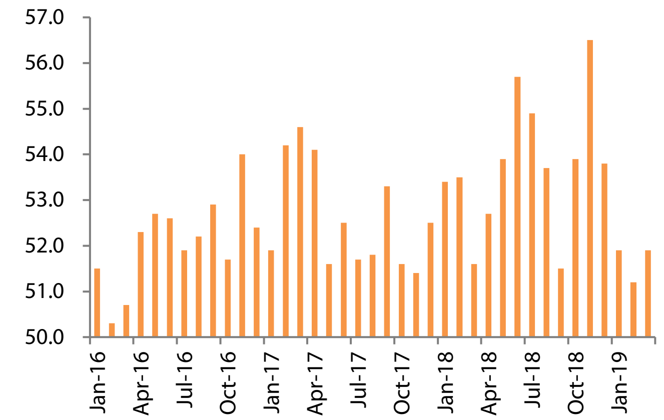
Source: SBV, Rong Viet Securities

Interbank interest rates of VND and USD



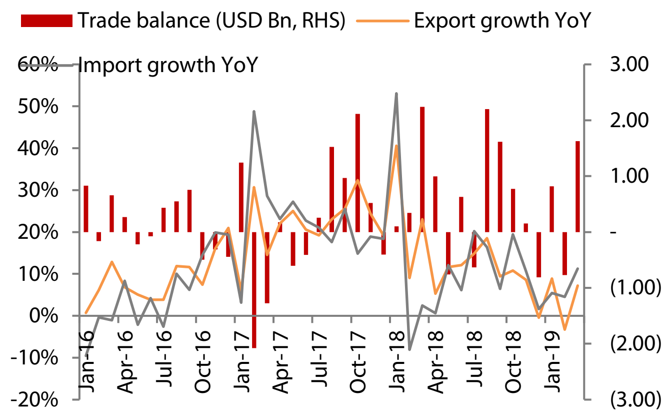
Source: SBV, Rong Viet Securities

Purchasing Managers' Index (PMI)



Source: Markit Economic, Rong Viet Securities

Trade of goods



Source: Vietnam Custom, Rong Viet Securities

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