

Vietnam
Special Report

Outlook on Vietnamese Banks

Another Year of High Growth Adds to Concerns

Analysts

Sabine Bauer
+852 2263 9942
sabine.bauer@fitchratings.com

Mic Kang
+852 2263 9924
mic.kang@fitchratings.com

Related Research

- *Global Financial Institutions Rating Criteria (December 2009)*
- *Banks in Asia (Excluding Japan): Outlook for 2010 (February 2010)*
- *Impact of Fiscal Measures on Vietnamese Banks' Outlook (April 2009)*
- *Vietnamese Banks - Focus on Asset Quality: Three Stress Scenarios (February 2009)*

Key Strengths: Revenue Generation Aided by Loan Growth

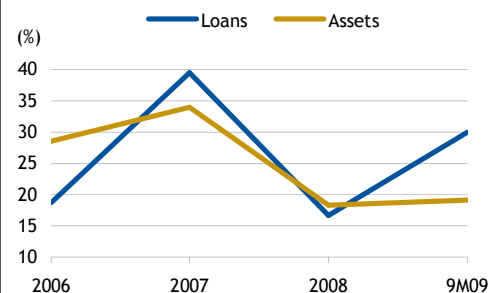
Vietnamese banks' profitability held up well in 2009 due to brisk loan growth and very low loan loss provisioning. The average operating ROAA of the six banks rated by Fitch Ratings increased to an annualised 1.9% in 9M09 (2008: 1.5%) as the fiscal stimulus measures mitigated borrower deterioration. However, in 2009 banks' asset growth lagged behind loan growth (see Chart 1) as Vietnamese banks reduced their holdings of less risky, liquid assets in favour of increased new lending. This development has supported key ratios such as ROAA and tangible equity/assets, but also contributed to a rise in credit risk. Loan-to-deposit spreads for local currency business contracted by 220bp in 2009 as a result of interest rate cuts, a government-administered interest rate ceiling for loans and competition for funding.

Sector-wide loans increased by 38% in 2009 as Vietnamese banks, particularly private ones, boosted lending in response to the authorities' economic stimulus measures. Although banks' ability to mobilise deposits remained solid, deposit growth (27% in 2009) could not keep pace with loan growth, resulting in an increase in the system-wide loans to deposit ratio (LDR) to 105% (2008: 95%).

Key Concerns: Lack of Rigour in Identifying NPLs; Borrower Quality; and Capital

Fitch believes that the local loan classification scheme and provisioning is less strict than that under IFRS. Fitch therefore continues to consider reported loan quality and reserve coverage levels to be overstated. The agency is also concerned that rapid loan growth will result in loan quality problems as underwriting standards typically weaken when banks expand quickly. Borrower quality may deteriorate once fiscal stimulus programmes are withdrawn, interest rates rise and/or the local currency sharply depreciates. In addition, exposures to the volatile property markets remain a concern. Therefore, Fitch expects Vietnamese banks to face serious challenges on asset quality, increasing existing concerns about capital.

Chart 1: Growth



6 banks rated by Fitch, 9M09 un-annualised
Source: Bank financial statements, Fitch

Solid revenue remains a valuable source for Vietnamese banks to generate much-needed capital; however, it may not be sufficient for some institutions. Despite notable strengthening in recent years Fitch considers the four major state-owned banks' capital and reserve coverage levels to be barely adequate. In Fitch's view, these institutions rely to various degrees on capital injections, particularly the country's largest bank, Agribank, whose capital adequacy ratio (CAR) remained well below the 8% minimum regulatory requirement in 2009. Private banks put their capitalisation under significant pressure in 2009 but their capital ratios remained more reasonable and above those of their state-owned peers.

Table 1: Overview of Vietnamese Banks Rated by Fitch

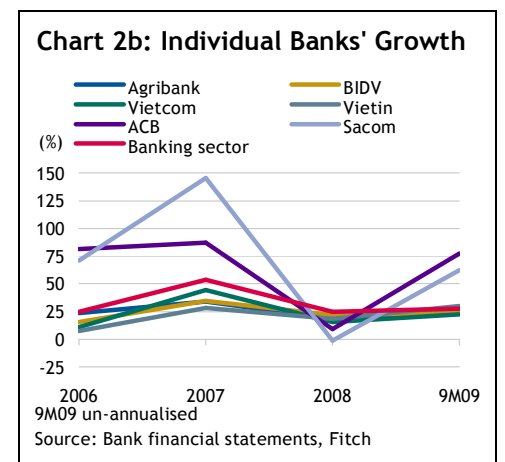
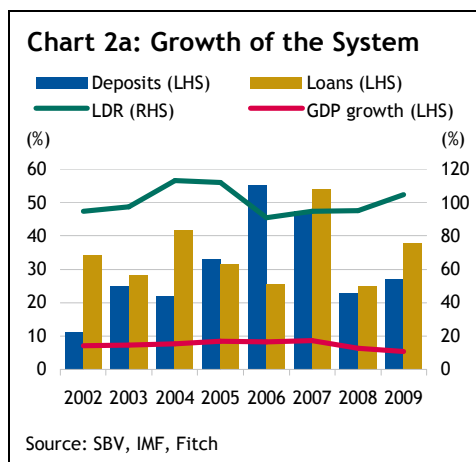
	Individual	Support
Asia Commercial Bank (Vietnam) (ACB)	'D'	5
Saigon Thuong Tin Commercial Joint Stock Bank (Sacombank)	'D'	5
Joint Stock Commercial Bank for Foreign Trade of Vietnam (Vietcombank)	'D'/RWN	4
Vietnam Joint-Stock Commercial Bank for Industry and Trade (Vietinbank)	'D/E'	4
Bank for Investment and Development of Vietnam (BIDV)	'D/E'	4
Vietnam Bank for Agriculture and Rural Development (Agribank)	'E'	4

RWN - Rating Watch Negative
Source: Fitch

Loan Growth – Excessive Among Private Banks

Strong loan growth in Vietnam continued in 2009. System-wide loans increased by 38% in 2009. This compares with 25% in 2008 but it is broadly in line with the strong growth achieved in 2002 and 2004 (see Chart 2a). Growth came to a halt in January with loan growth of just 1% compared with end-2009 (deposit growth in January 2010 was 0.3%).

The most important drivers of loan growth in 2009 were the central bank's loosened monetary policy, which, in tandem with the government's fiscal stimulus measures, fuelled loan demand and supported GDP growth of 5.3% in 2009 (2008: 6.2%). A large proportion of new lending was issued at artificially low borrowing rates associated with the government's interest subsidy programme. Of VND505trn (USD28bn) net new loans VND447trn, 89%, carried subsidised interest rates in 2009. For more details on the interest rate subsidies see the text box *The Three Subsidy Schemes* below.



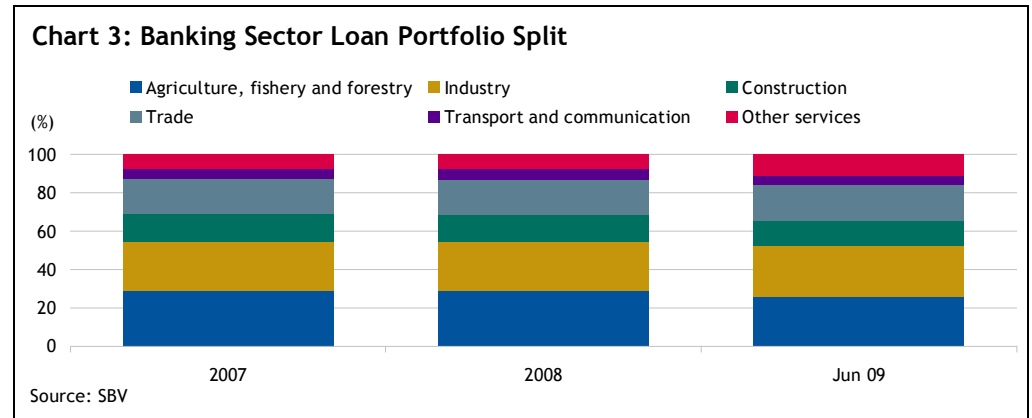
Banks with the Fastest Growth

The four large state-owned commercial banks (SOCBs) – Agribank, BIDV, Vietcombank and Vietinbank – continue to dominate Vietnam's banking system, accounting for 51% of system-wide loans at end-September 2009 (2008: 52%; 2007: 54%). They very actively distributed two-thirds of all loans at subsidised interest rates and thereby defended their market shares. However, their loan balances grew in line with the overall market in 9M09 (see Chart 2a), which suggests that new lending was offset by maturing and refinanced loans.

In stark contrast, the country's two largest privately owned banks – ACB and Sacombank – recorded exceptionally brisk loans growth in 9M09 (un-annualised): 78% and 62%, respectively. As shown in Chart 2b, both institutions returned to rapid expansion after a very short slowdown in the high-interest/high-inflation year of 2008. As a result, their combined loan market share grew to 7% at end-9M09 (2008: 5%; 2005: 3%).

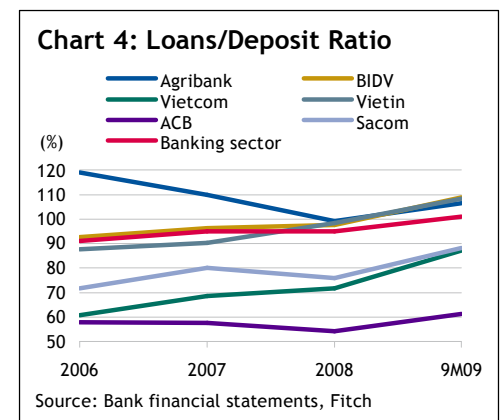
Destination of the Funds

At end-June 2009, subsidised loans represented 22% of the system-wide loan balance, but this portion of new lending appears not to have triggered large shifts in the sectors being financed. Sector concentrations remained broadly unchanged (see Chart 3 below), indicating that existing customers refinanced and/or increased borrowing.



The agricultural and industrial sectors each accounted for 26% and trade 19% of sector-wide loans at end-June 2009. Direct reported lending to the construction sector accounted for 13% of banking sector loans at end-June 2009. However, banks' total exposure to the construction/property development sectors is likely to be higher due to off-balance-sheet exposures (guarantees issued for real estate developments), and as they hold property collateral. The only noticeable increase was in "Other Services", which increased to 11% from 7% in 2007. This increase is difficult to explain due to the lack of more granular data.

In terms of borrowers, 15% of subsidised loans at end-June 2009 went to state-owned enterprises, 66% to the private sector, 17% to households and individuals and 1% to cooperatives. There is anecdotal evidence that some of these loans were invested in the stock and real estate markets, despite these uses not being eligible under the subsidy programme, and to some extent drove these. Borrowers may also have deposited these cheap funds at higher deposit rates, thereby benefitting from arbitrage gains.



Deposit Growth

Deposit growth, 27% in 2009, has not kept pace with loan growth. The system-wide LDR increased to 105% at end-2009 (2008: 95%), indicating that deposit funding was insufficient to cover outstanding loans. The Fitch-rated banks with the highest LDRs at end-9M09 were BIDV (109%), Vietinbank (108%) and Agribank (107%; see Chart 4). Vietcombank continues to benefit from a relatively low proportion of loans compared with its total assets (61% at end-9M09) and therefore its LDR was moderate at 87%. However, it had climbed 15 percentage points since end-2008, the highest increase in the Fitch-rated sample. Sacombank and ACB's steep loan growth also led to significantly higher LDRs but their absolute levels are not a concern.

Banks' funding remains dominated by deposits, of which about three-quarters are reported to be short term. The remainder have maturities of one to five years. Other funding sources include local interbank borrowings, loan facilities from international commercial banks, bilateral/multilateral institutions, repurchase agreements with the central bank and domestic issuance. The banks' main challenge in 2009 was securing sufficient (long-term) funding to support their lending activities; this will remain a key challenge in light of the State Bank of Vietnam's (SBV; Vietnam's central bank) overall loan growth target of 25% for 2010.

The Three Subsidy Schemes

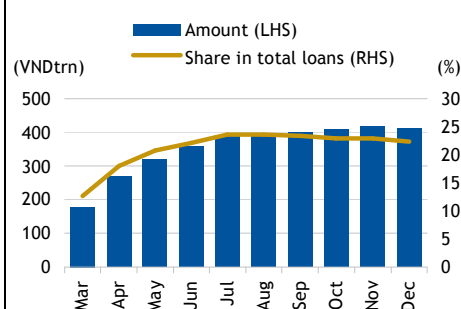
Vietnam's government and the SBV introduced the first interest subsidy scheme in March 2009. Local-currency loans to certain sectors issued in 2009 with maturities up to eight months and maturing at or before end-2009 were eligible for a 4 percentage-point interest rate subsidy. The authorities lengthened the maturity of eligible loans in April 2009 to 24 months, ie maturing in or before 2011 – the second subsidy scheme. The third subsidy scheme covers local currency loans issued in 2010 with maximum maturities of 24 months, ie maturing in or before 2012. However, the government reduced its subsidy payment to 2 percentage points of the borrowing cost for this third scheme. At the average lending rate of 12% at present, banks would only charge borrowers 10% and reclaim 2% from the central bank.

The support scheme entitles organisations and individuals to borrow for the development of domestic production, business and infrastructure. There are very detailed regulations governing which sectors are eligible, and banks can suffer sanctions if they do not monitor where the money goes. Specifically excluded areas include financing office construction if those buildings are for lease and financing the construction, repair, purchase of houses if for sale. Loans for trading and investing in securities and trading/selling real estate and land use rights are also ineligible.

The proportion of subsidised lending levelled off to below 22% of banking system loans at end-2009 from a high of 24% in July and August (see Chart 5a). The majority of these loans were issued by state-owned banks (see Chart 5b).

The interest subsidy programmes will not have any effect on banks' net interest margins as the government will refund the banks for the foregone interest portion.

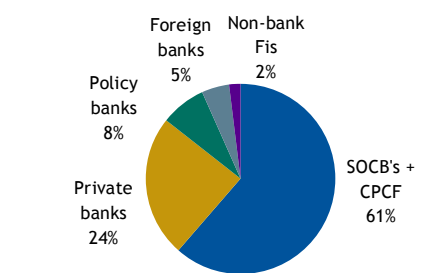
Chart 5a: Subsidised Loans^a



^a Excluding development banks (VND35trn at end-2009)
Source: SBV, Fitch

Chart 5b: Subsidised Loans

By type of issuing FI, as of 24 Dec 2009



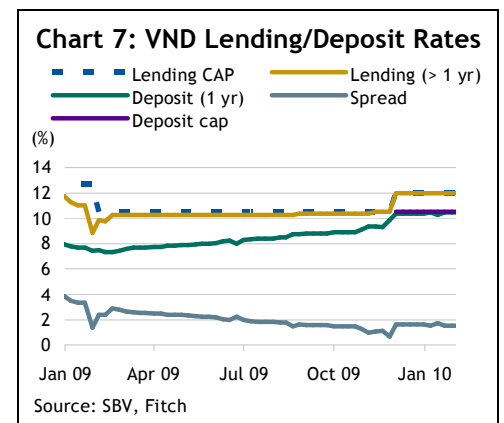
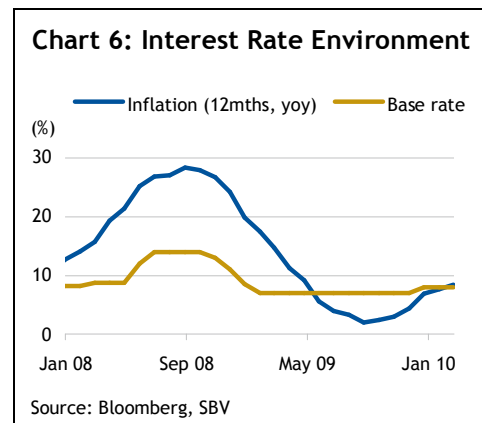
CPCF: Central People's Credit Fund
Source: SBV, Fitch

The interest subsidy programmes, which were only available for loans in local currency, made borrowing in foreign currency relatively more expensive and less attractive. Combined with depositors' preference for US dollar/gold deposits, this resulted in a decline of the sector-wide foreign-currency LDR to 75% at end-October

2009 (2008: 81%) compared with a 110% LDR in local currency. The sectors' LDR in foreign currency has been 60%-90% since end-2006. Whereas FX deposits accounted for 22% of total sector-wide deposits at end-October 2009 (2008: 24%), foreign-currency loans declined to 16% of total loans (2008: 20%); Fitch considers the latter a particular positive due to the higher risks involved in that type of lending.

Lending and Deposit Rates

By end-February 2010, all but US dollar lending rates have become regulated. Caps were as follows: Vietnamese dong lending rates 12% (150% base rate since May 2008); dong deposit rates 10.5% (since December 2009); and dollar deposit rates 1% (since February 2010). These measures put a floor on banks' net interest margins (NIMs) by providing for a minimum loans-to-deposits spread of 150bp (end-2009: 166bp, see Chart 7). Banks' NIMs are likely to stay noticeably above this level as deposit funding is biased towards significantly cheaper demand and term deposits with short maturities, dollar lending rates are uncapped and consumer loans remain unregulated. At the time of writing, reports indicate that SBV will allow banks to charge lending rates above the cap for certain Vietnamese dong loans. However, Fitch has not been able to obtain and review SBV's (English language) announcement on this.



As the Vietnamese dong remains under considerable devaluation pressure (the authorities devalued in November 2009 and February 2010), foreign-currency lending and deposit gathering remains higher risk (liquidity, credit, market risk) and therefore more profitable, as underlined by a higher loans-to-deposits spread (300bp at end-2009). This spread could increase by a further 200bp-350bp due to SBV's recently introduced cap on US dollar deposit rates. In Q309, US dollar deposit rates had already fallen to below 2%; this may have been the result of a concerted action to discourage borrowers from shifting to dollars.

During most of 2009, banks set Vietnamese dong lending rates at the ceiling and Fitch expects no change in this regard in 2010 unless SBV removes the caps. Banks raised rates for medium- and long-term dong deposits to around 10% at end-2009 from about 8% at the start of the year (see Chart 7). In particular, smaller private banks with less established deposit franchises had to raise rates to close to 10.5%, slightly below the lending rate cap at that time. Margins came under most pressure in Q409, when deposit growth significantly lagged behind loan growth. The lending rate cap in particular created difficulties for some smaller banks whose only option was to compete on price.

Loan Quality Overstated

In a number of banking systems, excessive loan growth has consistently been an early warning indicator of loan quality problems as underwriting standards typically weaken when banks expand quickly. In addition, it has proved very difficult for banks' infrastructure and risk-management capabilities to keep pace with

increasing loan turnover. Fitch therefore believes that there is a pronounced risk of loan quality deterioration in the medium term due to ongoing strong loan growth and the potential for a higher interest rate environment. In addition, loans in foreign currency (16% of sector-wide loans at end-October 2009) remain a concern due to the devaluation pressure on the dong. Among the foreign-currency loans, those to importers and other customers that have no direct FX/US dollar income are of most concern. Fitch does not have a breakdown of foreign-currency loans into customer groups to better quantify the related risks. Another concern remains banks' on- and off-balance-sheet exposures to the volatile property sector. The limited transparency at Vietnamese banks and the tendency to reschedule loans mean that any resulting bad-debt problem may be slow to surface.

According to the SBV's estimates, sector-wide non-performing loans (NPLs) deteriorated to 2.5% of system-wide loans at end-2009 (2008: 2.1%) and sector-wide special-mention loans (SMLs) were about 6.5% (broadly in line with the level for the Fitch-rated banks; see Table 2). The increase in the NPL ratio is a significant deterioration considering the denominator effect from strong loan growth and Fitch's expectation that borrower quality may have deteriorated less severely in 2009 as borrowers benefited from fiscal stimulus measures. Under the subsidy schemes, for example, corporate borrowers benefitted from lower borrowing costs once they had refinanced high interest-rate loans generated in 2008. This is very likely to be only a short-term effect; a tighter monetary environment would put borrowers under stress. An increase in interest rates would be particularly painful for borrowers if it were to coincide with the withdrawal of the interest subsidies.

Reported loan quality ratios under local accounting standards appear low and do not raise any obvious loan quality concerns. For the six Fitch-rated Vietnamese banks, average and individual NPL and SML ratios suggest moderate to manageable levels of impaired lending (see Table 2 and Charts 8 and 9). Thanks to the denominator effect of strong loan growth, the NPL ratio for the Fitch-rated sample declined in 9M09 to 2.3% according to Vietnamese Accounting Standards (VAS).

Table 2: Loans Classification Trends for Fitch-Rated Banks

	2007	2008	9M09
NPLs (VNDtrn)	16,400	20,000	23,100
NPLs/gross loans (%)	2.5	2.6	2.3
SMLs (VNDtrn)	67,600	71,400	60,700
SMLs/gross loans (%)	10.4	9.4	6.2

Source: Bank financial statements, Fitch

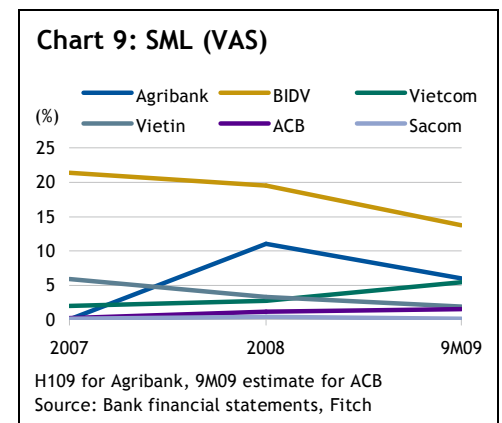
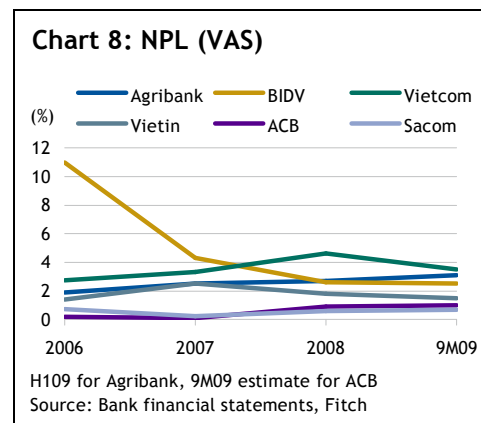
However, Fitch has repeatedly stated that in its opinion banks' loan classifications under local accounting standards (which follow the SBV classification scheme) are less strict than if international accounting standards were applied (see the agency's Special Report *Vietnamese Banks: Focus on Asset Quality - Three Stress Scenarios* published on 25 February 2009 and available on www.fitchratings.com for further details on the possible reasons for this).

Fitch understands that SBV's regulatory classification scheme would allow for stricter classification as banks can use internal rating models as a basis. Very few banks chose that route (to Fitch's knowledge, only BIDV) and it is unclear if these systems are adequately validated with historical data. Instead, banks prefer an ageing-based classification factoring in some qualitative factors. Consequently, Fitch believes that NPL/SML ratios according to VAS materially understate problematic loans.

Charts 8 and 9 illustrate the loan quality trends for the Fitch-rated banks. NPLs (loans classified as substandard, doubtful and loss, generally 90 days overdue) ranged from 3.5% at Vietcombank to 0.7% at Sacombank at end-9M09. SMLs (loans classified in regulatory Class 2, generally at least 10 days overdue) show a different

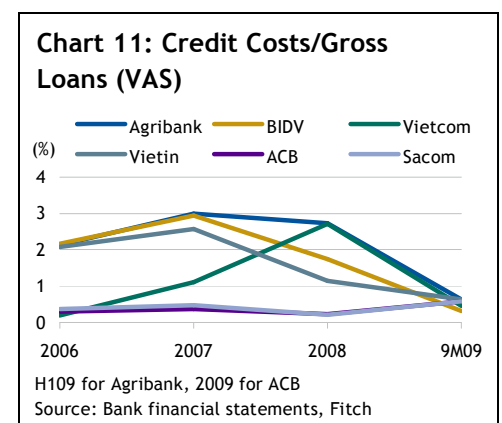
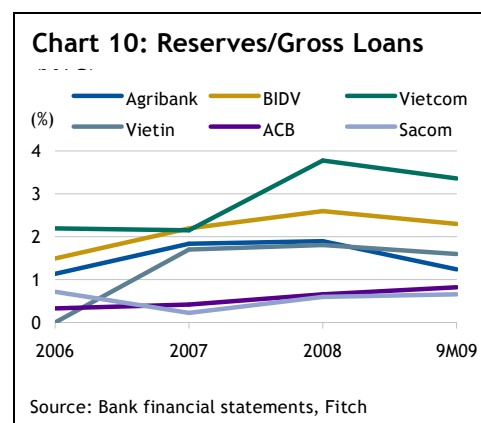
pattern. At most banks, SMLs to gross loans declined, with the most notable exception of Vietcombank, whose SML ratio climbed to 5.5% at end-9M09.

Fitch considers BIDV's loan classification as not directly comparable with that of the other banks as BIDV claims to attribute a relatively stronger weight to qualitative factors using internal risk models. Its audited classifications under local accounting standards and audited IFRS are therefore the same, which makes Fitch more comfortable with BIDV's higher reported numbers. There continues to be large gaps between audited VAS and IFRS loan classifications for the other state-owned banks (only the SOCBs have so far produced and shared audited IFRS accounts with Fitch). At end-2008, Fitch observed multiples of up to 5x for NPLs and up to 6x for SMLs.



Banks' reserve policies follow the central bank's fixed percentages for each loan class¹. In addition, banks can set aside general provisions. This mechanism transfers into reserve coverage levels ranging between 42% of reported NPLs at Agribank at end-H109 and 111% at Sacombank at end-9M09 (see also *Capitalisation – A Very Limited Cushion* and Table 6 below). As Fitch considers such coverage ratios less meaningful when NPLs are understated, the agency also assesses and compares simple coverage levels in terms of total loans (see Chart 10).

Levels of reserves to gross loans vary widely, from a very low 0.8% at ACB and 0.7% at Sacombank to a more reasonable but still limited 3.4% at Vietcombank at end-9M09. The SOCBs' reserve levels to gross loans fell in 2009 due to strong loan growth. ACB and Sacombank topped up reserves but their overall level is still low.

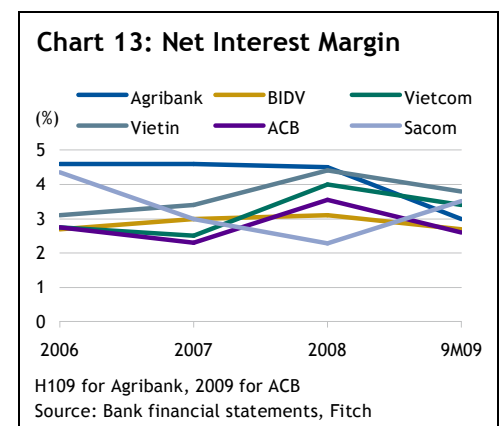
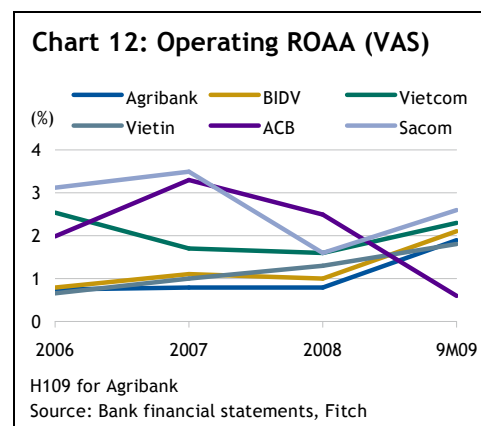


¹ Class 1 – performing: 0%, Class 2 – special mention: 5%, Class 3 – sub-standard: 20%, Class 4 – doubtful: 50%. and Class 5 – loss: 100%; certain collateral is deductible before applying these percentages

Fitch's concerns about adequate reporting of loan quality persist and therefore the agency considers the very low levels of reported credit costs (see Chart 11) unsustainable. This is particularly the case as average credit costs of about 54bp of gross loans for the Fitch-rated sample in 9M09 (annualised) remain materially below the 2006-2008 average of 150bp (see *Profitability* for further detail).

Profitability – The First Line of Defence

Fitch expects the Vietnamese banks' revenue generation – which is a strength – to remain solid during 2010 and even beyond. However, in the medium term profitability is very likely to be a function of loan deterioration and the potential implementation of gradually stricter loans classification and provisioning criteria. In 9M09, operating ROAA increased for all the Fitch-rated banks in Vietnam except ACB (see Chart 12).



Analysing the components of banks' operating ROAA line by line (see Table 3) illustrates that very low loan impairment charges were a common trend and the main driver for the SOCBs' strong reported profitability. Reported credit costs declined by 159bp relative to total assets at Agribank, 112bp at Vietcombank, 91bp at BIDV and 31bp at Vietinbank. The SOCBs also benefitted from relatively lower costs and as a result lower expenses overall more than offset the NIM squeeze (see Chart 13) due to the lending rate cap in a low interest rate environment, in tandem with strong loan growth and a shortage of deposits. Fitch considers that the NIM may be somewhat distorted in 2009 and 2010. There are indications that banks circumvent the administered caps by asking for loan fees and providing various incentives associated with new deposits.

Non-interest income (fee income, FX and gold trading income) is material for all the Fitch-rated banks but its impact differs from bank to bank (see Table 4). A portion that would normally be counted as interest revenue is likely to be reported in this category as banks create fees as lending rates are capped (although this is not compliant with SBV's directives). Among the rated banks, ACB and Sacombank have benefitted most from non-lending income, particularly due to their (gold) trading businesses. The authorities' recent decision to rein in gold trading activities, instructing banks to stop these activities, is likely to have a material impact on ACB and Sacombank's profit, as they are among the leading operators of gold trading floors in Vietnam.

Table 3: Changes to Components of Operating ROAA (2008-9M09^a)

(bp)	Revenue			Expenses ^b		Total change in operating ROAA
	Net interest income	Net fees and commissions	Other operating income	Operating cost	Loan impairment charges	
Agribank	-136	-10	39	58	159	111
BIDV	-31	8	-12	46	91	102
Sacombank	91	24	-32	16	-20	79
Vietcombank	-50	3	33	-29	112	68
Vietinbank	-48	3	19	45	31	50
ACB	-98	-8	59	-33	-11	-92

^a ACB: FY09, Agribank: H109

^b A negative number indicates an increase in costs/loan impairment charges

Source: Bank financial statement, Fitch

The next three paragraphs give a brief explanation of ACB's and Sacombank's profitability developments due to their distinct characteristics.

Sacombank was the only Fitch-rated institution to report materially higher NIMs in 9M09 due to reduced interest expenses on deposits (down 26% on 9M08). Fitch believes that this could be the result of a shift away from term deposits to cheaper demand deposits. Whereas term deposit rates were averaged 8%-10% in 2009, demand deposit rates were 2%-4%. At end-9M09, Sacombank's term deposits had declined to 80% of total deposits compared with 86% at end-2009. However, it is not clear if this is the only reason, as interim disclosure is limited.

Table 4: Non-Interest Income

(%) of gross revenue	9M09	2008-2006 (average)
Agribank	40 ^a	23
BIDV	27	31
Vietinbank	22	22
Vietcombank	25	27
ACB	46 ^b	37
Sacombank	34	43

^a End-June 2009

^b End-2009

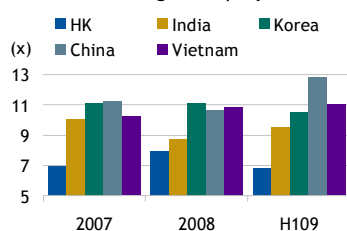
Source: Bank financial statements, Fitch

ACB's operating ROAA fell from 2.5% in FY08 to a low 0.5% in 9M09. Fitch cannot verify in detail the reasons behind ACB's development as the bank neither provided comments nor made available its detailed profit and loss statement. It could be that the bank suffered losses from its trading businesses. ACB's operating ROAA recovered to 1.7% for the full year due to strong "other earnings" in Q409. Its overall 12-month performance suffered from significantly lower NIMs, which declined 98bp if measured in terms of total assets (see Table 4) due to the unfavourable combination of capped lending rates in a lower interest rate environment and rising deposit rates upon the need to finance its particularly strong 78% loans growth. It is possible that interest income on securities also played a role but Fitch was unable to determine this effect due to a lack of detailed information at this stage.

ACB's profitability was also affected by lower fees and commissions compared with total assets (8bp lower, although increasing in absolute terms), higher loan impairment charges (11bp over total assets) and higher cost (33bp), all of which the bank was unable to offset via higher other operating income (59bp).

Chart 14: Asian Leverage

Gross loans/tangible equity^a



^a Top 10 banks, Vietnam: top 6 and 9M09
Source: Financial statements, Fitch

Sustainable Loss Absorption: Risk Buffer Analysis

Table 5: Loss Absorption Capacity of Profit

(%)	Agribank	BIDV	Vietcom	Vietin	ACB	Sacombank
Average pre-impairment ROAA (2006-2009)	2.7	2.4	2.5	2.2	2.7	3.0
Gross loans/assets end-9M09	77	74	61	69	36	58
Credit cost buffer (bp)	354	325	410	318	725	511
Assumption 1: Only 70% of profit available under stress						
Stressed pre-impairment ROAA	2.5	2.3	2.8	2.2	5.1	3.6
Assumption 2: Proportion of loans in assets increased by 15%						
Stressed gross loans/assets	89	85	71	80	42	67
Stressed credit cost buffer (bp)	248	227	287	222	507	358

Credit cost buffer: average pre-impairment profit/gross loans
Source: Bank financial statements, Fitch

Pre-provision profit represents banks' first line of defence against loan impairment charges and in this respect the Vietnamese banks rated by Fitch are relatively well positioned, with average pre-impairment profitability of 2.2%-3.0% of total average assets in 2006-2009. As Table 5 shows, this translates into a risk buffer for credit costs of between 318bp of end-9M09 loans for Vietinbank and 725bp for ACB. Applying rough stresses to pre-impairment earnings and the proportion of loans in assets reduces the credit cost buffer range to a still valuable 222bp-507bp (see Table 5).

It is evident that the credit cost buffer for the two privately owned banks is noticeably higher. This should serve them well as their customer base includes a relatively larger proportion of more vulnerable SMEs for which standard risk costs should be higher. In contrast, the four SOCBs count the larger, possibly less risky (state-owned) companies among their clients. Although the relations between these numbers seem intuitively right, Fitch considers the mis-pricing of risk to be a concern as risk-adjusted pricing is not a common practice in Vietnam. Loan pricing widely follows relationship considerations and risk mitigants like collateral are generally ignored. In addition, banks are exposed to concentration risk and these buffers, despite providing some comfort, may be insufficient to absorb losses from the defaults of several larger borrowers.

Capitalisation – A Very Limited Cushion

Fitch considers Vietnam's banking system overall, and particularly the SOCBs as weakly capitalised. A comparison with banking systems in other countries reveals that leverage for the six Vietnamese banks under Fitch's coverage is among the highest in the region (see Chart 14). Combined loans were 11x times tangible equity at end-9M09 (2008: 10.9x; 2007: 10.2x); only Chinese banks have a higher multiple (end-June 2009: 12.8x).

Fitch notes that the SOCBs have come a long way as the state has repeatedly injected additional capital (and is likely to continue doing so). Vietcombank and Vietinbank have also benefited from fresh capital associated with the privatisation of minority stakes. However, Fitch believes that current levels are not yet sufficient to provide a comfortable cushion against likely future loan impairment charges.

Capital levels at the two Fitch-rated private banks are noticeably higher. However, ACB and Sacombank's tangible equity to loans ratios declined by a substantial 500bp and 512bp, respectively in 9M09 (see Table 6). Measured by tangible equity/assets, the decline in ACB and Sacombank's capitalisation was less pronounced, but both banks' ratios are significantly lower due to their larger share of securities and trading-related assets. By this measure ACB is among the weakest of the Fitch-rated banks. A material proportion of ACB's (and to a lesser extent

Sacombank's assets are related to gold trading activities, which Fitch understands are likely to present limited credit risk, but market and operational risks persist.

At the SOCBs, loans grew faster than assets (see Chart 1); this has supported equity-to-asset ratios. The trend in tangible equity/gross loans ratios was less favourable: Vietcombank and Agribank's gradually increased and BIDV and Vietinbank's declined in 9M09 as retained earnings barely kept pace with loan growth.

Table 6: Changes in Key Capitalisation Ratios

	Tangible equity/tangible assets		Tangible equity/gross loans	
	End-9M09 (%)	Change from av. 2007-2008 (bp)	End-9M09 (%)	Change from av. 2007-2008 (bp)
ACB	5.8	-152	15.9	-500
Sacombank	8.6	-199	14.7	-512
Vietcombank	6.9	+48	11.3	+160
Vietinbank	7.0	+84	10.1	-14
BIDV	6.5	+101	8.8	-35
Agribank	4.7	+23	6.1	+16

Source: Bank financial statements, Fitch

Table 7 illustrates the drag on capital from reported but unreserved NPLs/SMLs. Provisioning appears sufficient to cover identified NPLs at most banks. Only at Agribank did uncovered NPLs amount to a substantial (31%) of tangible equity at end-June 2009. Factoring in coverage for 50% of SMLs would take a material toll on the SOCB's (already weak) capital. Agribank and BIDV's capital are most vulnerable (see comments on BIDV's provisioning practices in *Loan Quality Overstated* above). There is also a substantial drag on Vietcombank's capital as a quarter of tangible equity is required to cover identified NPLs and half of its identified SMLs.

Table 7: Potential Drag on Capital From NPLs and SMLs

	Reserves/NPLs		(NPLs-reserves)/ tangible equity		Reserves/ (NPLs+50% SMLs)		(NPLs+50% SMLs- reserves)/ tangible equity	
(%)	9M09 ^a	2008	9M09	2008	9M09	2008	9M09	2008
Sacombank	111.2	120.8	-0.5	-0.6	100.1	92.4	0.0	0.3
ACB	105.4	74.1	-0.2	1.0	60.9	45.0	3.1	3.6
Vietinbank	108.5	98.3	-1.2	0.3	66.1	51.5	8.1	17.4
Vietcombank	97.4	82.0	0.8	6.9	54.5	63.3	24.9	18.2
BIDV	90.8	98.3	2.6	0.5	25.2	20.7	77.2	121.8
Agribank	41.5	70.7	30.5	13.9	22.1	23.1	76.2	109.0

^a Agribank: H109 instead of 9M09, ACB: Q109 instead of 9M09

Source: Bank financial statements according to VAS, Fitch

All banks hold significant collateral as risk mitigant but Fitch has doubts on the accuracy of valuations and marketability of the collateral assets. It therefore assigns very limited credit for it.

Potential Capital Needs

The agency estimates that the Fitch-rated banks would need additional capital of an aggregated VND30trn for each bank individually to have a prudent 8% tangible equity/assets ratio at end-9M09. In addition, VND35trn would be necessary to cover all their NPLs and 50% of SMLs. The derived VND65trn gap equated to 4% of GDP at end-9M09. Sacombank was the only bank in this sample that met both requirements at end-9M09. Assuming 100% SML coverage would increase the capital gap for the six rated banks to VND94trn or 6% of GDP at end-9M09.

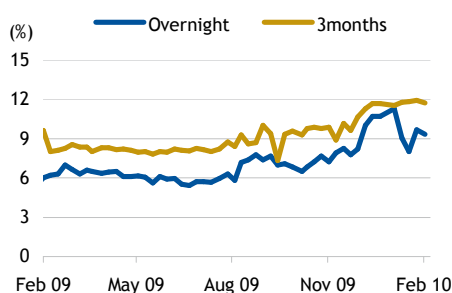
The above estimate is based solely on the banks' 9M09 interim data and excludes the VND18trn capital the authorities reportedly injected into three SOCBs in February 2010.

Liquidity Outlook Tight

Banks' ability to refinance will be key in 2010 to ensure stable liquidity in the banking system. There is a market for domestic issuance ("valuable papers"), but banks have to date not accessed international capital markets. Funding remains dominated by deposits, of which, however, three-quarters are short term while the remainder have maturities of one to five years. The mismatch between the maturities of assets and liabilities is only marginally offset by regulatory required deposit reserves. SBV requires banks to deposit 3%/4% of Vietnamese dong/FX deposits with maturities below 12 months (1%/2% for above 12 months). In the event of more severe liquidity strains, Fitch would expect banks to sell down their holdings of government securities (to the government or the central bank if necessary) or use them as collateral for repurchase agreements with the central bank. In January 2010 the SBV intervened providing VND15trn (USD833m) liquidity via its open-market operations to improve liquidity at some institutions.

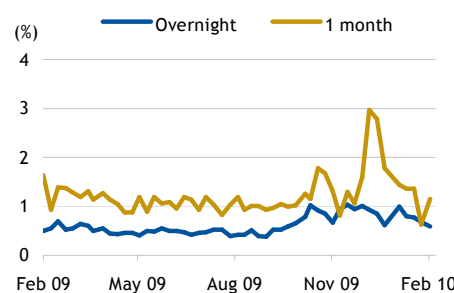
During 2009 the interbank market in local currency functioned and rates across all tenors were relatively stable (see Chart 15). The rise in December 2009 reflected SBV's 100bp interest-rate increase. At the same time, the SBV devalued the Vietnamese dong by 5.4% and ordered seven state-owned companies to sell foreign currency to the banks to ease tight US dollar liquidity (see Chart 16). Demand for dollars remained high amid devaluation pressure on the dong. The situation improved in January 2010, when the banks became able to buy material amounts of foreign currencies from state-owned enterprises. In the same month the SBV also lowered the reserve requirement ratio on foreign-currency deposits with maturities below one year to 4% from 7% to support FX liquidity. The dong remained under pressure, however, and the SBV devalued it again by 3.3% in February 2010.

Chart 15: VND Interbank Rates



Source: SBV, Fitch

Chart 16: USD Interbank Rates



Source: SBV, Fitch

A Brief Note on FX Risks in the Banking Sector

In general, the Fitch-rated banks tend to keep their FX assets/liabilities positions matched and therefore the market risk from changes in the dong/dollar rate should be mitigated. Some banks, like ACB, also hold significant long US dollar positions, thereby speculating that they will benefit from a devaluation of the Vietnamese dong.

Table 8: FX/Gold Deposits

Deposits (%)	9M09	2008
Agribank	n.a.	9
BIDV	n.a.	21
Vietinbank	17	18
Vietcombank	37	46
ACB	n.a.	27
Sacombank	22	23

Deposits and valuable papers

n.a. - Not available

Source: Bank financial statements, Fitch

A sharp devaluation of the dong, if this were to occur², would be very likely to cause domestic borrowers to default on their FX loans (16% of sector-wide loans at end-October 2009) as servicing/repaying them becomes more expensive. This applies in particular to non-export related borrowers who cannot generate income in foreign currency. Such granular data is not available, however. As a consequence, banks would suffer from high credit costs – in aggregate of up to 16% of gross loans, which would very quickly eat into capital (see the risk buffer analysis in Table 5). In addition, the market risk position would no longer be matched and banks would have an open short funding position. Repaying these deposits (22% of sector wide-deposits at end-October 2009) would obviously become more expensive if there were a sharp dong devaluation. There are also associated liquidity risks should depositors demand rapid repayment of their FX deposits.

Table 8 indicates decline in the proportion of FX deposits for those banks where 9M09 data is available. Vietcombank is traditionally the most exposed to FX risks due to its bias toward international trade and its more sophisticated capital markets activities and investments.

² To date, has SBV controlled the exchange rate and only allowed gradual devaluations

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](http://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE.

Copyright © 2010 by Fitch, Inc., Fitch Ratings Ltd. and its subsidiaries. One State Street Plaza, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. All of the information contained herein is based on information obtained from issuers, other obligors, underwriters, and other sources which Fitch believes to be reliable. Fitch does not audit or verify the truth or accuracy of any such information. As a result, the information in this report is provided "as is" without any representation or warranty of any kind. A Fitch rating is an opinion as to the creditworthiness of a security. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed, suspended, or withdrawn at anytime for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of Great Britain, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.