



High leverage and rising bad debt heighten credit risk for Vietnam domiciled companies
by [Shuai Shuai](#)

- Vietnam domiciled companies continue to raise capital via bond sales
- The NUS-CRI Aggregate (median) Forward 1-year Probability of Default (Forward PD) suggests deteriorating credit outlooks for both Vietnam’s corporates and banks

Vietnam’s response to the COVID-19 pandemic is globally recognized as one of [the most successful](#) in the world with only [1095 cases](#) among the country’s 97mn population. Despite the global economic downturn, Vietnam is expected to be one of the few countries in the world and the only Southeast Asian economy [to keep growing in 2020](#). This does not mean, however, that Vietnamese firms will be left unscathed. The pandemic-induced economic slowdown has negatively affected the debt repayment ability of some Vietnamese firms and is set to increase the amount of bad debt in Vietnam’s banks. In agreement, the NUS-CRI Aggregate (Median) Forward 1-year Probability of Default (Forward PD¹) suggests deteriorating credit outlooks for Vietnam firms (see Figure 1).

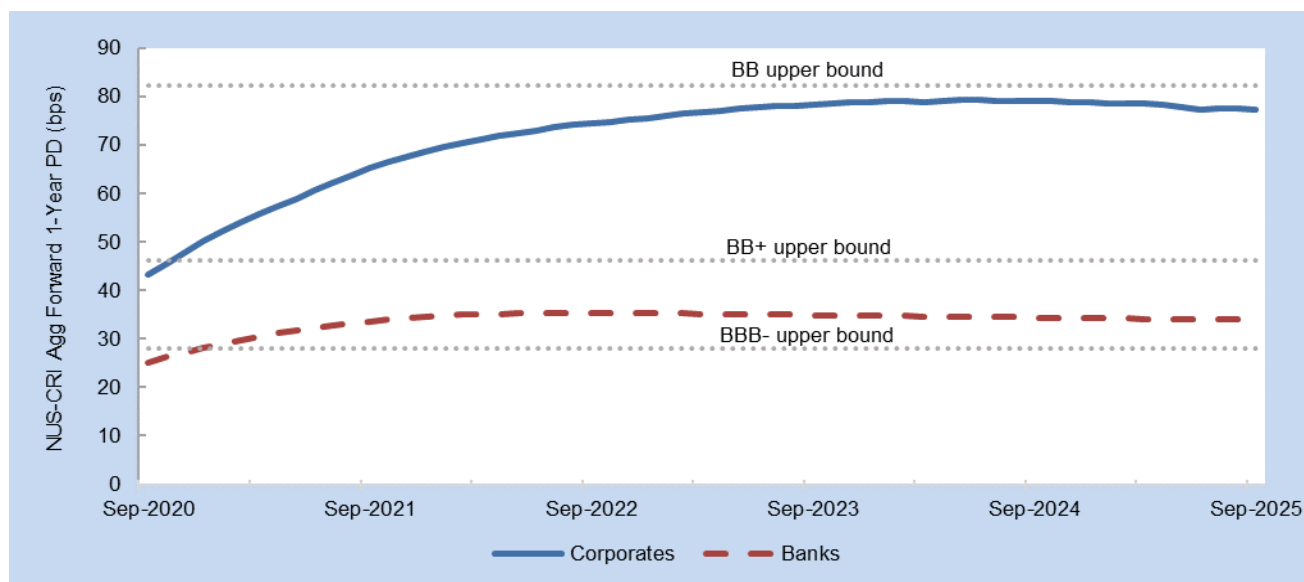


Figure 1: NUS-CRI Agg Forward 1-Year PD of Vietnam domiciled banks and corporates based on data feed as of Sep 2020 with reference to the PDiR2.0² bounds. *Source: NUS-CRI*

Moreover, the NUS-CRI Probability of Default implied Rating 2.0 illustrates the overall worsening credit quality on Vietnam domiciled companies. As shown in Figure 2, the proportion of companies that are considered as non-investment grade will increase in the next year, indicating a worsening credit outlook for Vietnam’s domiciled firms.

¹ The Forward PD estimates the credit risk of a company in a future period, which can be interpreted similar 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 1 year plus 6 months, conditional on the firm’s survival in the next 6 months.

² 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.

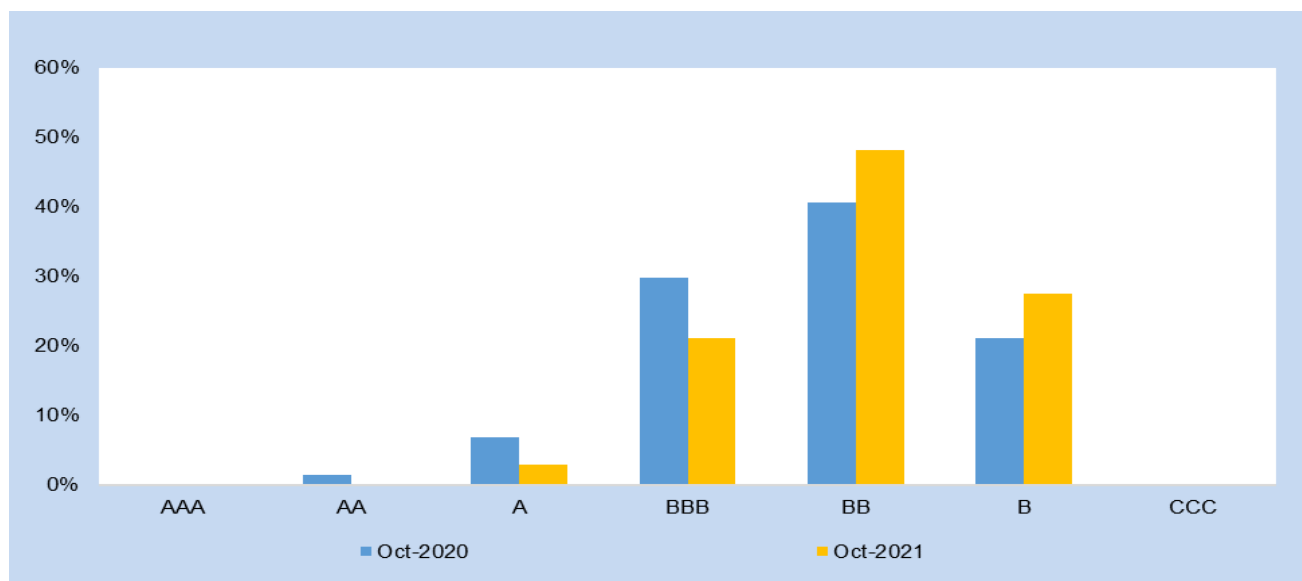


Figure 2: PDIR2.0 of Vietnam domiciled firms as of current (Oct 2020) and future (predicted Oct 2021). Source: NUS-CRI

Vietnam domiciled companies raised [VND 280tn](#) via bond sales in 2019. Furthermore, corporate bond issuance in the first six months of 2020 [rose 50% year-on-year](#) to over VND 156tn. As a result, the firms increased their leverage from an aggregate Debt/EBITDA ratio of 5.88 in 2019 to 6.36 in 2020. This high leverage could impair the firms' abilities to refinance or raise capital moving forward. With many firms struggling with cash flow revenue due to the pandemic, the relatively lower credit quality has translated to a higher risk premium reflected in higher yields. Though higher coupon rates are an attractive incentive for investors to inject liquidity in the Vietnamese capital markets, concerns about corporate's ability to repay that debt contribute to the worsening credit outlook as seen in the Forward PD above.

In addition to the highly geared nature of the Vietnamese domiciled firms, the government has [imposed various regulations](#) to limit the issuance of corporate bonds. For instance, firms can only issue bonds six months after the previous issue is concluded. While it seems appropriate given the aforementioned concerns, it may come at a serious cost should the prevailing macroeconomic conditions of the economy stagnate or deteriorate. In this environment, firms would require access to cash to tide through the periods of dampened income and demand. Another important new regulation is that any new issuance plus existing bonds should not cause the [debt/equity ratio to exceed 5](#). Since some companies' bonds are already worth [50-100 times](#) their equity, they would not be allowed to refinance or raise further debt. As such, this government-imposed cap limits capital raising flexibility for Vietnamese domiciled firms as they face more restrictions and 'red-tape' when servicing their debt. Banks are also getting [more cautious](#) about lending due to the pandemic-induced slowdown and rising bad debt.

In an economy that is very dependent on bank credit, which stood at 138.4% of GDP [in 2019](#), the credit outlook for Vietnamese domiciled banks is negative as demonstrated by the Forward PD of banks in Figure 1. This is due to several banks in Vietnam experiencing rising [bad debt ratios](#) as their clients face liquidity issues. The non-performing loans (NPL) ratio of credit institutions [rose to 1.96%](#). Based on 23 local credit institutes, the [expected outstanding debt](#) affected by Covid-19 epidemic of VND 2000tn accounts for about 23% of the whole system's outstanding loans. Unlike previous years, this year's bad debts also [arise from previously good customers](#). The sudden surge of overdue loans threatens Vietnamese banks' earnings and capital accretion momentum, as many banks will likely face capital shortfalls should the weak economic conditions persist.

Despite Vietnam's success in managing the COVID-19 outbreak, the country faces further headwinds. While Vietnam has captured many manufacturers that have left China or looked to [diversify their manufacturing](#), it has become one of the targets of US protectionist measures. With a large trade deficit of USD 55.7bn with the US, Vietnam has been subjected to harsh sanctions on products such as [Vietnam steel](#). As the US government also plans to investigate Vietnam for alleged currency manipulation, this could lead to major trade sanctions on Vietnam. This threatens to introduce even more uncertainty on the future credit health of Vietnam's firms as the country continues to walk the tightrope with its US relations.

Credit News**After record US corporate bond sales, slowdown expected**

Oct 3. While many expected a slowdown from the record high corporate issuance from Q2 2020, this quarter saw the extension of the year's all-time high bond bonanza. Investment-grade issuers such as Apple Inc and Gilead Sciences Inc raised more than USD 267bn while non-investment grade issuers like Charter Communications Inc and Occidental Petroleum Corp raised over USD 119bn. Moving forward, analysts call that bond redemption would creep up to sales. As the US flip the page through the presidential election and the next fiscal bill, companies should move forward with balance sheet recovery and debt rebalancing. ([WSJ](#))

Volvo Cars ready to sell CO2 credits to rivals as hybrid sales soar

Oct 2. Swedish carmaker Volvo has sold so many hybrid models in Europe that it is open to selling its CO2 credits to rivals that are struggling to meet new emission rules. These new rules require auto manufacturers to reduce their average CO2 emission of 130g/CO2 per km to 95g/CO2 per km this year or face large fines. The group has also announced that it had sold its first EUR 500mn green bond to finance its development of electric vehicles. The issue received orders amounting to EUR 2.5bn, shedding light on the huge popularity of green debt even at a time of great economic uncertainty. The company is planning for half of its fleet to comprise of pure electric vehicles by 2025. ([FT](#))

Foreigners rush into China's policy bank bonds at record pace

Oct 2. Efforts in the liberalization of China's debt capital markets proved worthwhile as yield-seeking investors piled onto the policy bank issuances. Data from Natixis shows that a net inflow of over CNY 300bn was recorded in the first 8 months of 2020. The policy banks include the China Development Bank, the Agricultural Development Bank of China, and the Export-Import Bank of China. All of which are prominent in their provision of support through various sectors, namely infrastructure, manufacturing, and technology. As such, the new influx of capital has better equipped the policy banks with the ability to support the economic recovery of the nation and its projects moving forward, such as China's Belt and Road Initiative. ([FT](#))

Covid-linked debt rush ignites direct lending market

Sep 30. Medium-sized businesses have for years raised debt from direct lenders that sit within larger private equity groups. However, more investment from deep-pocket investors flowing into some investment firms now meant that investment firms have enough capital to lend to larger corporates. This shift has been accelerated by the coronavirus with some firms able to write a USD 1bn loan on their own. Even more of these big-checke deals could have arisen had it not been for the US Federal Reserve buying corporate bonds and slashing interest rates. This enabled borrowers to instead raise money in the bond market. ([FT](#))

Upbeat bond market at odds with banks over scale of Covid risks

Sep 29. Historically, the absolute ratio of the banks' loan loss reserve to their total loans would positively correlate with the US corporate BBB option-adjusted spread. However, today, analysts recorded a divergence of these two variables which seems to suggest that the US banks and the market take differing views on the existing macro-economic environment and sentiments. The Chief Investment Officer for Insight Investment North America reckons that the tight bond spreads might be the apt representation of credit risk as Q2 2020 saw the decline and stagnation in credit card, commercial, and mortgage defaults. Credit has returned to the capital markets and the trend has seemed to bypass the banks that have very cautiously tightened their lending standards. ([FT](#))

Shale bankruptcies pile on, Lonestar latest to succumb to weak demand ([Reuters](#))

H2O suffers payment problems on illiquid bonds ([FT](#))

SVP bets on pandemic debt stress with USD 1.6bn fund launch ([FT](#))

Regulatory Updates

IMF pushes for changes governing debt restructurings

Oct 1. The International Monetary Fund has warned that if the current international debt architecture continues, there runs the risk of a sovereign debt crisis caused by the COVID-19 pandemic. Relief for poor countries hard hit by the coronavirus has been limited as private-sector participation in the debt service suspension initiatives has failed to materialize. The IMF has called for the G20 debt service suspension initiative to be extended for another year till the end of 2021. There is also a call for increased debt transparency so that creditors know what debts are owed by countries and under what terms, encouraging restructuring. Official bilateral creditors were also encouraged to agree on a common approach to restructuring official bilateral debts with a common term sheet requiring debtors to layout debts and seek comparable terms for official and private debt. ([Reuters](#))

Fed's Main Street lending may be missing core group of firms – survey

Sep 30. One of the key mandates for the Main Street program is to provide firms that are otherwise solvent before the pandemic with the credit they need to move towards recovery. However, this intent ran contrary to the data reflected by the Fed survey as they found that many firms were too severely hurt from the lockdown and the following recession to be able to meet their debt obligations. As of right now, there is no sign of a pick-up in the usage of the program as 75% of the survey participants reported that they did not partake in the Main Street initiative. For those that had made loans, the Main Street program was responsible for less than 2.5% of their total commercial and industrial loans. ([Reuters](#))

Government for waiving 'interest on interest' on loans up to INR 20mn during moratorium period ([Bloomberg Quint](#))

Indonesia central bank relaxes short-term liquidity loan rules for banks ([Business Times](#))