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Vietnamese developers' credit risk rises as worsening financing environment leads to credit crunch

by [Raghav Mathur]

- **NUS-CRI Agg PD of Vietnamese developers increases as credit crunch raises fears of liquidity risk, amidst weakening economic growth forecasts**
- **NUS-CRI Forward PD suggests that credit risk is to remain stable, yet elevated, buoyed by stable fundamentals amidst a worsening operating and financing environment**

Stress in Vietnam-domiciled property developers (Vietnamese developers) has catalyzed a rout in Vietnam's credit and equity markets, making them one of the world's worst-performing markets in 2022. Vietnamese developers have seen a rise in their credit risk since the beginning of this year, as shown by the NUS-CRI Aggregate (median) 1-year Probability of Default (Agg PD) in Figure 1a, by close to 60bps. The latest increase in the industry's Agg PD comes on the back of equity and bond sell-offs following the government's announcement of raising key policy rates by 100bps in Oct-2022. The negative impact of the tightening financing environment was further compounded by a loss of investor confidence in the real estate sector due to a slew of high-profile anti-corruption and fraud-related detainments of a major Vietnamese developer's management team.[1] Nevertheless, the credit risk outlook, as suggested by the NUS-CRI Aggregate (median) Forward 1-year Probability of Default (Forward PD[2]), remains stable (within the BB bound when referenced to PDiR2.0[3] over the next 24 months), though still elevated. This outlook may be due to the relatively stable fundamentals of the industry, though the financing environment in the domestic market creates headwinds.

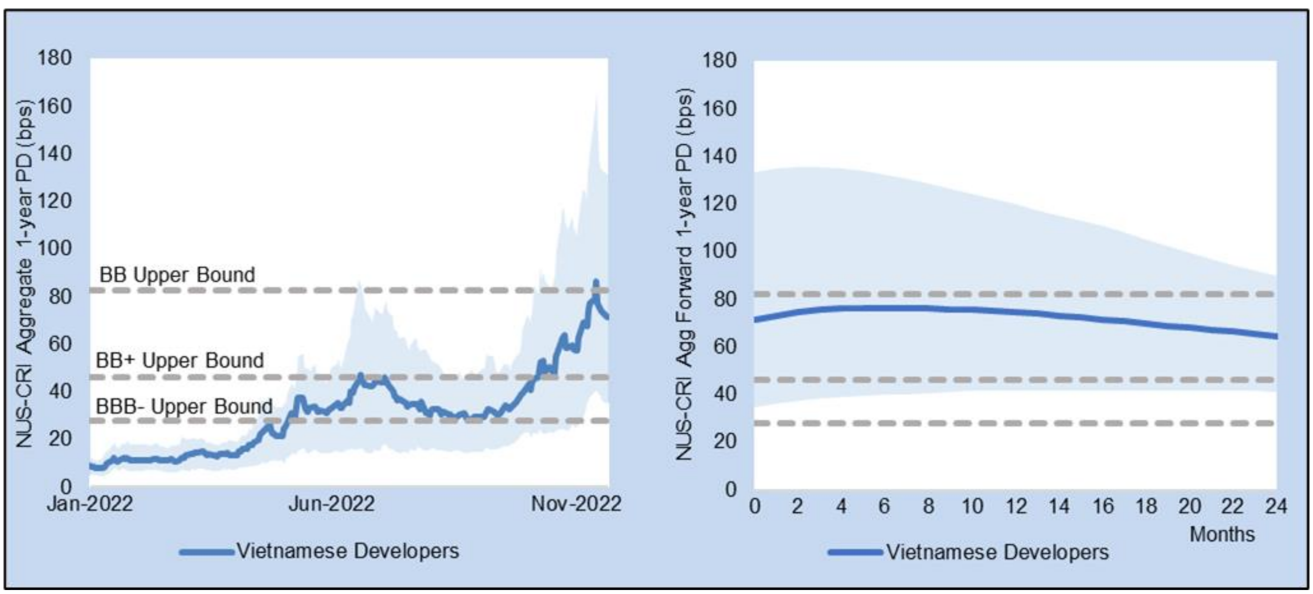


Figure 1a (LHS): NUS-CRI Agg (median) 1-year PD for Vietnamese developers and their interquartile range with reference to PDiR2.0 bounds from Jan-2022 to Nov-2022. Figure 1b (RHS): NUS-CRI Agg (median) Forward 1-year PD for Vietnamese developers and their interquartile range as of Nov-2022, with reference to PDiR2.0 bounds. *Source: NUS-CRI, Bloomberg*

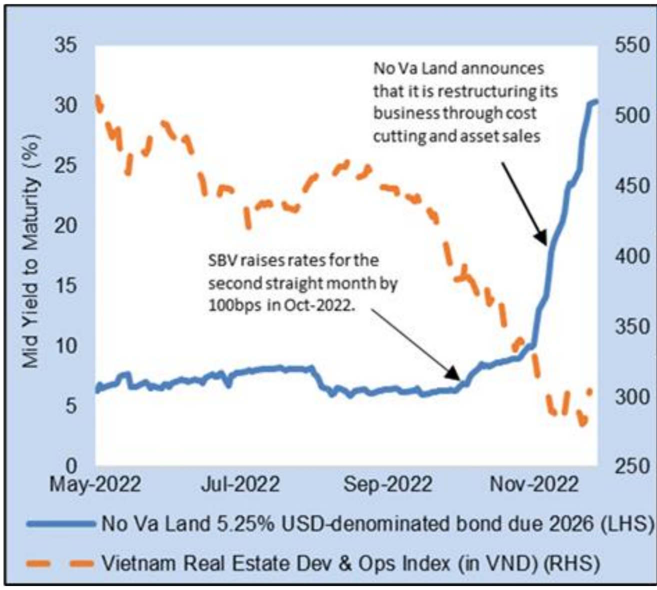
[1] The resultant impact on the wider credit markets has witnessed a run on banks, such as Saigon Commercial Bank, due to their perceived connections with the fraudulent developer. Agg PD for Vietnamese banks as a whole has also increased since the start of this year, due in part to the ongoing real estate crisis, and can be found here.

[2] The Forward PD estimates the credit risk of a company in a future period, which can be interpreted similarly to a forward interest rate. For example, the 6-month Forward 1-year PD is the probability that the firm defaults during the period from 6 months onwards to 18 months – this is conditional on the firm's survival in the next 6 months.

[3] The Probability of Default implied Rating version 2.0 (PDiR2.0) provides a more familiar interpretation through mapping the NUS-CRI 1-year PDs to the S&P letter grades. The method targets S&P's historical credit rating migration experience exhibited by its global corporate rating pool instead of relying solely on the reported default rates.

The State bank of Vietnam (SBV), Vietnam's central bank, decided to raise interest rates by a further 100bps in Oct-2022 due to the risk of capital outflow further weakening the Vietnamese Dong (VND). The threat of imported inflation as well as a weak economic growth forecast for 2023 saw the SBV tighten policy for a second straight month in October, threatening an even worse financing environment for the real estate industry that had been facing a credit crunch due to the onset of new financing regulations. Though the new regulations are set to provide transparency in private placements of bonds by introducing more stringent disclosure standards, a longer-term credit positive, they have made accessing the bond market for new issuances and refinancing more difficult in the near term.[4] Adding to the woes in the financing environment are the credit caps[5] put forth by the SBV, which limits the growth of credit extended by banks to a maximum of 14% this year (current credit growth has already reached 11.5%, leaving Vietnamese developers a smaller buffer to tap into bank credit). This worsening financing environment, where bond issuances and access to traditional debt capital are limited, may be reflected in the elevated credit risk outlook shown in the Forward PD in Figure 1b.

The worsening financing environment is already beginning to impact the real estate industry as companies seek capital to complete stalled projects and meet working capital needs. With a plethora of real estate developers stopping or postponing investments and constructions, Vietnamese developers have turned to shadow loans at higher borrowing costs and discounted asset sales to raise the necessary cash.[6] The financing distress that these developers are currently facing increases the perceived riskiness of this industry and signals distress to investors. As such, both bonds and stocks issued by developers have tanked. For example, as seen in Figure 2, Vietnam's second-largest listed developer, No Va Land Investment Group, saw the yield on its USD-denominated 5.25% loan due 2026 skyrocket by close to 25 percentage points since the beginning of Oct-2022. The Refinitiv Vietnam real estate development and operations index has also fallen by close to 21% since the beginning of Oct-2022.



Metrics	Q4 2021	Q1 2022	Q2 2022	Q3 2022
Total Debt to EBITDA	3.56	3.38	3.47	2.89
Interest Coverage Ratio	4.59	2.05	2.77	2.69
Current Ratio	1.87	1.86	1.66	1.88
Operating Margin (%)	16.79	18.46	19.39	15.5

Figure 2 (LHS): Mid YTM of No Va Land's 5.25% USD-denominated bond due 2026. Refinitiv Vietnam Real Estate Development & Operations Price Return Index. Table 1 (RHS): Median leverage, coverage, liquidity, and profitability metrics for Vietnamese developers over the preceding four quarters. *Source: Bloomberg, Refinitiv*

However, looking at the industry's fundamentals, as seen in Table 1, the industry's total leverage, coverage, liquidity, and profitability have remained relatively stable since the beginning of 2022. Going into the crisis, having stable financial health may help Vietnamese developers avoid further worsening of their credit profile, potentially suggesting why the median Forward PD term structure over the next 24 months does not continue to increase. However, should the adverse financing environment continue to gather steam over the next few quarters, the industry could face a potential liquidity crunch. Currently, Vietnamese developers have close to VND 375tn maturing between 2022 and 2025, making up close to 40% of all Vietnamese bonds maturing in the period. As bond yields rise and access to bond markets for further refinancing diminishes, the liquidity profile of the

[4] The new regulation also states that issuers cannot increase capital or restructure their capital sources (unless involved in a debt restructuring) through bonds. Issuers may only issue bonds for investment plans or investment projects.

[5] The credit growth cap was introduced by the State bank of Vietnam in 2011. It assigns a growth cap to the entire banking sector's credit expansion. The growth cap may be adjusted on a quarterly basis. Due to the current credit crunch, the government has requested the SBV to increase the credit cap to allow for real estate financing for completion of stalled projects, though, as of Nov 23, 2022, the central bank has decided to not increase it.

[6] The Ho Chi Minh City Real Estate Association is also currently seeking an extension of developers' bond terms by a period of one year, with the aim of reducing the repayment burden for bond issuers.

industry's most vulnerable firms, as suggested by the sample's upper quartile Forward PD in Figure 1b, is likely to worsen.[7]

Moving forward, the government has taken initiative to strengthen the country's bond market in order to relieve the pressure felt by Vietnamese developers. It announced the creation of a ministerial-level task force that is to address the current real estate crisis while pledging to take broader steps to boost investor confidence, reduce borrowing costs, and speed up the process for developers to get land rights. These initiatives, if materialized, do bode well to improve the credit risk of the industry in the long term, however, it is unlikely that they will materially impact the short-term financing and operating conditions for distressed developers.

[7] To make matters worse, with the VND depreciating to historic lows, developers that have issued USD-denominated bonds, like No Va Land Investment Group, face heightened repayment and foreign currency liquidity pressure.

Credit News

China local governments face debt squeeze worth USD 2tn

Nov 25. China's provincial governments have accumulated a substantial amount of outstanding debt that is close to the Ministry of Finance's risk threshold of 120% of income. Although the risk of default remains low, they are likely to face heightened refinancing pressures as more than 40% of their outstanding debt is set to mature over the next 5 years. The main driver of stress is the property sector where revenue from land sales has fallen substantially. (Bloomberg)

Junk-rated companies face greater downgrade risks as economy slows

Nov 25. Soaring interest rates and an economic slowdown have heightened credit risk of high yield companies in consumer goods, healthcare and entertainment industries which are dependent on consumer demand. Ratings firms warn that default rates and downgrades may see an increase in the coming quarters as companies face refinancing pressures in a high interest rate environment. Ratings downgrades may add pressure on company balance sheets as lower ratings lead to further increases in financing costs. (WSJ)

Emerging-market bond laggard Asia is primed for rebound in 2023

Nov 28. Emerging market bonds may see a turnaround as inflation in emerging markets shows signs of easing. For the majority of 2022, emerging market bonds have lagged other developing counterparts due to the perception that central bankers in this region were slow to raise interest rates. However, now with inflation easing, central banks have begun to signal that the tightening cycle may soon be over. Analysts also expect that higher inflows from overseas investors will boost bond markets in the coming quarters. (Bloomberg)

Chinese lenders to pump USD 162bn of credit into property developers

Nov 24. Following the government's rollback of stringent leverage controls on the real estate sector, China's biggest banks have been committed to extending USD 162bn credit to the country's real estate developers. The move marks an important turning point for the real estate sector which has been struggling with a liquidity crisis for the past 2 years. Additionally, the government has also announced a 16-point property relief plan to buoy the real estate sector, which accounts for 25% of the country's GDP. (FT)

Investors pump almost $16bn in to US corporate bond funds

Nov 26. With inflation showing signs of easing, inflows into US corporate bonds have surged to USD 16bn, their highest level since July 2020. Investment grade bonds have seen an inflow of USD 8.6bn as compared to USD 7.1bn in high yield bonds. The jump in inflows follows the October CPI report which reported a fall in annual inflation rate to 7.7% from a peak of 9.1% seen in June. (FT)

Nigeria debt service load to soar as local borrowing costs spike (Bloomberg)

China's industrial profits drop further as COVID woes take toll on economy (Reuters)

European companies are tapping bond markets again as investors return (Reuters)

Regulatory Updates

China central bank to offer cheap loans to support developers' bonds

Nov 25. People's Bank of China (PBOC) is encouraging financial firms to buy bonds issued by property developers via offering cheap loans. The loans, extended through PBOC's relending facility, are likely to be priced lower than the benchmark interest rate. This should incentivize financial institutions to invest in private developers' onshore bonds. The central bank is also drafting a whitelist of good quality and systemically important developers to further boost investment in the debt-ridden property sector. (Reuters)

Bank of Korea needs strong signs inflation curbed before pivot

Nov 25. Governor Rhee Chang Yong noted that the central bank needs stronger signs that inflation is under control before even considering pivoting away from the current contractionary monetary policy stance. Factors for consideration include the Federal Reserve's policy decision in December, global oil prices, China's Covid policies and credit conditions in Korea. As of last Thursday, the central bank raised the key interest rate by 25bps to 3.25%. Within the board, 3 members think that the terminal rate stands at 3.5% while 2 others allow the possibility of the rate going above 3.5%. (Bloomberg)

Bank of Canada says high rates starting to work, housing and debt a worry (Reuters)

Austrian central bank defends compulsory mortgage-lending standards (Reuters)

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