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The Vietnamese financial economy: reforms and development, 1986-2016

Quan Hoang Vuong

In an age of reform, Vietnam's financial systems have come to a critical stage in which the quality of policy-making, independence of the central banking operations and over-risk controls will ultimately be required if the country is set to move forward in a sustainable fashion. Analysts may have different views about Vietnam's financial economy, but all agree that it has evolved and grown fast over the past three decades. The next course of development will depend on how Vietnamese society views *raison d'être* of its financial systems and financial health. But the process will much depend on the economic growth of the economy as a whole. Failing to support a sustained growth puts VFS's existence at risk as economic growth helps mitigate higher risk-taking behavior and contain instability in less competitive markets.

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JEL Classifications: E44, E58, F36, G00

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The Vietnamese financial economy: reforms and development, 1986-2016

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Abstract:

In an age of reform, Vietnam's financial systems have come to a critical stage in which the quality of policy-making, independence of the central banking operations and over-risk controls will ultimately be required if the country is set to move forward in a sustainable fashion. Analysts may have different views about Vietnam's financial economy, but all agree that it has evolved and grown fast over the past three decades. The next course of development will depend on how Vietnamese society views *raison d'être* of its financial systems and financial health. But the process will much depend on the economic growth of the economy as a whole. Failing to support a sustained growth puts VFS's existence at risk as economic growth helps mitigate higher risk-taking behavior and contain instability in less competitive markets.

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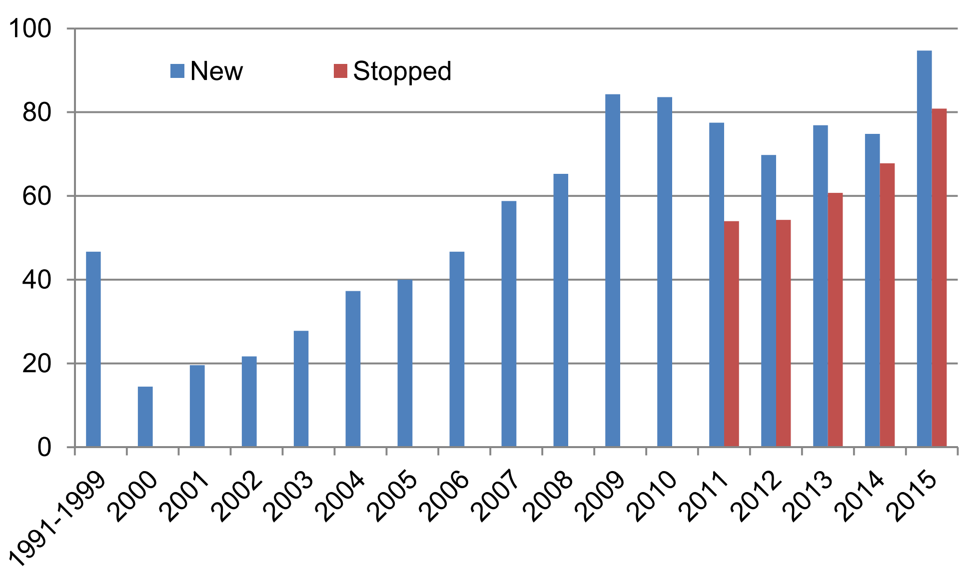
Introduction

Before the launch of extensive economic reforms, usually referred to as *Doi Moi*, Vietnam's economy was devastated by 30-year warfares with two world's military powers, France and the United States, ending in 1975. In the next 10 years Vietnam suffered from major failing economic experiments from 'cooperatization' in agriculture, "industry and commerce rehabilitation", price-wage-currency reform, etc. under the centrally planned mechanism (Wood 1989), as well as the international isolation and U.S. trade embargo when its troops entered Cambodia to overthrow Khmer Rouge (Riedel & Turley 1999). Worse off, a brief border war with China in 1979 led to suspended economic activities and a shortage of production materials in many years. Vietnam's gross domestic product (GDP) per capita declined to US$97 in 1989 whereas External Debt/GDP reached 330% (Vuong 2010).[1] The economy languished and became one of the poorest in the world.

Things have since changed. With a 92-million population, its GDP was US$204 billion in 2015, resulting in a GDP per capita of US$2,282 after 30 years of socioeconomic transitions, a remarkable achievement compared to US$437 in 1986. *Doi Moi* has enabled the marketization/internationalization of the economy, bringing about the fruits of the market (Dutta 1995; Napier & Vuong 2013b; Riedel & Turley 1999; Vuong 2010), with the financial system facilitating the transformation (Siregar 1997). The banking system had total assets of US$307 billion in 2015, approximately 150% of GDP.

A vibrant business sector is behind the growing financial sector. According to the Ministry of Planning and Investment (MPI), 94,700 enterprises were created in 2015, registering an additional capital of US$27.3 billion. Nonetheless, some problems remain in both macro-policy realm and corporate sector's microstructure (Oh 1999; Riedel & Turley 1999; Pincus 2015) as in 2015, 80,900 enterprises dissolved or temporarily closed, 50% higher than that of 2011 (Fig. 1). Part of the reasons for business failures rests with the financial sector itself. In short, a well-functioning financial system is a *sine qua non* for Vietnam's sustained growth (Vuong 2016a).

Figure 1. Newly created vs. closed/stopped businesses



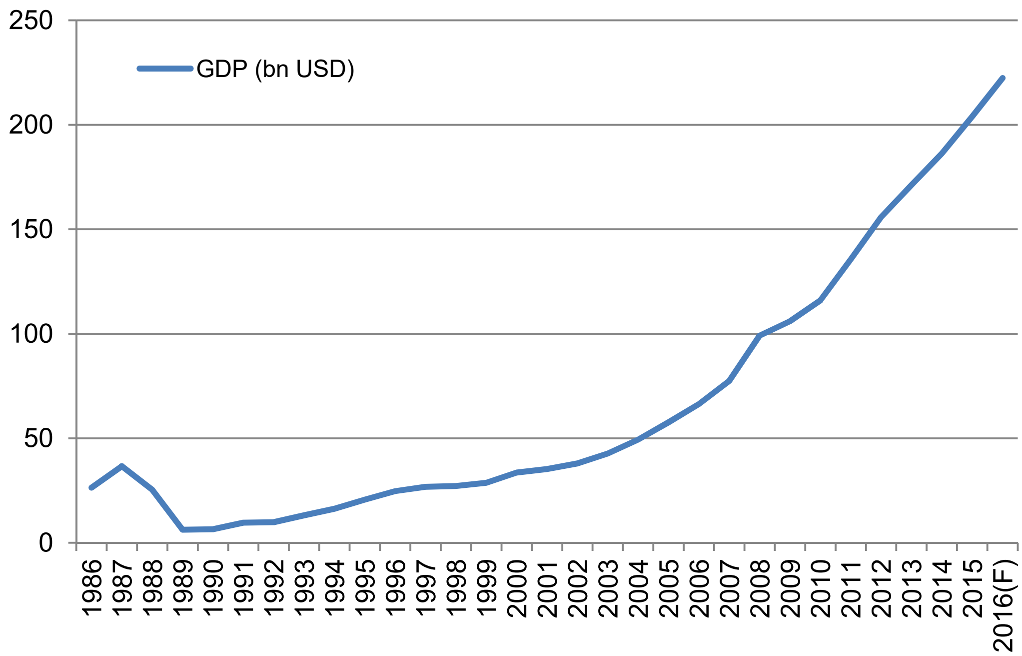
Source: MPI. Unit: 1000/year.

Economic foundations and governance framework

Economic foundations

The restoring of economic stability laid out economic foundations for the development of the financial system, and its thriving forms of institution, growing asset and equity bases (Roman 1995; Oh 1999). Success in fighting 1990s inflation rested with the management of exchange rate fluctuations combined with a restrictive monetary policy that contained broad money (M2) supply (Gourjon 2006). In addition, the surge of economic activities has turned opportunities resulting from *Doi Moi* into positive GDP changes, for a growing population of Vietnam (Fig. 2).

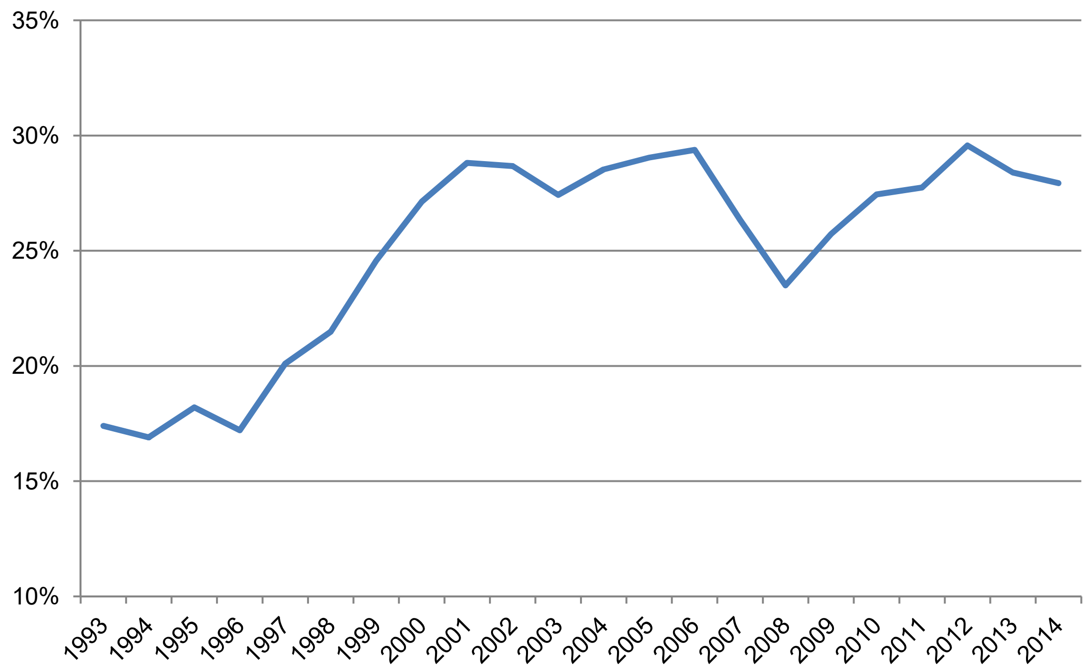
Figure 2. GDP in current prices



Source: Vuong 2010; ADB 2014/2015.

In 2015, GDP per capita of US$2,282 made Vietnam a lower middle-income country. Households have more money to spend and invest as the domestic savings ratio remains high, approximately 30%. The improved savings rate, in turn, helps to counter future economic shocks (Sepehri & Akram-Lodhi 2005).

Figure 2. Gross domestic savings ratio, 1993-2014



Foreign direct investments (FDI) also facilitated transformations with financial resources, technologies, markets, and new business methods. The stock of FDI-capital realizations by 2015 totaled approximately US$139 billion (Table 1).

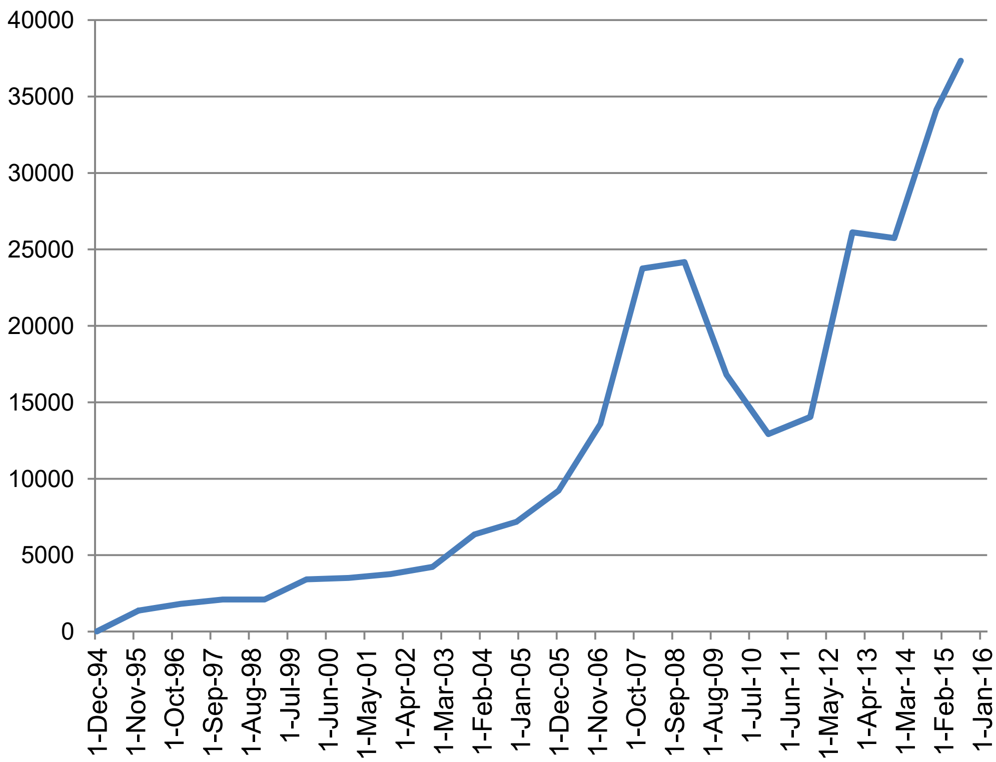
Table 1. FDI Statistics, 1988-2015

Year	Number of Projects	Registered Capital	Disbursed Capital
1988-1990	211	1,603.5	N/A
1991	152	1,284.4	428.5
1992	196	2,077.6	574.9
1993	274	2,829.8	1,117.5
1994	372	4,262.1	2,240.6
1995	415	7,925.2	2,792.0
1996	372	9,635.3	2,938.2
1997	349	5,955.6	3,277.1
1998	285	4,873.4	2,372.4
1999	327	2,282.5	2,528.3
2000	391	2,762.8	2,398.7
2001	555	3,265.7	2,225.6
2002	808	2,993.4	2,884.7
2003	791	3,172.7	2,723.3
2004	811	4,534.3	2,708.4
2005	970	6,840.0	3,300.5
2006	987	12,004.5	4,100.4
2007	1,544	21,348.8	8,034.1

2008	1,171	71,726.8	11,500.2
2009	1,208	23,107.5	10,000.5
2010	1,237	19,886.8	11,000.3
2011	1,191	15,618.7	11,000.1
2012	1,287	16,348.0	10,046.6
2013	1,530	22,352.2	11,500.0
2014	1,843	21,921.7	12,500.0
2015	2,013	22,760.0	14,500.0
Source: GSO. Capital unit: million US$.			

The financial markets had been virtually inexistent before 1990 although money, bank deposits, loan transactions did exist. With VFS reforms this component economy has grown up fast (Román 1995; Vuong 2010).

Figure 3. National Reserve (forex/gold; million US$)



Source: WB-WDI/SBV/Author's estimate.

Over time, VFS has been able to build up the national reserve that is regarded as "*coussin-de-sécurité*" against economic shocks that tend to occur frequently in an open emerging economy (see Fig. 3).

Governance framework

Along the process of reforms, new regulations constitute the governance framework required for achieving VFS's strategic goals. The transition period has made this task of lawmaking and enforcement particularly challenging. There are different promulgators in Vietnam: the Politburo, National Assembly (NA), President, Government (Govt) and Prime Minister (PM), Ministries and ministerial-level agencies. Legal documents consist of resolution; laws; circular/decision/directive; and, decree.

Table 2. Legal documents governing the Vietnamese financial system:

	2007	2008	2009	2010	2011
By Govt and PM	46	36	16	6	11
By SBV	94	106	103	35	57
By NA	1	1	0	6	3
Other Ministries	3	34	3	9	4
	2012	2013	2014	2015	2016-2M
By Govt and PM	16	3	6	2	0
By SBV	50	49	87	55	23
By NA	4	0	0	0	0
Other Ministries	16	0	1	3	0
Source: SBV <http://www.sbv.gov.vn/portal/faces/vi/pages/vbqppl>					

The regulatory framework that governs VFS has been built over the past ten years (Table 2). The State Bank of Vietnam (SBV) has issued a relatively large number of regulations. Documents listed in Table 3 are important for regulating a large spectrum of financial activities.

Table 3. Key financial regulations

Subject	Docs	Date	Remarks
Central bank	Law 46/2010/QH12	16/06/2010 (NA)	Law on the State Bank of Vietnam (SBV)
	Decree 96/2008/ND-CP	26/08/2008 (Govt)	Functions, responsibilities, and structure of SBV.
Credit institutions	Decree 10/2011/ND-CP	26/01/2011 (Govt)	Amending/supplementing Decree 141/2006/ND-CP.
	Circular 03/2007/TT-NHNN	05/06/2007 (SBV)	Implementing Decree 22/2006/ND-CP.
	Decree 141/2006/ND-CP	22/11/2006 (Govt)	Legal capital levels of credit institutions
	Directive 02/2006/CT-NHNN	23/05/2006 (SBV)	Measures to mitigate credit risks.
	Decree 22/2006/ND-CP	28/02/2006 (Govt)	On organization/operation of FOCBs in Vietnam
	Decree 109/2005/ND-CP	24/08/2005 (Govt)	Amending Decree no. 89/1999/ND-CP.
	Decree 89/1999/ND-CP	01/09/1999 (Govt)	On deposit insurance.
Non-bank financial companies (NBFIs)	Decree 81/2008/ND-CP	29/07/2008 (Govt)	Amending Decree No. 79/2002/ND-CP.
	Decree 79/2002/ND-CP	04/10/2002 (Govt)	Regulations on finance companies.

Insurance companies	Law 61/2010/QH12	24/11/2010 (NA)	Amending/supplementing the insurance business law.
	Decree 62/2009/ND-CP	27/07/2009 (Govt)	Detailing/guiding the Law on Health Insurance.
	Law 25/2008/QH12	14/11/2008 (NA)	Law on health insurance.
	Decree 114/2008/ND-CP	03/11/2008 (Govt)	Implementing the Bankruptcy Law applicable to financial institutions.
	Decree 94/2008/ND-CP	22/08/2008 (Govt)	On Vietnam Social Insurance.
	Decision 96/2007/QD-BTC	23/11/2007 (MOF)	Ministry of Finance (MOF) promulgating the regulation on universal life insurance products.
	Decree 46/2007/ND-CP	27/03/2007 (Govt)	Financial regulations on insurance and broker firms.
	Decrees 43/2001/ND-CP; 42/2001/ND-CP	01/08/2001 (Govt)	#43: Financial regime applicable to insurance and brokerage firms; #42: Implementing the Law on Insurance Business.
	Law 24/2000/QH10	09/12/2000 (NA)	Law on Insurance Business.
	Circular 03/2000/TT-NHNN5	16/03/2000 (SBV)	Implementing Decree 89/1999/ND-CP.
Securities companies	Law 62/2010/QH12	24/11/2010 (NA)	Amending/supplementing the Law on Securities.
	Decree 114/2008/ND-CP	03/11/2008 (Govt)	Implementing the Bankruptcy Law applicable to FIs.
	Decisions 27/2007/QD-BTC; 55/2004/QD-BTC	24/04/2007; 17/06/2004 (MOF)	Regulation on securities companies
	Decision 78/2000/QD-UBCK	29/12/2000 (SSC)	The State Securities Commission (SSC) amending the regulation on securities companies.
Investment funds	Decree 138/2007/ND-CP	28/08/2007 (Govt)	Regulation on local development investment funds.
	Decisions: 30/2006/QD-BTC; 71/2005/QD-BTC; 63/2005/QD-BTC; 73/2004/QD-BTC	12/05/2006; 21/10/2005; 14/09/2005; 03/09/2004; (MOF)	Supplementing/amending the regulation on securities investment funds and fund management companies.
	Decision 05/1998/QD-UBCK3	13/10/1998 (SSC)	Regulation on securities investment funds and fund management companies.
Leasing companies	Decree 95/2008/ND-CP	25/08/2008 (Govt)	Amending/supplementing Decree 16/2001/ND-CP.
	Directive 01/2007/CT-NHNN	06/03/2007 (SBV)	Reorganizing operation of financial leasing companies.
	Circular 08/2006/TT-NHNN	12/10/2006 (SBV)	Guiding syndicated financial leasing activities under Decree 16/2001/ND-CP.

	Decree 16/2001/ND-CP	02/05/2001 (Govt)	On financial leasing companies.
	Decree 64/CP	09/10/1995 (Govt)	Provisional regulations on financial leasing companies.
Source: Ministry of Justice; URL: <http://moj.gov.vn/vbpq/en/Pages/ssearch.aspx>			

Studying the history and contents of these regulations can help us learn a great deal about how the financial system has developed over the course of time.

The contemporary history

Important events of the history of VFS are summarized in Table 4, starting the National Bank of Vietnam—the predecessor of SBV—established on May 6, 1951, following President Ho Chi Minh's Ordinance 15/SL to facilitate the rebuilding of the economy and preparing for the resistance war against the French troops. The main tasks of the NBV then were to (Vuong 2010):

i) issue notes;
ii) regulate circulation of money and the credit to support business of industry and agriculture;
iii) mobilize the free means of the population;
iv) administer the state treasury;
v) manage forex affairs and settlements with foreign countries;
vi) direct the currency and credit policy

Table 4. Milestones of the financial system

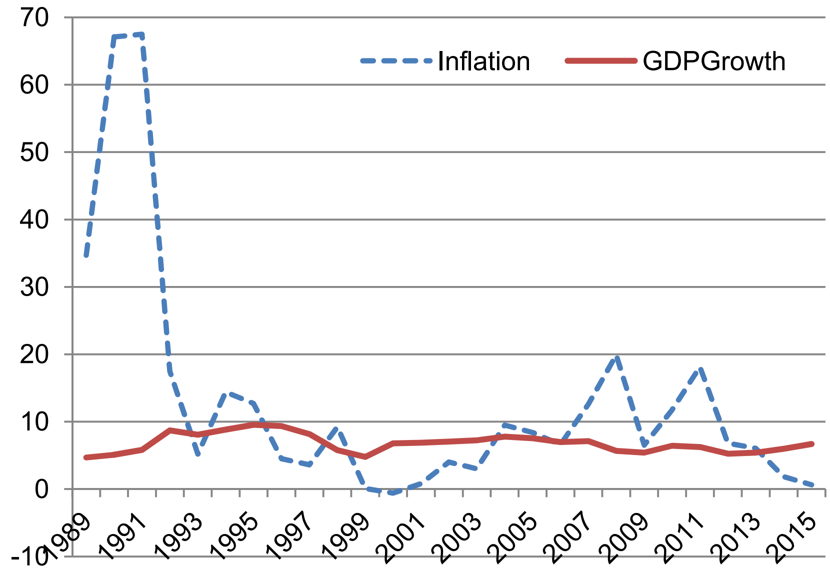
Year	Events	Remarks
1951	Establishing of National Bank of Vietnam	The monobank system.
1957	Establishing of Vietnam Construction Bank	Predecessor of BIDV
1962	Vietcombank	Vietcombank as a spinoff from Forex Control Department of the central bank
1985-86	The devastating economic crisis, hyperinflation, currency devaluation	Failure of the so-called Price-Wage-Currency experiment
	Post-*Doi Moi*	
1986	Launching *Doi Moi* at the Sixth National Congress of the Communist Party of Vietnam.	Recognizing/legalizing different types of economic ownership in the Vietnamese economy.
1987	The Law on Foreign Investment passed	
1986-88	Hyperinflation	3-digit inflation: 748% (1986), 223% (1987) and 394% (1988).
1988-89	Banking reforms started with the birth of a two-tiered banking system.	26/3/1988: Decree 53/HDBT laying the foundation to "transform the banking system to commercial operations". SBV was consolidated to manage the monetary, credit and credit institutions. State Treasury Department was spun off from the central bank. Four SOCBs focused on commercial specializations. Positive real interest rate policy

		implemented.
1990	Chain collapse of credit cooperatives.	Thanh Huong credit scandal broke out in March 1990 leading to the arrest of well-known entrepreneur Nguyen Van Muoi Hai who had mobilized money from masses through a large system of 900 money-receiving outlets, offering 12-15% interest rate/month during 1987-1989. A chain collapse occurred, causing an irrecoverable loss of VND37bn. (Using average US$:VND forex rate of 2,500, this loss was ~US$14.8 million or 0.235% GDP of Vietnam in 1989.)
1990	The State approved two Ordinances on SBV and commercial banking system.	Decision 403-CT to transform state-owned specialization banks into SOCBs: BIDV, Vietcombank, Incombank, and Agribank.
1992	Amended Constitution.	Legalizing and protecting private property rights.
1991-92	First JSCBs/FOCBs licensed. First Western investment funds and unit trusts in Vietnam.	Law on Credit Institutions 1990.
1991-92	Financing arrangement by France and Japan. U.S. Govt signaled warming relations, allowing American firms to set up offices and do contract works for FIEs in Vietnam.	US$55 million grant and US$85mn loans arranged for Vietnam to pay off its US$142mn arrears to IMF since 1985.
1993	IMF restored Vietnam's borrowing eligibility after an 8-year suspension.	Vietnam formally settled arrears to IMF in Oct. The Fund approved a US$233mn loan, following President Clinton's decision to ease 2-decade economic sanctions on Vietnam.
1993	WB granted loans of US$320mn through IDA facilities, and ADB US$76mn.	After Vietnam paid off her US$13.5mn arrears to ADB.
1992-93	The historic visit of François Mitterrand. ODA inflows.	French ODA: US$33mn (1992), US$65mn (1993). PM Vo Van Kiet visited South Korea and Australia, securing ODA grants US$50mn and AU$100mnn.
1994	The lifting of the U.S. trade embargo on Vietnam.	Clinton's administration.
1995	Normalization of diplomatic relations with the United States. Becoming a member of ASEAN (Association of Southeast Asian Nations).	Marking the process of reintegrating into the world economy. IMF, WB, and ADB opened offices. Donors community has become active.
1997	The collapse of a group of 50 companies related to Minh Phung-Epco alliance.	Irrecoverable loss of VND 3,000 billion during 1993-96. They mobilized VND 6,000 billion, US$32 million 400 credit contracts with six banks.
1997-98	Asian currency/financial crisis.	Vietnam issued Brady Bonds for settling US$553mn distressed loans in 1998.
2000-01	Inauguration of the first stock market: HSTC (predecessor of Ho Chi Minh City Stock Exchange, HOSE).	Started with four privatized SOEs. Ultra-thin trading. Primitive products. First collapse in May 2001: the first stock market collapse before the market was

		born.
2005	Opening HaSTC (today's Hanoi Stock Exchange/HNX). The 2nd Vietnamese government bond offering since *Doi Moi*.	US$750m international bond issue; the rate of 7.125%.
2006	Stock prices surged, leading to over-optimistic sentiment and high levels of P/E.	Following "bullish reports" about prospects of Vietnam stock market.
	Post-WTO	
2007	Vietnam joined WTO.	US$10.2b FPI flooded during 2006-07 without proper sterilization.
2007	Vietnam Stock Market reached the record high.	HOSE VN-Index: 1,171 on 12/3/2007.
2007-08	2-digit inflation recurred.	12.6% (2007); 19.9% (2008).
2008-09	The stock market in turmoil. USD 6 billion stimulus package released, 2008Q4-2009Q1.	Govt Decision 131/QD-TTg, subsidizing borrowings costs by 4%-max.
2010	Vinashin's default on its financial obligations to international lenders.	Vinashin's collapse caused an irrecoverable loss estimated at US$4.4 billion.
2011	The arrest of Huynh Thi Huyen Nhu, a banker.	Largest financial fraud, causing an estimated loss of VND 3,300b. 4 banks, 9 companies involved during 2007-2011.
2011-12	2-digit inflation recurred.	11.75% (2011); 18.13% (2012).
2011	Struggled to control credit growth <20%, and M2 growth < 16%.	Policy rate jumped from 9% to 11% (17/2/2011), then 12% (1/5/2011).
2012	The arrest of ACB finance mogul Nguyen Duc Kien. Vinalines on the verge of bankruptcy, former CEO and Chair arrested.	6/2012: SBV removed interest rate cap for commercial loans, liberalizing interest rates.
2013	The launch of VAMC.	Dealing with bad debt problems in the banking system. Back to restrictive monetary policy.
2014	External debt ~US$72bn.	38.6% GDP.
2015	State budget showed signs of stress.	MPI Minister stated needs of renewed reforms.
2016	AEC officially came into existence.	ASEAN regional economy: 660-million population; US$2,500b GDP.

With *Doi Moi* and a two-tiered banking system, VFS has come into existence. Its early task was to fight late-1980s inflation. The battle was continuing well into the early 1990s. In the 2010s, once again inflation plagued the economy—see Fig. 4—and the battle was resumed, making VFS's members constantly vigilant.

Figure 4. Inflation vs. Growth (% p.a.)



Data: General Statistics Office/GSO.

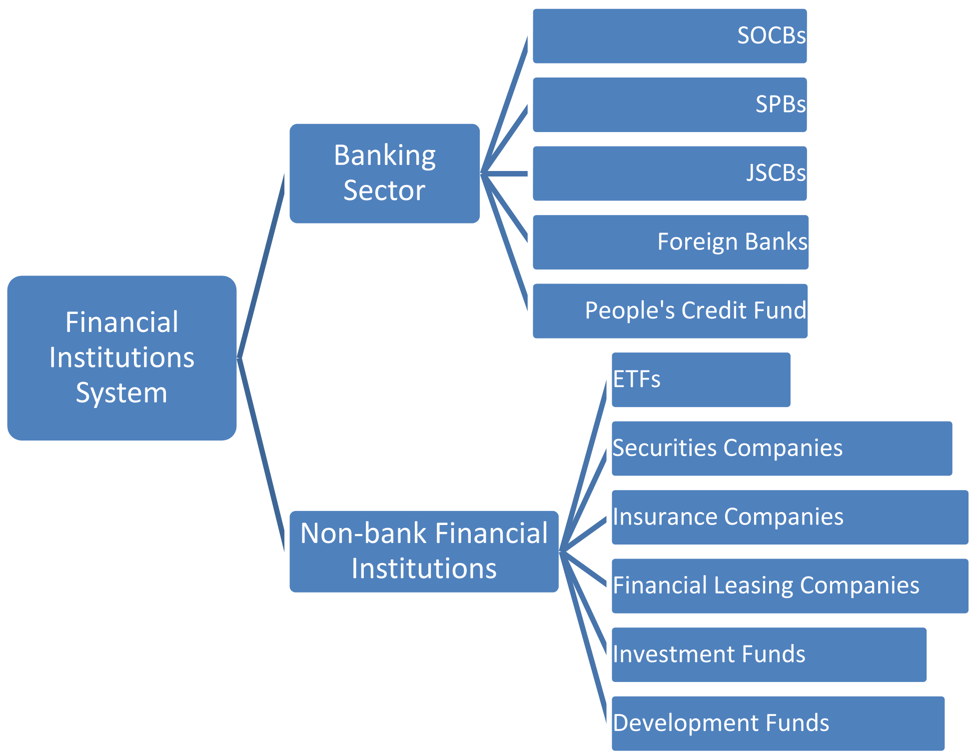
Institutions–markets–instruments

Institutions

The transformation from a centrally planned model to a market-oriented economy faced numerous hurdles due to economic disorders, virtually zero savings, hyperinflation, and heavy reliance on money printing. Institutions building process in VFS took place in this period.

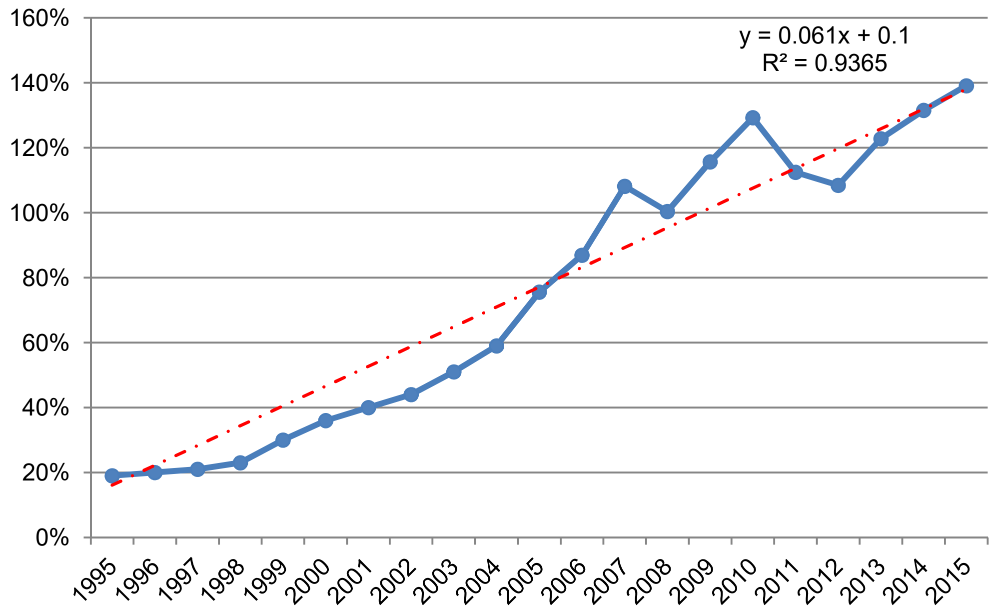
Most important types of financial institutions are presented in Fig. 5. VFS has been bank-based, with 80% of financial intermediation conducted by a handful of powerful banks. But banks resources had been limited until the mid-2000s with the size of the banking sector being modest, M2/GDP <80% (Fig. 6), while Thailand and Malaysia had M2/GDP>100% in 2000 (ADB 2014). In 2015, the banking sector accounted for 92.25% of VFS's assets.

Figure 5. VFS's Structure



Correlated with the pace of inflation and economic expansion, the process of monetizing Vietnam's economy started in the early 1990s, and accelerated mid-2000s, when the equity market boomed, leading broad money supply (M2) to surge (see Fig. 6), standing at US$267 billion at 2015 year-end.

Figure 6. M2/GDP during 1995-2015



Sources: SBV, GSO, ADB, and author's estimates.[2]

At the dawn of *Doi Moi*, 1986, total credit supply jumped by 1,897% compared to that of 1976, and by 326% of 1980. By the end of 1990, the total credit balance in the economy was 4,361% of the 1986 amount (or, 63,789% of the 1980 amount). Most counter-inflation measures employed then were "situational reactions," not without negative consequences. Early adoption of the so-called monetary policy measures only arrived in 1991, having learned the market-based economic mechanism the hard way: slower money velocity could help weather hyperinflation, given certain economic conditions. A significant slowdown in credit growth then followed.

In the 1990s, this critically important task has been performed through a two-tiered banking system, with the State Bank of Vietnam in the command, and SOCBs/JSCBs playing the role of market performers. Credit growth went down to 70% in 1992, and then to 27.5% in 1999, helping to reduce inflation level of almost 400% in 1988, down to 67.5% (1991), then 17.5% (1992), and then 0.1% (1999). Table 5 shows a changing institution composition over time.

Table 5. Financial institutions (FI) in Vietnam

	2001	2006	2008	2011	2016
SOCB	5	5	5	4	4
SPB	1	2	2	2	3
JSCB	39	34	39	37	31
FOCBs - Branches	26	31	44	48	55
FOCBs - 100%	--	--	2	5	6
FOCBs - JV	4	5	6	6	7
People's Credit Fund (PCF)	959	--	--	906	--
NBFI - Financial Cos.	7	8	22	18	17
NBFI - Financial Leasing Cos.	8	8	12	12	11
Securities Companies	8	15	87	105	81
Listed Companies (HSX/HNX)	18	106/87	175/168	303/396	312/388
Securities Trading Accounts (million)	0.009	0.106	0.53	1.19	1.48
Insurance Companies	18	29	38	38	61
Note: SOCB: State-owned commercial banks; JSCB: Joint-stock commercial bank; FOCB: Foreign-owned commercial bank; JV: Joint-venture; NBFI: Non-bank financial institutions; SPB: Social policy bank.					

Before PCFs, in 1990, about 300 credit cooperatives existed and mobilized a total amount of deposits worth US$100 million, offering high-interest rates to depositors (De Vylder & Fforde 1996). With an underdeveloped legal framework and a serious lack of risk management skills/knowledge, many just danced with wild fluctuations of inflation and interest rates, and finally went bankrupt. Their chain collapsed pushed hundreds of thousands in financial distress, causing a first nationwide post-*Doi Moi* financial crisis. It took nearly two decades for VFS to restore the populace's confidence.

PCFs resemble the credit cooperatives regarding social traits, but with market principles and joint-stock ownership. PCFs are particularly suitable for delivering rural microfinance. At present, the system of PCFs collectively has total equity of US$140 million, and total assets US$3,545 million. NBFIs, inclusive of PCFs, accounted for 8% of the total assets of the financial system in 2011, estimated at 200% of GDP.

Markets and instruments

The banks, credit markets, and products:

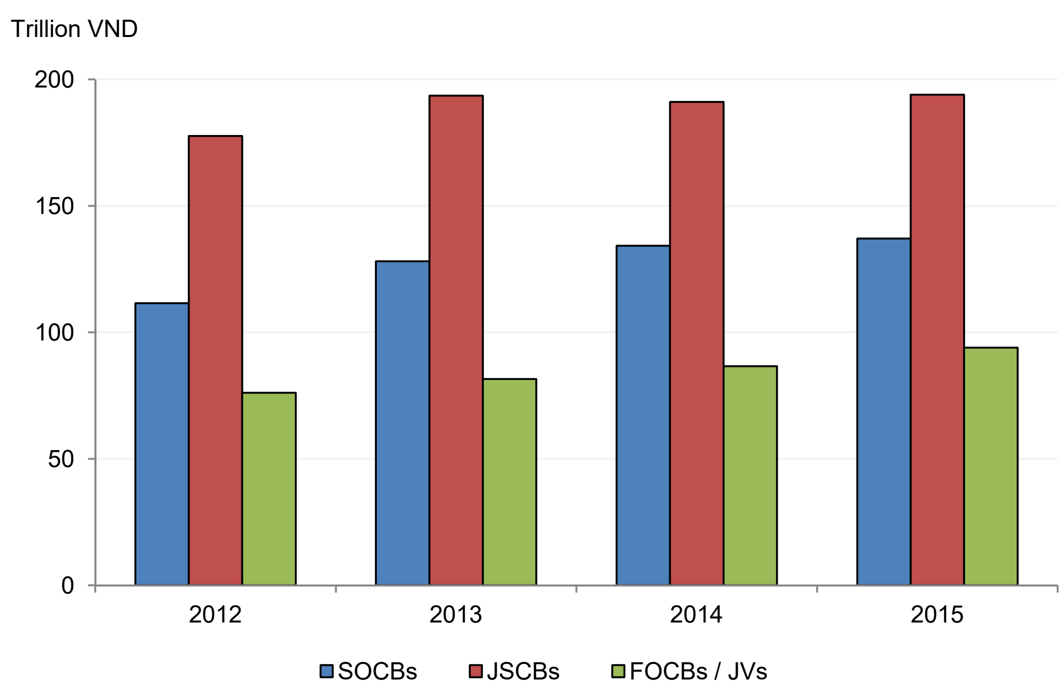
The banking industry has been dominated by four SOCBs: Vietcombank, BIDV, VietinBank, and Agribank. They are largest regarding total equity and assets (Fig. 7-8). The second 'family' consists of 31 JSCBs. Tier-1 JSCBs were founded during 1992-1993 with such names as ACB, Eximbank, Sacombank, VPBank, Techcombank...

Also, during 1990-1996, SBV issued licenses for 20 rural areas commercial banks. In the next ten years, only four new firms were licensed. Following Dec. 1557/QD-NHNN by SBV Governor on Aug 9, 2006, these rural banks, if satisfying financial and operational conditions set out by the central bank, may be 'converted' to normal JSCBs, which would be allowed to conduct business in urban areas. Most of them formed the tier-2, although some moved up the value chain and managed to expand and become more creditworthy and sizable, such as HDBank.

In the late 1990s, many commercial banks, both rural and urban, performed poorly causing a great deal of risk for the economy and bad debts to skyrocket. SBV had to put a number of banks in "special supervision", a *de facto* state of the moratorium so that restructuring–M&A–dissolving operations could be performed without causing further damage to VFS. The number of commercial banks went down from 51 in 1997 to 39 in 2001.

After US-Vietnam BTA in 2001, and accession to WTO in 2007, Vietnam's banking market has opened to both FDI and FPI, leading to a surge in foreign banks' operation in the domestic market.

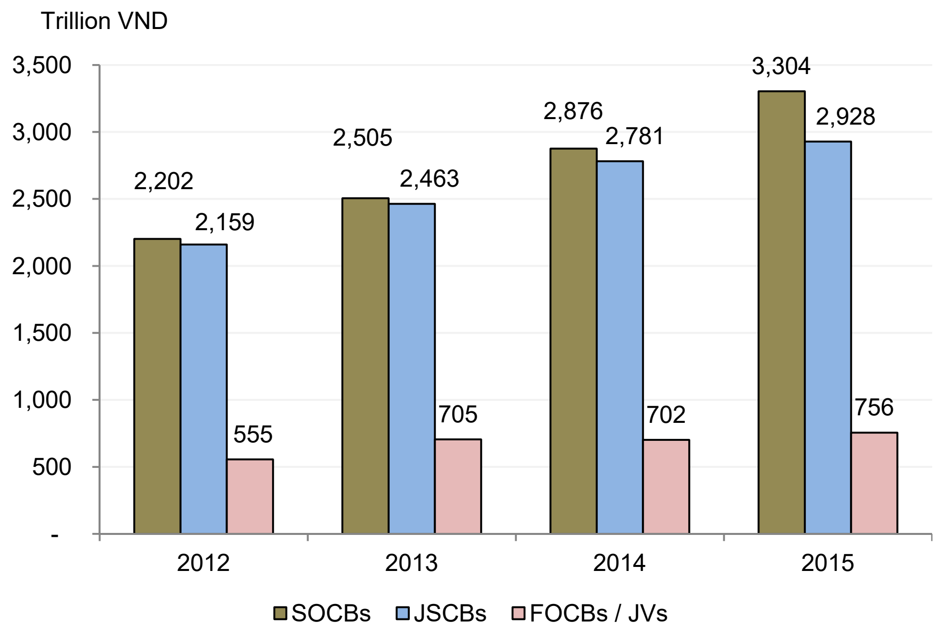
Figure 7. Bank's capital aggregate by ownership



On April 19, 2005, SBV Governor issued decisions 457/2005/QD-NHNN requiring banks to maintain 8% CAR defined by total equity to total risky assets, and 888/2005/QD-NHNN (Jun 16, 2006) that each bank branch have a minimum of VND 20 billion.

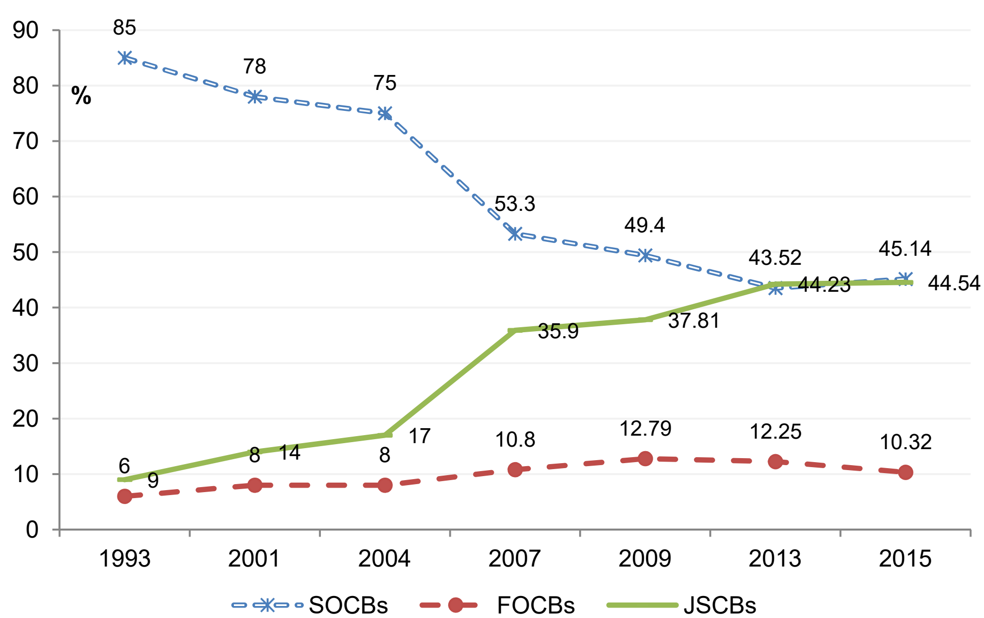
Banks frequently issued shares to shore up their capital base. Thus by the end of 2006, most commercial banks had equity three times of the 2004 level.

Figure 8. Changes in banks' total assets



From Fig. 8, although total assets of SOCBs have declined over the past years, they are still holding the largest assets in the system, outweighing the foreign banks. However, JSCBs collectively have become stronger, and on par with SOCBs.

Figure 9. Assets by ownership



Source: Author's compilation.

There are special entities in the banking sector, established to serve the development and poverty reduction programs: Vietnam Bank for Social Policy (VBSP), Vietnam Development Bank (VDB), and Cooperative Bank of Vietnam (CoopBank).

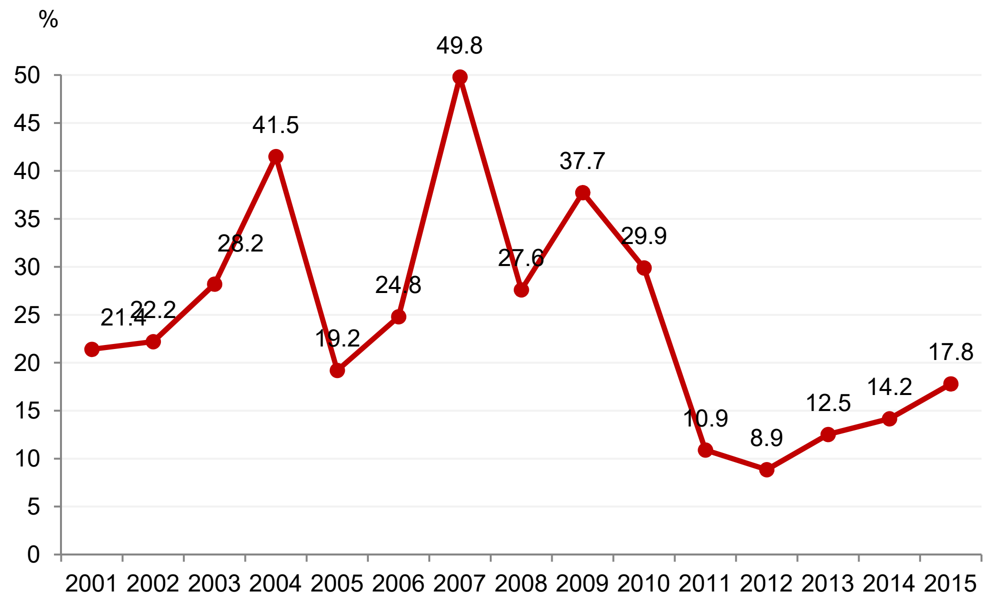
VBSP was established following Decree 131/2002/QD-TTg (Oct 4, 2002) by restructuring the then Bank for the Poor, with initial equity of VND 5,000 billion. In early 2016, this bank had a total capital of US$486 million and total assets of US$6.56 billion. VDB was founded on May 19, 2006 (PM's decision 108/2006/QD-TTg), initially with a chartered capital of VND 5,000 billion. Its total assets in 2013 were US$14.2 billion. CoopBank was the result of the transforming of the Central People's Credit Fund based on license 166/GP-NHNN (Jun 4, 2013), having a statutory capital of VND 3,000 billion. As of Jan 2016, CoopBank had total equity of US$162 million and total assets of US$1,020 million.

Domestic commercial banks have been able to increase their equity base thanks to public offerings on the Vietnam Stock Market (VSM). Since 2005, banks have collectively raised the additional equity amount of US$13 billion. In 2015 the capital adequacy ratios were 9.4% at SOCBs, 12.7% JSCBs and 33.8% FOCBs.

Banks' profitability and investment efficiency have generally been considered modest, and showed some sign of decline in recent years, with ROEs in 2014 for SOCBs standing at 6.92%, JSCBs 4.64% and FOCBs 3.79%; and ROA: SOCBs 0.53%, JSCBs 0.40% and FOCBs 0.61%.

The development of the banking sector is correlated with the expansion of credit supply to the economy. The credit-to-GDP ratio was 71% in 2006, and 116% in 2010. On average, annual credit growth was 33% in the 2006-2010 period. In this period, both FDI and FPI inflows surged abruptly, adding a large amount of money to the economy. In 2007 alone, US$17.7 billion flowed in, leading to the central bank's net forex purchase of US$10.2 billion. Without being sterilized properly, M2 surged by 46% in the year, creating a tremendous inflation pressure. The credit growth rate slowed down to 18% in 2015 while both M2 and bank deposits expanded by around 14% in the same year.

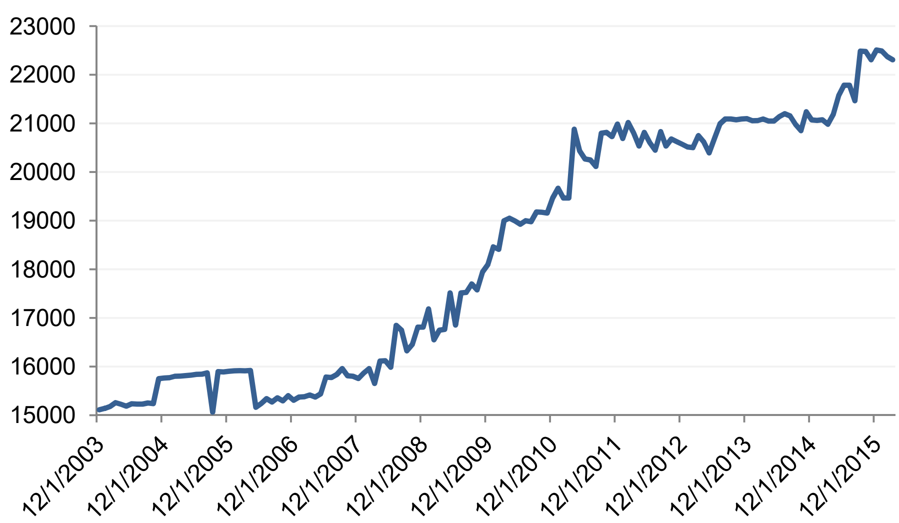
Figure 10. Credit growth (%/year)



Source: SBV.

Banks also earn their incomes from forex operations. Fluctuations and increasing transaction volumes have created a lucrative market for commercial banks. Vietnamese individuals are allowed to keep foreign currency deposits (FCD), mostly USD, in their bank accounts and saving books. A higher FCD/M2 ratio reflects the 'dollarization' issue. This indicator for VFS varied from 5% during 1992-1996, to 19% (2000-2001), 15% (2008-2009), 20% (2010), and to 15% (2011-2015).

Figure 11. US$:VND exchange rate, 2003-2016



Source: OTC-Interbank

Banks' forex revenues come from various trades: spot, swaps, futures, and options. No aggregates are available, but some typical examples can illustrate the market size in 2011. Eximbank had total values of currency swaps for its clients worth US$195 million, and other FIs US$5.78 billion. ACB Bank also held a total value of gold futures call options worth US$1.78 billion and sold put contracts totaling US$1.73 billion.

In addition, to diversify sources of income, banks have expanded retail banking services to reach out to individuals with more bank cards, ATMs and POS. Domestic debit cards and ATMs appeared first in 1993, and international credit cards in 1996. But ATM and POS became popular only in 2003 when the number of bank cards nationwide reached 234,000. Electronic banking activities have since flourished, with 31.7 million cards in 2010, and 88.21 million in 2015.

Table 6. Bank cards, ATM and POS

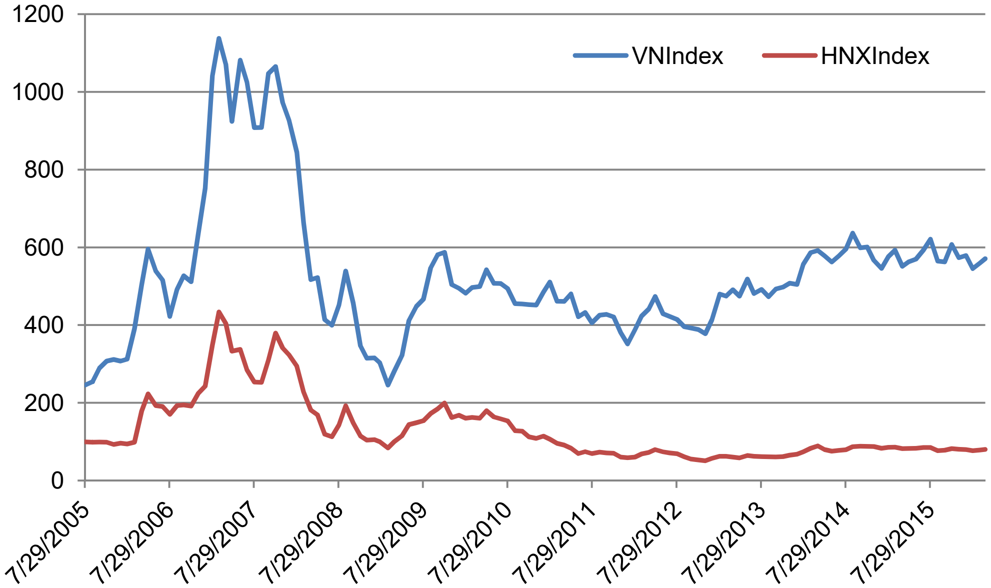
Year	Debit	Credit	Prepaid	Domestic	Int'l.	Total	ATM	POS
2010	30.12	0.44	1.14	30.115	1.585	31.70	11,700	54,000
2011	39.48	1.05	1.47	39.48	2.52	42.00	13,600	77,500
2012	50.89	1.62	1.78	50.26	4.03	54.29	14,500	104,900
2013	61.11	2.43	2.67	59.87	6.34	66.21	15,400	132,000
2014	73.59	3.29	3.51	71.61	8.78	80.39	16,018	172,360
2015	-	-	-	-	-	88.21	16,112	192,255
Source: SBV; unit: million cards (except for ATM/POS).								

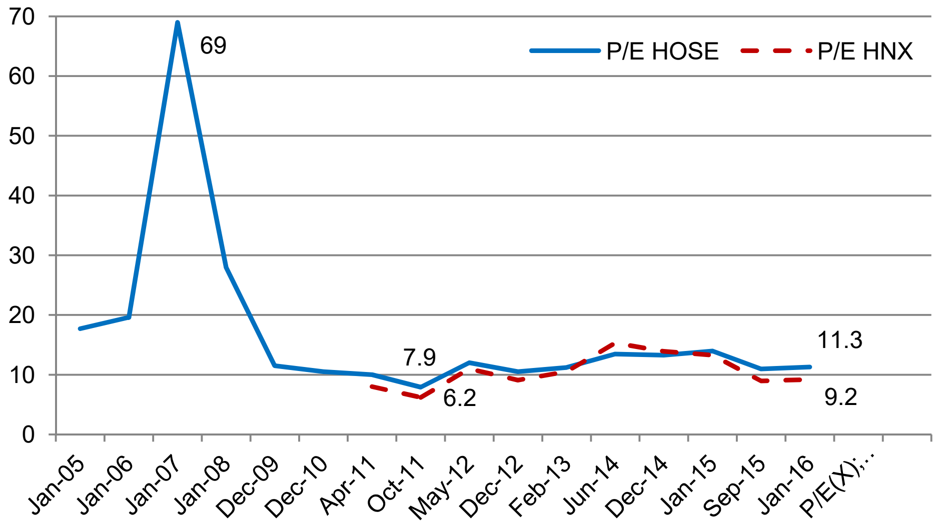
Bank cards are now shifting to integrated-circuit card technology. Cards can help with payments for numerous types of bill (electricity, water, cable TV, phone, and online transactions). Quality and security of electronic banking have improved significantly since 2011. The above fact shows a tremendous development if one looks to the fact that by 2011, only 15% of adults had access to a debit card (Kalra 2015).

Vietnam Stock Market (VSM):

VSM consists of two stock exchanges: HOSE (starting in July 2000) and HNX (starting July 2005). Fig. 12 shows the evolution of two widely cited market indexes during 2005-2015 (VNIndex/HNXIndex–above), and average Price/Earning ratios (P/E–below) for HOSE/HNX.

Figure 12. VNIndex (HOSE) and HNXIndex





As of March 2016, VSM has 312 joint-stock companies listed on HOSE and 388 on HNX; with a total market capitalization of nearly 33% of GDP.

Table 7. Listed firms on VSM

Year	Newly listed firms	Newly listed shares (million)	Market values of new shares (billion VND)
2000	5	47.11	11,359
2001	4	13.95	1,341
2002	10	53.93	6,672
2003	2	4.98	161
2004	26	5.20	626

2005	9	187.16	12,142
2006	138	1,971.91	325,687
2007	52	1,489.99	173,036
2008	81	1,016.14	48,486
2009	132	4,237.41	354,247
2010	233	3,996.70	86,077
2011	83	2,289.34	68,695
2012	30	2,236.46	100,044
2013	17	308.68	7,313
2014	45	3,822.42	92,455
2015	112	4,604.76	75,824
2016(*)	19	989.27	8,148
Source: Author's compilation. (*) As of March 20, 2016.			

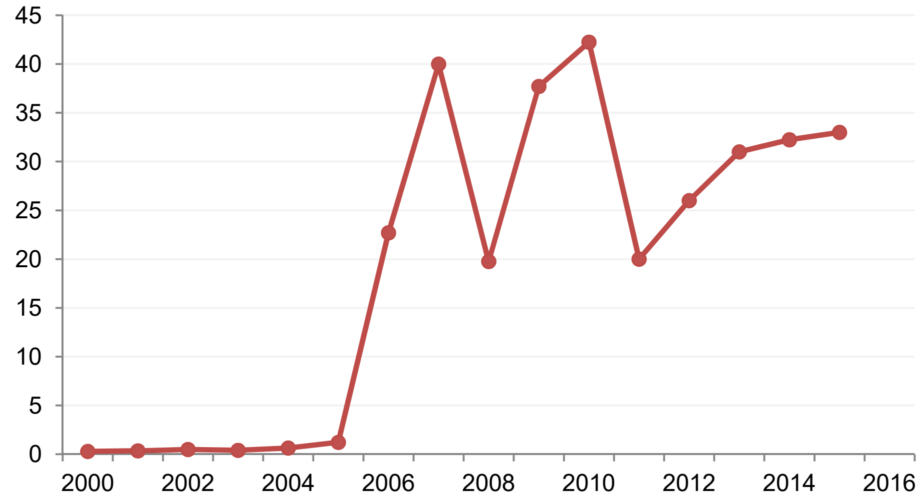
Both size and liquidity have grown over time. If in 2005, the average daily trade was <700,000 shares, the figure increased to 2.6 million in 2006, and 18 million in 2008. In 2014, VSM saw the largest trade volume of 47.4 billion shares, worth about US$35 billion. In 2016Q1, the average daily value was around US$100 million.

Table 8. Liquidity on VSM, 2011-2015

Year	Trade volume (billion shares)		Trade values (billion VND)	
	HOSE	HNX	HOSE	HNX
2011	18.88	7.94	-	-
2012	-	12.14	216,881	-
2013	16	10.57	260,985	82,081
2014	30.45	16.98	533,052	199,527
2015	28.13	11.54	482,046	135,035

As seen in Fig. 13, market size increased fast during 2006-2015, with 2015 year-end market capitalization standing at 33% of GDP.

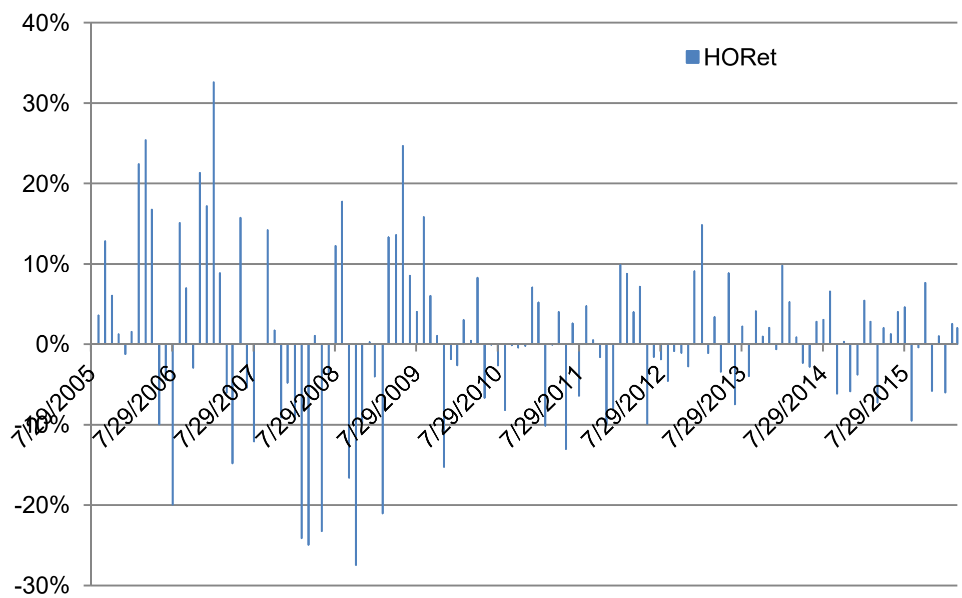
Figure 13. VSM market capitalization (%GDP)

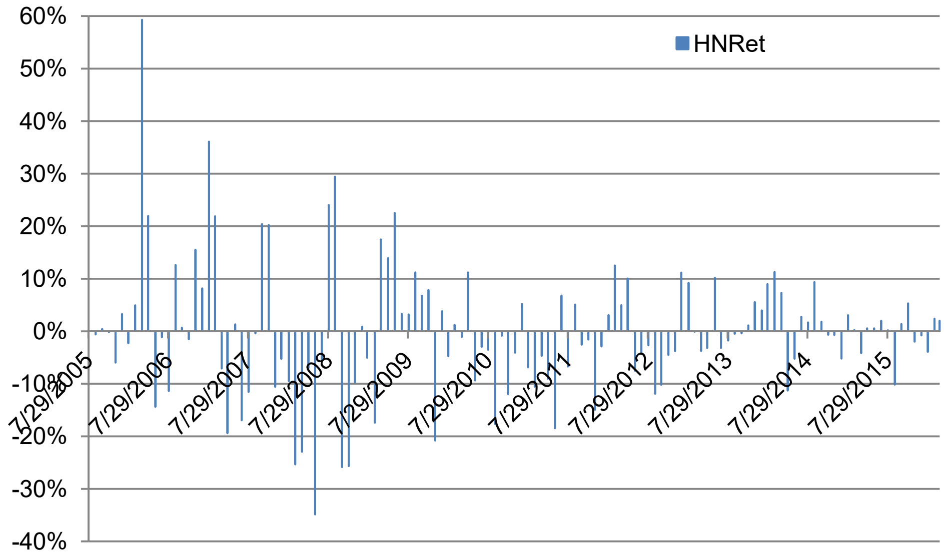


Source: Author's compilation from SSC/HOSE/HNX reports.

Two nosedives of stock prices seen in 2008 and 2011 occurred when inflation rates were 19.89% and 18.13%, respectively. The worst year in VSM 17-year history was 2011 when HOSE's value decreased by 25% from that of 2010; HNX lost 36%. Index returns on HOSE/HNX based on VNIndex/HNXIndex are provided in Fig. 14, where market volatility changes over time.

Figure 14. Monthly index returns on VSM (HOSE/HNX)



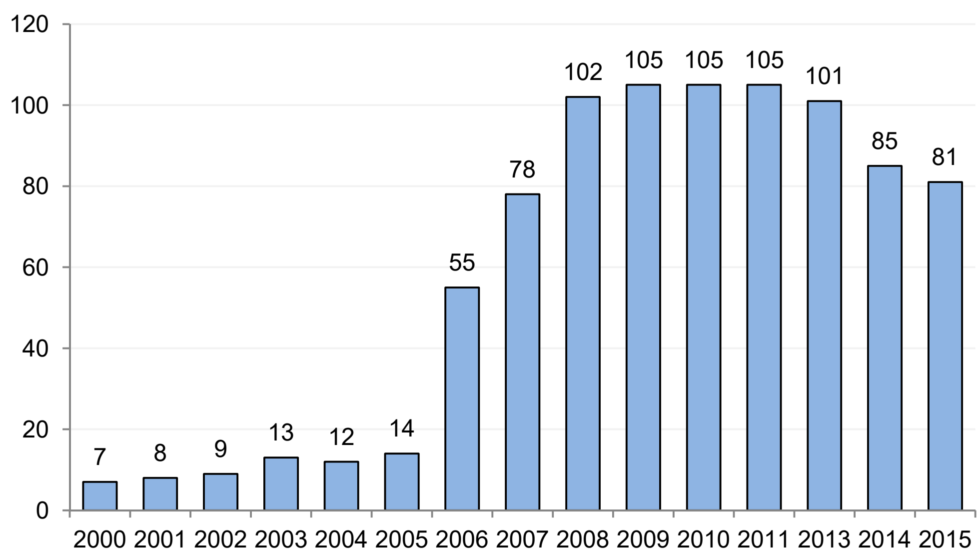


VSM can now perform better in both IPOs and seasoned offerings. Firms have issued shares worth approximately US$100 billion in VSM's first 17-years. During the 2010-2015 period, US$53 billion was raised, of which in 2015 the total value of funds raised reached US$13.2 billion, or about 28% of Vietnam's total capital expenditures. In addition, VSM helped to attract about US$15 billion FPI.

<u>Securities broker firms</u>:

The number of securities companies grew with VSM's size, as shown in Fig. 15.

Figure 15. Number of securities firms, 2000-2015



Soure: SSC.

Dozens of securities broker firm have made their fortune on VSM, especially those with strong equity (Table 10) and dominating market shares (Table 9).

Table 9. Top 10 broker firms by market share in 2015

HNX		HOSE	
Company	Share (%)	Company	Share (%)
Saigon Securities	11.27	Saigon Securities	12.92
VNDIRECT	9.94	Ho Chi Minh City Securities	12.45
Saigon-Hanoi Securities	8.34	VietCapital Securities	9.91
KIS Vietnam	6.36	VNDIRECT	5.64
MB Securities	5.19	MB Securities	5.35
VietCapital Securities	4.82	Saigon-Hanoi Securities	5.00
HCMC Securities	4.61	ACB Securities	4.28
Maritime Securities	4.41	KIS Vietnam	4.21
ACB Securities	3.81	BIDV Securities	4.11
FPT Securities	3.54	FPT Securities	2.90

About 800,000 stock trading accounts were registered with the Vietnam Securities Depository Center (VSD) in 2009, a substantial increase from 530,000 in 2008. But in March 2016, VSD already counted 1.48 million trading accounts.

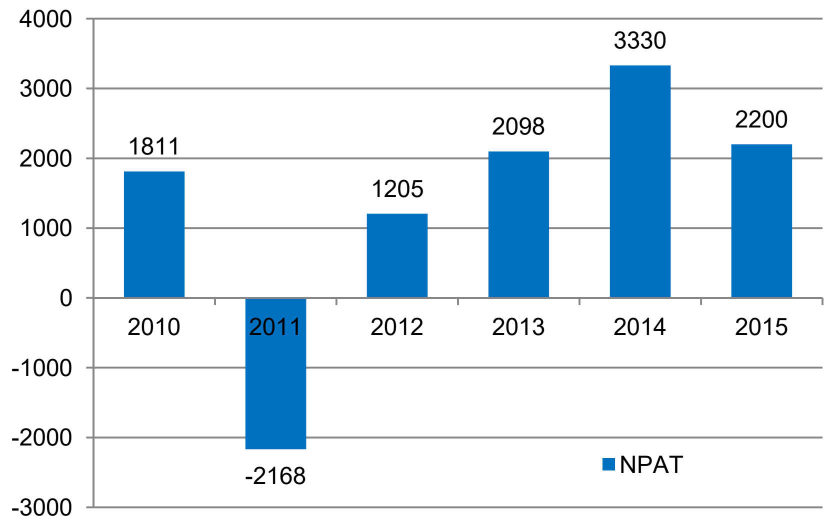
Table 10. Securities firms with the largest chartered capital by 2015

Firms	Capital (billion VND)
Saigon Securities	3,538
Agribank Securities	2,120
Kim Long Securities	2,025
VNDirect Securities	1,550
ACB Securities	1,500
HCMC Securities	1,273
MB Securities	1,221
KIS Vietnam	1,112
Techcombank Securities	1,000
Saigon-Hanoi Securities	1,000

Source: SSC/HNX/HOSE.

High inflation and restrictive monetary policy caused brokerage firms to make a substantial loss in 2011. In 2014, surviving firms were able to improve their performance, and their collective profits jumped to US$150 million. The sector's ROA and ROE were 5.15% and 8.58%, respectively in 2014, twice of those of 2010.

Figure 16. Net-Profit-After-Taxes (NPAT) of securities firms



Source: SSC; unit: billion VND.

By the end of 2015, only 81 survived the fierce competition who collectively held total assets of US$3,395.5 million and total equity of US$1,891 million. Among them, 20 largest made total revenues of US$345.5 million, and profits of US$131.8 million.

Insurers/Insurance markets:

Before *Doi Moi*, the insurance business had been monopolized by Bao Viet Insurance, an SOE established on 17/12/1964 offering two dozens of basic insurance needs. The reform came with Decree 100/CP (18/12/1993), which allowed private and foreign investors to participate in the business. The scope of activities also expanded, covering a wide range of previously inexistent activities.

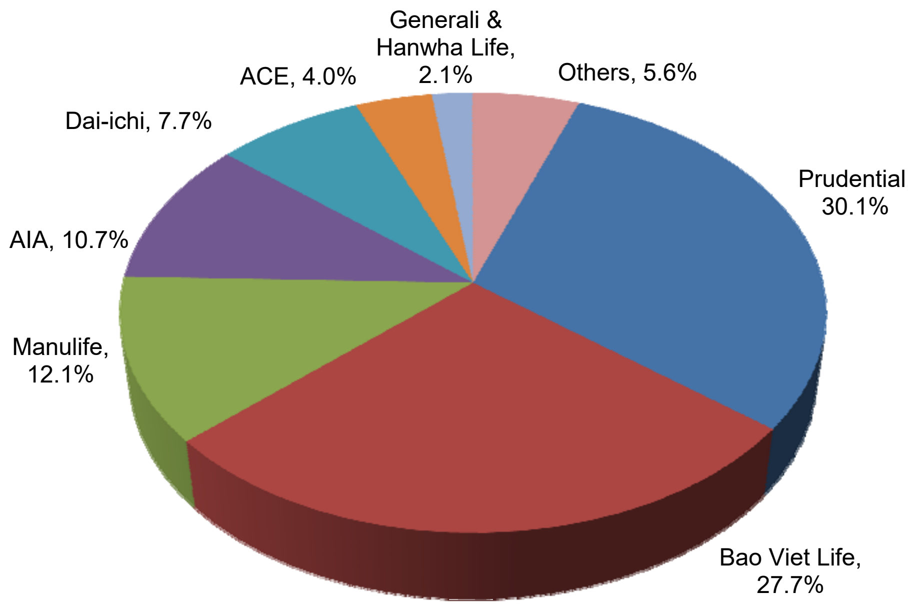
The market boomed in 1995 when dozens of insurance firms and JVs were licensed. Additionally, 40 foreign insurers' representative offices and nearly 70,000 insurance agents were approved. Nowadays, 61 insurance and related service firms are fully operational in Vietnam, offering 800 different products meeting almost every consumer's need.

Table 11. Number of insurance and service broker businesses in Vietnam

	2007	2008	2009	2010	2011	2013	2015
Nonlife insurance	22	27	28	29	29	29	29
Life insurance	9	11	11	12	14	16	17
Reinsurance	1	1	1	1	2	2	2
Service broker firms	8	10	10	11	12	12	12
Branch of foreign nonlife	0	0	0	0	0	0	1
Total	40	49	50	53	57	59	61

It is also noteworthy that six life insurance businesses have been offering pension products—namely Manulife, AIA, Daiichi, PVI Sun Life, Bao Viet Life, and Prudential.

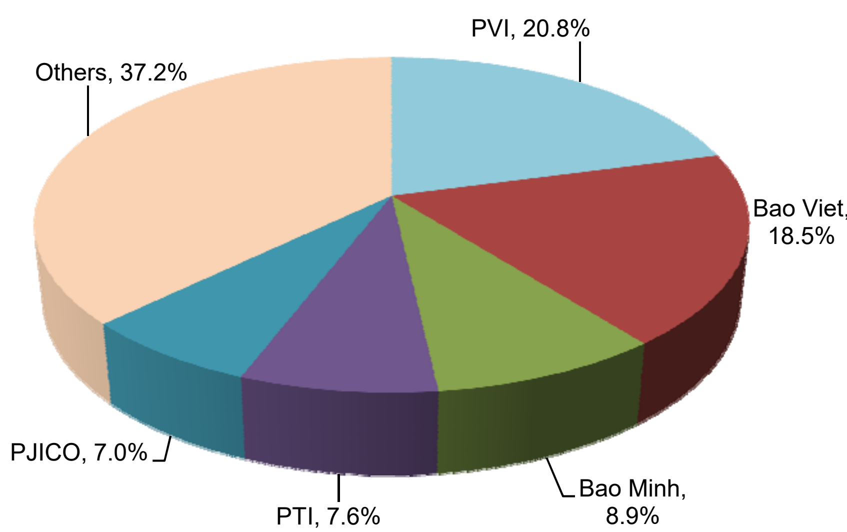
Figure 17. Life insurance market share in 2015



Source: Department of Insurance Market Administrion

Conventional nonlife insurance needs are mainly served by domestic firms—as shown in Fig. 18—with PetroVietnam Insurance (PVI) occupying the largest share due to the surge of risky oil exploring/mining activities during 1995-2015.

Figure 18. Nonlife insurance market share in 2015

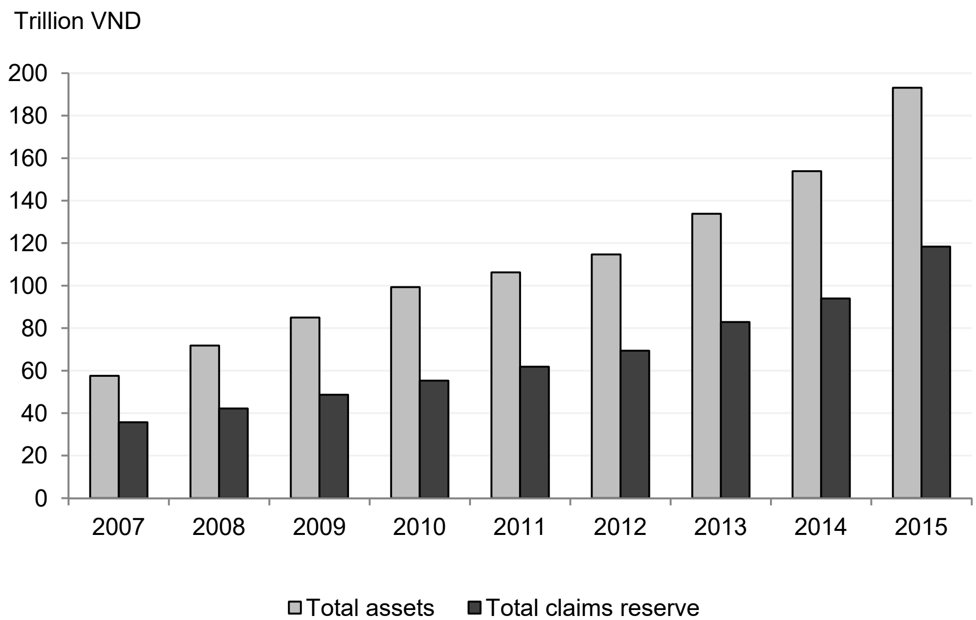


Source: Department of Insurance Market Administrion

In 2015, total insurance revenues were estimated at approximately US$3.13 billion, representing an annual growth of 21.43%, of which nonlife revenues reached US$1.46

billion, and life-insurance revenues US$1.67 billion. Revenue growth for life insurance was at 29.5%, outpacing nonlife, 14%. Insurers also honored total financial obligations worth about US$955 million.

Figure 19. Financial aggregates of the insurance industry



Source: Department of Insurance Market Administration; unit: trillion VND.

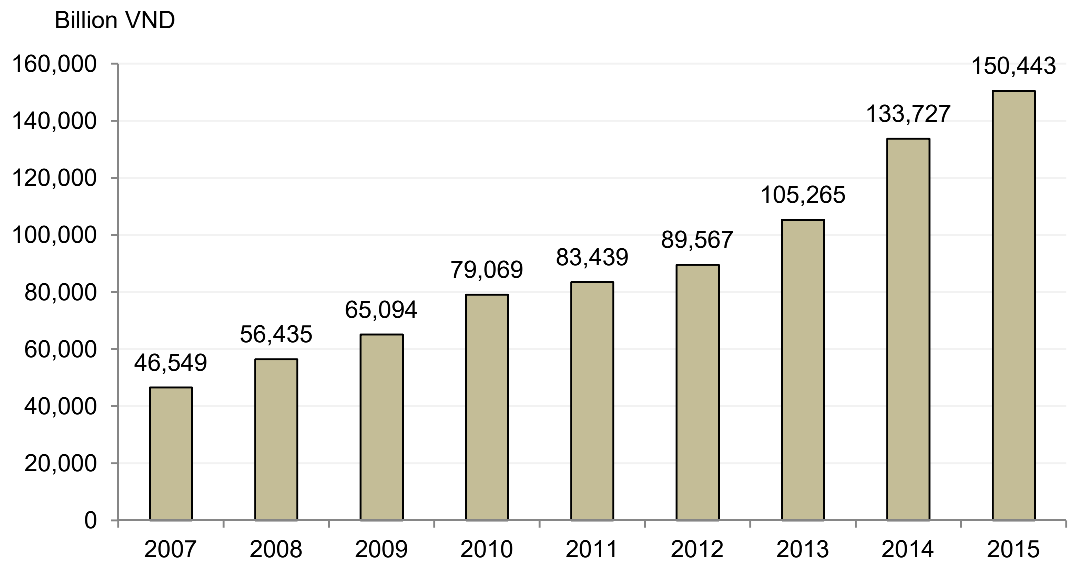
Total assets of the insurance sector stood at US$8.78 billion in 2015, increasing by 12.68% from 2014, of which, nonlife subsector accounted for 31.8%, and life 68.2%.

Table 12. Industry's revenues breakdown

	2007	2010	2013	2015
Insurance revenues	17,650	30,842	47,626	68,688
- Nonlife	8,213	17,070	24,359	32,038
- Life	9,437	13,772	23,267	36,650
Investment revenues	6,623	8,296	10,147	13,000
Total	24,273	39,138	57,773	81,374

Total revenues of 12 insurance brokerage firms also reached US$26.8 million in 2015, increasing by 14.3% from 2014.

Figure 20. Investments by insurance companies



Source: Department of Insurance Market Administrion.

Insurance companies made investments into the economy, with 2015 total stock standing at US$6,383 million, 79.2% of which came from life insurers. Insurers have recently been the main buyers of government bonds, increasingly bonds with long maturities. In 2015, they bought 20-year government bonds worth US$283 million; a group of major insurers even proposed the government to issue 30-year bonds.

With over 200,000 registered agents, life insurance firms have been able to sell new policies during 2013-2015: 1,178,390; 1,252,157; 1,298,776. Industry experts expect life insurance market will continue to expand by 25% in 2016, and nonlife insurance 18%. The number of agents increased during 2005-2015 from 35,000 to almost 70,000.

Financial companies:

First financial companies were licensed in 1997 to provide consumer finance and serve domestic trades. Their collective balance sheets showed an increase in shareholders' equity from US$520.8 million in 2012 to US$815.6 million in 2015, and total assets decreased from US$7.49 billion to US$4.04 billion.

Table 13. Financial companies

Firm	Location	License / date	Capital (billion VND)
Post&Telecom Finance Co. Ltd. (PTI)	Hanoi	03/GP-NHNN; 10/10/1998	500
Maritime Bank Finance Co. Ltd. (formerly: Vinatex Finance Co.)		255/GP-NHNN; 16/11/2010	500
EVN Finance Joint-Stock Co.		187/GP-NHNN; 7/7/2008	2.500
Handico Finance Joint-Stock Co.		157/GP-NHNN; 6/6/2008	550
Vietnam Techcom Finance Joint-Stock Co. (formerly: Chemical Finance Co.)		340/GP-NHNN; 29/12/2008	600
Song Da Finance Joint-Stock Co.		137/GP-NHNN; 23/5/2008	686
Vietnam Shipbuilding Finance Co. Ltd.		04/GP-NHNN; 16/3/2000	2.523

Vinaconex-Viettel Finance Joint-Stock Co.		304/GP-NHNN; 14/11/2008	1.000
Cement Finance Joint-Stock Co.		142/GP-NHNN; 29/5/2008	605
Mirae Asset Finance Co. (Vietnam) Ltd. (100% FOC)	HCMC	250/GP-NHNN; 11/11/2010	500
VPBank Finance Co. Ltd. (formerly: TKV CMF Co.)		02/GP-NHNN; 30/1/2007	1.500
HD-Saison Finance Co.		05/GP-NHNN; 8/5/2007	550
HomeCredit Vietnam Finance Co. Ltd. (100% FOC; formerly: PPF Finance Vietnam)		112/GP-NHNN; 18/4/2008	550
Prudential Vietnam Finance Co. (100% FOC)		10/GP-NHNN; 10/10/2006	616
JACCS International Vietnam Finance Co. Ltd.		90/GP-NHNN; 13/4/2010	550
Toyota Financial Services Vietnam Co. Ltd. (100% FOC)		208/GP-NHNN; 24/7/2008	500

As non-deposit-taking firms, they are focused on nonbank services, especially riskier consumer goods financing. In the 2014-2016 period, they financed about 20% of consumer goods purchases nationwide, with interest margins typically running from 25-30% p.a., twice of the normal bank rates. Several pioneers are now exploring personal wealth management services in the context of increasing risks due to higher unpredictability of profits of financial assets such as gold, forex or equity stocks, whereas the number of Vietnamese super-rich is expected to grow fast over the next ten years.

Financial leasing:

Six first financial lessors appeared in the mid-1990s, providing small-scaled term-finance alternatives to private SMEs, who then suffered from discriminatory lending by SOCBs. Banks also established their wholly-owned financial leasing subsidiaries, as lessors could be more flexible regarding decision-making. From 2000, the government raised the bar for new entrants, requiring an equity minimum of US$5 million. Lessors also entered a race in equity. Thus their equity base increased to US$70.5 million in 2005, and then US$136.4 million in 2007, even though all lessors generated a mediocre NPAT of US$4.73 million (ROE~3.5%).

In the post-WTO period, lessors performed poorly, with profit margins declining over time. Flexible contract terms at times became dangerous as executives manipulated regulations and made financing decisions for personal profiteering, especially at SOCB-founded lessors such as the case of Vu Quoc Hao—former CEO of Agribank Leasing Co. 2—who was sentenced to death in an embezzlement trial in 2014.

By 2016Q1, only Vietinbank Leasing, Vietcombank Leasing, BIDV Leasing, ACB Leasing, and Sacombank Leasing remain active while the rest drown in bad debts and losses.

Investment companies/ETFs and equity products:

When Vietnam—then called "the last frontier economy of Asia"—opened its door to the world in the early 1990s, pioneers, namely Templeton Vietnam Opportunity, Vietnam Fund, Vietnam Enterprise Investment Fund–VEIF, Vietnam Frontier Fund, Beta Mekong Fund, Beta Vietnam Fund, Lazard Vietnam, swiftly mobilized US$700 million funds to make risky investments. But after the Asian financial crisis in 1997-98, only VEIF and Vietnam Frontier Fund remained in the country. The underdevelopment of domestical capital markets and lack of opportunities created a deadlock in investment industry until the birth of Vietnam stock market and acceleration of equitization programs, which sold off equity of SOEs (Painter 2005; Sjöholm 2006).

The new wave of investment funds in Vietnam started after the launch of the Vietnam Stock Market (VSM) in 2000. The FPI surge occurred in 2006-2007 after bullish reports HSBC and Merrill Lynch. Subsequently, 20 funds and 17 fund management firms were granted a business license by SSC (Table 14)—even Morgan Stanley managed to make its presence in Vietnam.

Table 14. Active investment funds in Vietnam

Manager	Fund	Start	Equity	Remarks
Dragon Capital	Vietnam Growth Fund	2004	US$190mn	US$283.85mn NAV 24/3/2016.
	Vietnam Enterprise Investment Ltd.	1999	–	US$530.6mn NAV 24/3/2016.
Deutsche Asset Management	DWS Vietnam Fund	2006	–	US$323.82mn NAV (29/2/2016); Singapore listed.
BIDV-Vietnam Partners	BVIMVIF	2007	VND1500bn	
IndochinaCapital	Indochina Vietnam Fund	1999	–	Private/closed-ended funds
	Indochina Land Holdings–ILH	2005	–	Private/closed-ended funds
	ILH–2	2006	US$265mn	Private/closed-ended funds
	ILH–3	2010	US$180.3mn	Private/closed-ended funds
Mekong Capital	Mekong Enterprise Fund–MEF	2002	US$18.5m	12-y life; divested from 9/10 investments; the first growth capital private equity fund.
	MEF–II	2006	US$50mn	12-y life; exited: 7/10 investments in retailing/distribution/FMCG.
	MEF–III	2015	US$87.4mn	Target: US$150mn equity. 10-y; focus: retail/restaurants/consumer products/services.
	Vietnam Azalea Fund	2007	US$64mn	10-y life; exited from 4/10 investments.
VinaCapital	Vietnam Opportunity Fund	2003	–	Closed-end; London. US$738.7mn (NAV 30/1/2015)
	VinaLand Fund	2016	US$65mn	–
	Vietnam Infrastructure Ltd	2007	–	US$209.2mn (NAV 31/12/2015)
	DFJ VinaCapital LP	2006	US$1.02bn	–
Vietnam Holding Asset Mgt.	Vietnam Holding Limited	2006	US$125mn	Closed-end/London AIM; NAV>US$215mn (24/3/2016).
Deutsche Asset Management	FTSE Vietnam UCITS–ETF	2008	–	US$325.33mn NAV (23/3/2016); London
JPMorgan	JPMorgan Vietnam Opportunities Fund	2006	–	US$138.3mn NAV (29/2/2016); Hong Kong-listed unit trust.
Van Eck Global	Market Vectors Vietnam–ETF	2009	–	US$329.97mn NAV (24/3/2016); NYSE/Arca

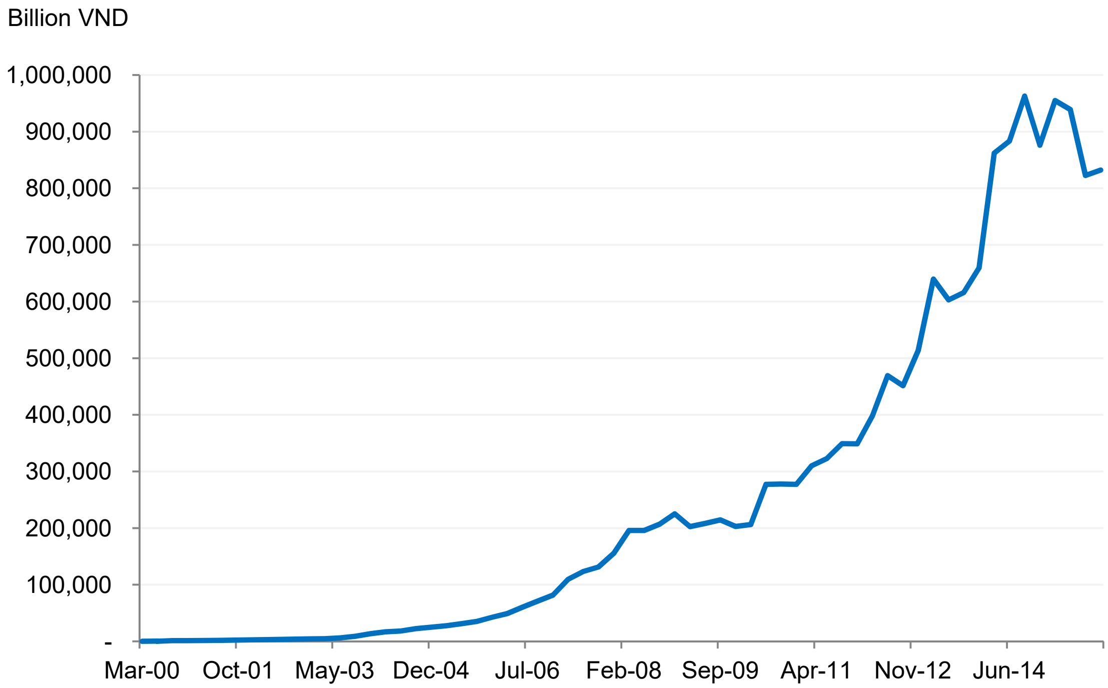
BlackRock	iShares MSCI Frontier 100 Fund	2012	–	US$420.38mn NAV (23/3/2016); VSM weight: 3.52%. NYSE/Arca
PXP Vietnam Asset Mgt.	PXP Vietnam Emerging Equity Fund	2005	–	US$116.17mn NAV (29/2/2016). Open-ended/Berlin.
Saigon Asset Management	Vietnam Property Holding	2007	–	US$16.87mn NAV (30/3/2015). Open-ended.
	Vietnam Equity Holding	2007	–	US$37.53mn NAV (11/3/2016).
Lion Global Investors	LionGlobal Vietnam Fund	2007	–	US$123.75mn NAV (29/1/2016). Open-ended/unit trust.
Artémis	Red River Holding	2008	–	US$156m portfolio (1/3/2016).
Jaccar	Jaccar Capital Fund	2006	–	US$26mn portfolio.
	Vietnam Century Fund	2009	–	US$36mn portfolio.
	Jaccar Holdings	2006	–	US$50mn portfolio.

As there exist different types of investment funds operating and holding equity assets in VSM, it is impossible to track all data on investments, portfolio values, and funds' performance. But the authorities—SSC and HOSE/HNX—can monitor local ETFs, such as VFMVN30.

Bond markets:

From 2005, VSM has also served as a major distribution system of government bonds, organizing public auctions. The government borrowed from public bonds investors approximately US$48 billion in the 2010-2015 period, mostly 3- and 5-year terms (see Appendixes A2-A3).

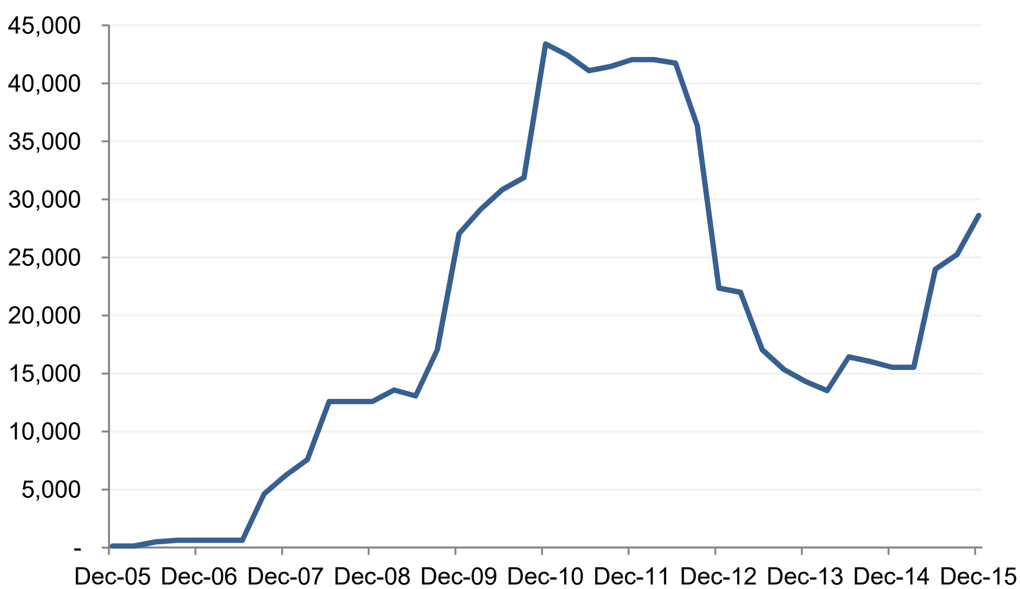
Figure 21. Government bonds (outstanding)



Source: ADB/Asian Bond Online (accessed March 23, 2016)

In 2011, the bond market was worth 15% GDP, with >90% being government bonds. The total value of outstanding government bonds is now estimated 22% of GDP. Thus bonds have become a major source for financing state budget deficit.

Figure 22. Corporate bonds (outstanding)



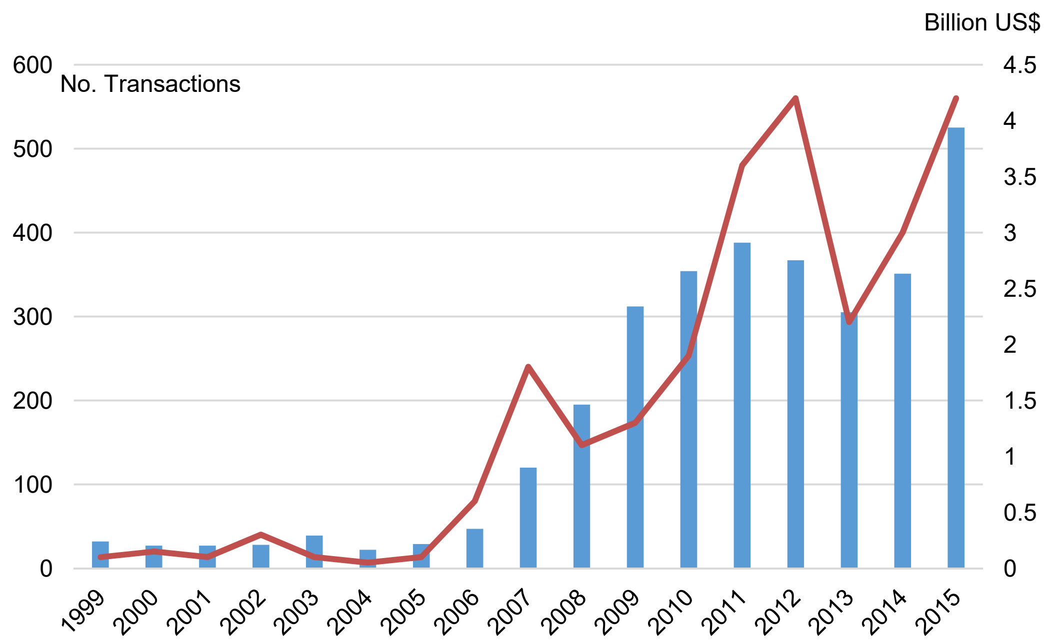
Source: ADB/AsianBondOnline (accessed: March 23, 2016)

While the government bond market has been picking up since 2005, the corporate bond market remains quite modest. The corporate bond is the game where few large corporations—banks included—dominate and seek to tap public sources of debt finance.

M&A market:

M&A activities started in Vietnam mid-1990s. The risk spillover during the 1997 Asian financial turmoil triggered early transactions such as the merger between Phuong Nam JSCB and Dong Thap Rural JSCB in 1997. The first noteworthy cross-border M&A deal was Colgate Palmolive's acquisition of Da Lan Toothpaste—then occupying a 30% market share—for US$3 million. But the real surge in M&A activities started in 2006, speculating on Vietnam's continuous prosperity post-WTO, with 47 deals completed, worth total US$0.6 billion.

Figure 23. M&A in Vietnam



Source: IMAA

More deals completed in 2007: 120; totaled US$1.8 billion. M&A transactions have since made a multi-billion-dollar market with hundreds of completed deals each year as more firms wanted to acquire assets, brands or accesses to emerging lucrative market segments (Vuong, Napier & Samson 2014).

Larger M&A deals appeared in 2013 with Warburg Pincus's acquiring 20% of Vincom Retail and KKR's US$400 million purchase of Masan's equity. The market peaked in 2012 and 2015, with total value each year standing at US$4.2 billion, counting 367 and 525 deals, respectively. M&As among domestic firms was increasing during 2008-2012, from 22% to 45% of the market. Acquiring firms from Japan, Singapore, South Korea, and the U.S. dominate the market.

Table 15. Typical M&A deals in 2014-2015

Transaction	Complete	Value	Remarks
Southern Bank/Sacombank	5/2015	Post-M&A Sacombank's assets/capital: US$13.2bn/US$838mn.	Sacombank in tier-1 JSCBs; >560 offices in Vietnam/Laos/Cambodia; >15,500 workers.
BIDV/Mekong Housing Bank	5/2015	US$156mn merger.	Post-merger BIDV's capital/assets: US$1.63bn/US$33.33bn. >1,000 branches/offices.
VietinBank/PG-Bank	5/2015	US$143mn merger; adding US$1.19bn to VietinBank's assets.	Post-merger Vietinbank's assets/capital: US$31.7bn/US$1.85bn.
Maritime Bank/Mekong Development Bank	8/2015	Total assets worth US$5.38bn/Equity US$560mn.	The merger was part of the banking consolidation plan by the SBV.
Credit Saison/HDFinance	5/2015	US$185mn for 49% HD-Finance.	Credit Saison/Mizuho Financial Group to expand in ASEAN.
FairFax Asia/BIDV Insurance (BIC)	4/2015	US$50mn for 35% BIC equity.	BIDV offered 41 million shares to FairFax.
Dongbu/Post&Telecom Insurance (PTI)	5/2015	US$45.8mn for 37% PTI.	PTI holds >7% of the US$1.6bn property insurance market.
Smartlink/Banknetvn	12/2014	Merger	Merger forming a nationwide system serving: 51 banks/NBFIs, 16,000 ATM, 105,000 POS, 55 million cards, 70 million switching operations/year. Potential revenue: US$4bn/year.
Public Bank Berhad/BIDV	7/2014	$62.5mn for 50% equity of VID Public Bank JV.	PBB Malaysia acquired 50% equity holding by BIDV in VID-Public to establish PBB Vietnam 100%-FOC.
VPBank/TKV-CMF	6/2014	VND1000bn for 100% acquisition of TKV-CMF.	State-run coal/bauxite mining conglomerate TKV required to exit from non-core business investments.

Banking–finance–economic growth

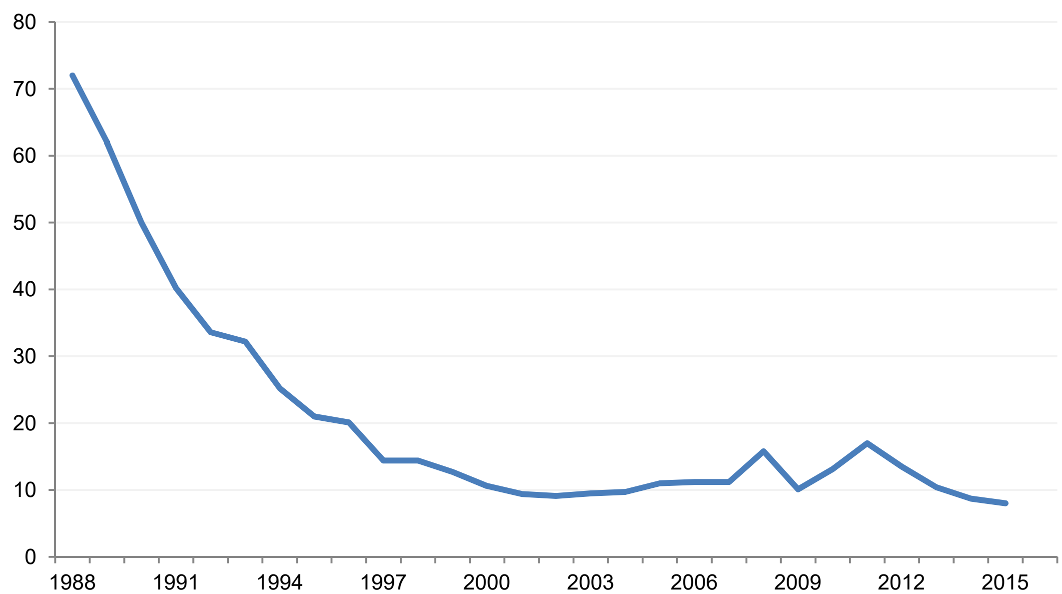
Interconnectedness

The relationship between financial markets and long-term economic growth has been rich in the literature. Empirical results suggest that well-functioning system contributes to economic growth by amassing financial resources and allocating them to sectors that can use them productively (Leung 2009; Vuong & Napier 2014). Financial markets can also provide tools and signals that help monitor the economy's efficiency and changing risks, and redirect resources under specific economic mechanisms. The financial tools are also behind a great number of techniques and paradigms for bettering corporate governance and promoting trade.

Financials guide firms' behavior based on their opportunity of accessing an external source of finance (O'Toole & Newman 2012). Better access to finance, associated with a reasonable cost of funds, would likely reduce both operating and opportunity costs of firms, and hence improve business outcome. Technology transfer also requires the smooth functioning of the financial system. If this occurs in society in large scale, well-functioning financial markets will contribute to long-term economic growth; Credit/GDP and M2/GDP increases show some positive effect on Vietnam's growth in the 1997-2006 period (Anwar & Nguyen 2009). Also, FDI efficiency shows some evidence of reliance on the efficiency of the financial markets. Thus financial factor has both direct and indirect effects on economic growth of Vietnam.

Vietnam's leadership now considers steps of liberalizing the financial system, giving more freedom to market players. Although the government's interventions are still unavoidable sometimes, they are now used more cautiously, and policymaking tends to be increasingly evidence-based.

Figure 24. Average lending rates



Increases in M2 induce increasing outputs through thanks to reduced costs and more investments in the productive sector as Hung & Pfau (2009) provide evidence that money shock is responsible for as little as 0.64% of shock in prices, but for over 44% of real output increase in the short run. But as both the capacity of absorbing money and the technical efficiency by productive sector are bounded, too much finance by later decrease economic efficiency (Vuong & Napier 2014). Passing some thresholds of size/growth, the financial sector tends to compete with the rest of the economy for resources and its enlargement is no longer growth-enhancing (Nguyen, Le & Freeman 2006; Cecchetti & Kharroubi 2012).

In addition, with the existence of stock markets, integration into the world economy increases interdependency among capital markets and contagion risks. There is evidence that VSM has been influenced by American, Chinese and Japanese stock markets, of which risks spillover from the Japanese stock market was found to be the strongest (Wang & Lai 2011). Also, Pham & Riedel (2012) argue that the conduct of monetary policy in Vietnam during the higher inflation period was generally 'clumsy'. Management of foreign exchange fluctuations has been a burden on SBV/SOCBs, limiting the ability to pursue an independent monetary policy. Financial sector liberalization helps promote not only growth but also macroeconomic stability.

Inclusive financing: microfinance-venture capital-crowdfunding

Microfinance:

Jobs creation has been a major economic achievement. From the mid-1990s, most jobs have been created by the private SMEs. The problem with the SMEs subsector has been a constant lack of access to financing and unequal playing field where they are subjected to higher costs of fund and operations (O'Toole & Newman 2012; Yoshino & Taghizadeh-Hesary 2014). Kalra (2015) reports only 8% of Vietnamese saved money and 16% had a loan with a financial institution in 2011.

In a context that 30% of adults borrowed from friends/family and that among the poorest income quintile in Vietnam, only 6% had access to formal financial services (Kalra 2015), seeking microfinance is perhaps a logical consequence. Microfinance has now been one of the important solutions and a sign of financial market liberalization, although evidence on positive effects of microfinance has been mixed (IFC 2014). The presence of microfinance institutions (MFIs) and microfinance activities can be traced back to 1980s under various formal and informal types of financing such as credit cooperatives, 'Hui' or small group's alternate borrowings. By mid-1996, 674 people's credit funds collectively gathered about 275,000 members, mobilizing US$48 million funds and lending out US$67mn (Fallavier 1998).

However, the concept of formal microfinance appeared in the early 1990s, and its credit-based schemes were first implemented under donor-funded programs. Microcredit has usually been associated with inherent services such as access to saving facilities and provision of basic insurance (Vuong 2010). Nonetheless, the commercial viability of MFIs has always been a question due largely:

i) relatively high administrative costs;
ii) riskier due to lack of management resources and standard governance;
iii) lack of collaterals by borrowers, leading to a propensity to increase interest rates.

Hainz, Dinh & Kleimeier (2011) present evidence that richer credit borrowers tend to succeed in securing larger loan amounts, reducing 'friction' and paying lower costs of the fund while access to fast-improving banking infrastructure is still limited within the upper-middle-income class, mainly residents of major cities. According to IFC (2014) only 16.5% of the adults in rural areas, and 29.8% of adults in urban areas have an account at a formal financial institution as of 2011, whereas the averages for the East Asia & Pacific developing region are 50.1% and 68.7%, respectively.

Although still limited in scale, improvements of MFI activities can be seen with more recent statistics. The three major domestic systems that are partly responsible for microfinance activities, namely VBSP, VBARD, PCFs collectively served 9.6 million clients by the end of 2013, providing a total amount of credit worth US$8,034 million. While it is still not easy to learn about genuine microcredit portion of this portfolio, by the end of 2012, genuine MFIs (exclusive of VBSP/VBARD/PCFs) provided US$108 million microcredit to 480,000 clients (IFC 2014). This cause of sustainable development—supported by multilateral organizations—also leads to microfinance initiatives such as ADB-managed US$40mn ADF program in conjunction with the Japan Fund for Poverty Reduction's technical assistance.[2]

Venture capital financing:

Due to the predominant credit-based financing agenda by the Vietnamese government, venture-capital activities had a slow start in the 1990s, and Vietnam's entrepreneurial financing initiatives have significantly diverged from international venture-capital policy patterns (Klingler-Vidra 2014). Today's best known venture-capital funds (VCF) include IDG Ventures Vietnam, Kamm Investment, CyberAgent Ventures, DFJ VinaCapital, Indochina Capital, Mekong Capital, Vietnam Partners.

IDGVV is the pioneer with its presence in Vietnam dated back in 1992, with IDG financing PCWorld Vietnam—first computer publication. Formally established in 2004, it now holds a portfolio of US$100 million investments in 42 technology, ICT/Media and consumer sector companies, including such successful projects as VNG, Apollo, VC-Corp, VietnamWorks.

In 2015, the government also explored the opportunity of setting up a VCF to support newborn ecosystem for tech-related entrepreneurs, with assistance from state-financed sci-tech supports agencies such as NAFOSTED/NATIF/NATEC, Vietnam Startup Fund, and Vietnam Silicon Valley Project. Still, there is a lack of local funds so that early-stage tech startups are underfinanced. The government and its research institutes believe a national VCF will be a prime solution, helping nurture this critically important component of the entrepreneurship ecosystem with seed funding.

In March 2016, 500-Startups announced its plan to set up a US$10 million VCF focused on Vietnam-connected startups. The typical investment in a startup venture runs from US$100,000 to 250,000. Apart from the finance, the fund intends to support startups with their international network of 3,000 mentors and founders, and credit facilities with such partners as Amazon and Facebook.

Still, the venture-capital industry remains modest and underdeveloped despite a batch of emerging VCFs that have come into existence since the 2000s (Klingler-Vidra 2014).

Crowdfunding:

This financing mechanism has become a buzzword over the recent years when entrepreneurship programs seek to find alternative finances for entrepreneurs' creative, yet risky, ideas (Vuong 2016a, 2016b). The AEC is expected to attain US$8 billion market for crowdfunding in the latter half of the 2010s when the world's crowdfunding industry reaches US$96 billion in size. It was heard of for the first time in Vietnam in 2012, but the legal framework for governing crowdfunding operations has not been in place leading to higher perceived risks. Vietnam's finally got the first ever crowdfunding platform IG9 in mid-2013.

Most crowdfunding activities center around a handful of Internet-based platforms: ig9.vn, fundstart.vn, 500.co, inspireventures.com, cyberagentventures.com... Despite its novelty, local entrepreneurs are receptive to crowdfunding and on steep learning curves. By

2016, this entrepreneurial finance concept has become somewhat familiar, offering key values of:

- Increasing awareness and helping to build trust gradually;
- Getting around strict collateral requirements;
- Testing if new projects are perceived as well by the larger community;
- Facilitating the communications and connecting startups to different circles in society.

The crowdfunding industry has still been nascent, but it appears that with the fast increasing entrepreneurship community and receptive entrepreneurs, Vietnam would likely become the second country in ASEAN—after Malaysia—to institutionalize a crowdfunding framework with a development roadmap.

Inherent risks and challenges

VFS's bank-based nature induces inherent risks of structural problems as, at present, total banking assets—SPBs included—amount to 180% of GDP, and >92% of VFS's assets. Additionally, during 2005-2010, state institutions increased holdings in SOCBs/JSCBs from VND 1 trillion to 15 trillion without facing any regulatory restrictions (Pincus 2015), although inefficiencies of state-owned non-core investments had been well-informed. Meanwhile, the inflation problem remains, making the system even more vulnerable to economic shocks (Vuong 2010; Nguyen, Cavoli & Wilson 2012; Kalra 2015).

Too much power of the financial sector also likely leads to the situation where financial institutions compete with productive sectors for resources, increasing the risk of misallocation (Stiglitz 2016). Addiction to financial resource is also real. In addition, resource without innovative capacity and value-added activities by companies becomes a drag on the corporate sector—a kind of financial "resource curse"—through destructive creation of resource-rich, uninnovative and rent-seeking quasi-business organizations (Vuong & Napier 2014). Rampant practices of directed lending and relationship-based credit granting further add to the increased risk of financial failures, or worse off, financial frauds (Vuong, Napier & Tran 2013; Vuong 2016a,b).

Use of credit in Vietnam has generally been regarded as inefficient. The real estate market consumed 80% of credit supply in 2013, crowding out other productive sectors of the economy. More recently, government's economic stimulus package in 2008 induced risk-taking behaviors and arbitrage opportunities holders of speculative assets, potentially causing risks of overinflating bubbles in real estate and financial assets markets (Dinh, Malesky, To & Nguyen 2013). The risk of misallocation of finance increased substantially in the context that only 20% of finance for entrepreneurs/SMEs was informal, pushing costs of the fund to 3-6 times of the formal banking rates (Thanh, Cuong, Dung & Chieu 2011). This is a serious issue for the Vietnamese economy in general (O'Toole & Newman 2012). Selfish commercial interests tend to entice banks—currently under interest controls—to protect their margins by transferring operational costs to customers (Pham 2015). The banking sector also encountered numerous scandals that led to jail terms for many senior bankers (Table 16 provides some examples).

Table 16. Noticeable arrests of bankers

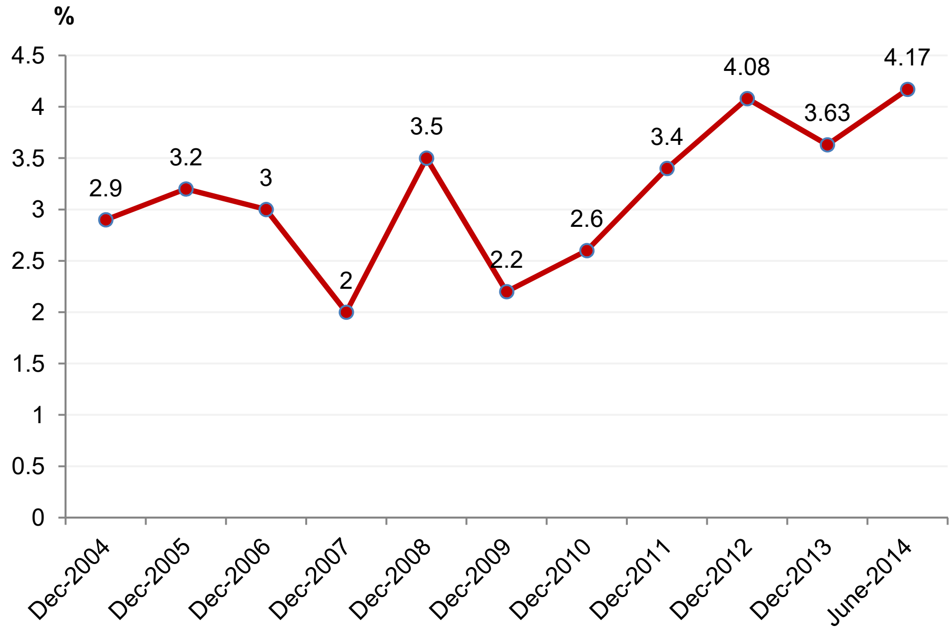
Name	Position	Bank	Year

Pham Quyet Thang	CEO	GP-Bank	2016
Huynh Nam Dung	Chair/BOD	MHB	2016
Nguyen Xuan Son	Chair/BOD/PetroVietnam	OceanBank	2015
Nguyen Minh Thu	Chair/BOD	OceanBank	2015
Do Tat Ngoc	Chair/BOD	Agribank	2014
Ha Van Tham	Chair/BOD	OceanBank	2014
Phan Thanh Mai	CEO	VNCB	2014
Pham Cong Dan	Chair/BOD	VNCB	2014
Pham Thanh Tan	CEO	Agribank	2013
Do Hung So	Director/Hau Giang Office	LienVietbank	2013
Tran Xuan Gia	Chair/BOD/Former Minister of MPI	ACB	2012
Nguyen Duc Kien	Co-founder	ACB	2012
Nguyen Thi Huong Gian	Vice-CEO	SeaBank	2012
Huynh Thi Huyen Nhu	Deputy Division Chief	VietinBank	2012

Another persistent challenge is habitual practices of using a large portion of short-term funds to provide long-term credit, causing mismatch risk and adversely affecting asset-liability management (ALM) equations. The ratio changed for SOCBs over time from 21.5% (2012) to 25% (2014) and 34% (2016); and for JSCBs: 18%, 21%, 37%, respectively. The issue appears to worsen even though the size of the banking system has increased significantly. Thus a structural issue remains structural!

In reality, realizations of the risks mentioned above are reflected through the imminent problem of non-performing loans (NPL) within VFS. Official bad debt ratio—provided in Fig. 25—is usually regarded by experts as well below international standards, triggering disagreements even among concerned authorities.

Figure 25. VFS's bad debt ratio



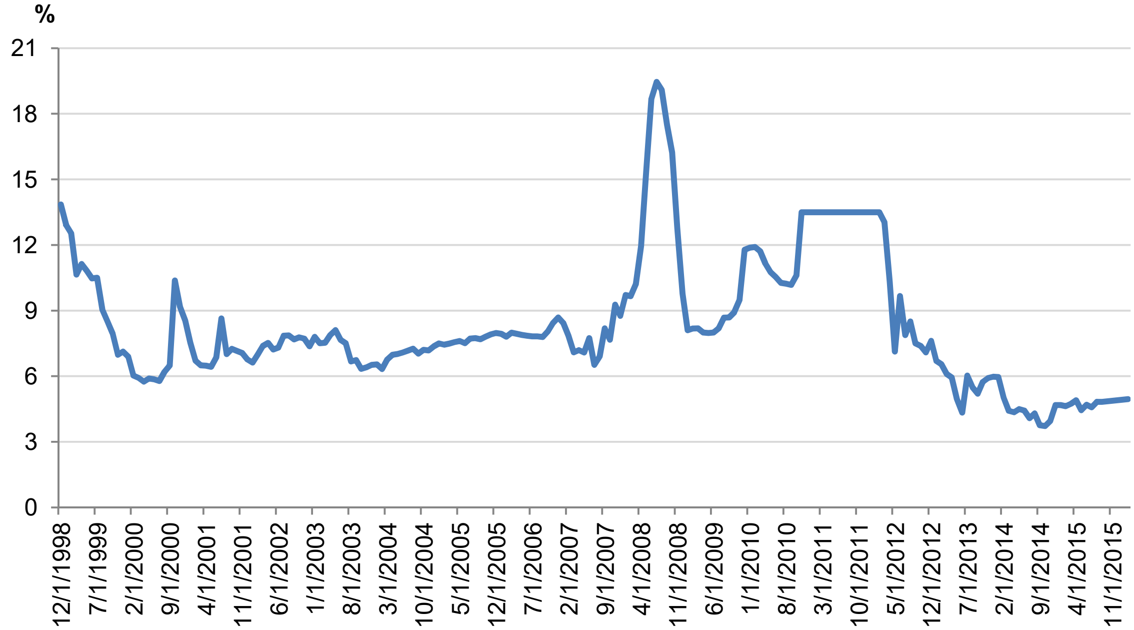
Source: SBV reports

The creation of VAMC and its questionable credibility show how serious the problem of bad debts is. Without an essential solution, this deeply rooted problem would further increase risk appetite by the rich firms, especially those in speculative assets markets. Needless to say, the information asymmetry problem, nested in banks' cross-holding of banks' equity, would make the risk skyrocket (Pincus, 2015).

Facing these issues, recent positive signs of the banking system such as a lower Lending-to-Deposit Ratio (LDR) of around 80% during 2014-2016, and positive growth rate of deposits at banks may serve as the system's pain reliever for some time. However, the signs may, unfortunately, reflect the truth of a lower capacity to consume finance within the productive sector and society's liquidity preference, even though interest-earning capacity decreases.

Fig. 24 shows that over the past decades, commercial lending rates in Vietnam have been constantly high, rarely below 10% p.a. Among banks, their interbank borrowings show wildly-fluctuating costs of the fund. And, each short period of lower costs of the fund was followed by a longer period with rate jumps (Fig. 26), evidence of liquidity-crunch and ALM-risk amplification. This phenomenon is a real threat to any large and long-term project as it makes financial calculations uncertain and risky.

Figure 26. 3-Month Interbank Rate



Data source: State Bank of Vietnam.

With the AEC coming into existence from December 31, 2015, new challenges also arrive. By 2015, ASEAN enterprises have registered a total FDI-capita stock of US$57 billion (2,700 projects), surpassing South Korea (US$45 billion/4,020 projects), Japan (US$38 billion/2,700 projects). Regional players are taking up the opportunity to strengthen their standing in VFS (Skully & Perera 2012). A typical example is Public Bank Berhad's swift move to close its 20-year-old VID Public Bank JV with BIDV to establish its locally-registered wholly-owned banking entity. That augurs for a coming competition, whose complexities and fierceness may not be fully appreciated by domestic FIs (Vuong 2016a).

Reform needs

It is generally agreed that financial reforms have to a large extent supported the transformation of Vietnam's economy (Kovsted, Rand & Tarp 2005; Bayraktar & Wang 2006; ADB 2014; WB 2014). And, persistent problems—as having been observed—are now putting pressure on VFS to renew reforms (Leung 2009; Tra & Riedel 2012).

#1: The structural problem of the financial sector will need to be addressed adequately, as the with fast-growing assets of the sector—now already 200% of Vietnam's GDP—all structural problems pertaining to its subsectors will be amplified, making the economy increasingly vulnerable to economic shocks (ADB 2014, 2015). Vietnam's financial deepening is quite high compared to the majority of lower middle-income countries. Although VFS openness improves access to financial services and the efficiency of financial intermediaries (Bayraktar & Wang 2006), its functions of reducing the cost of funds and stimulating capital accumulation/economic growth face serious limitations. Therefore, the opening of the sector does not suffice to address the structural problem, following evidence on VFS itself (Leung 2009; Nguyen & Nguyen 2009; Vuong 2010; Tra & Riedel 2012). Renewed reforms of the governance system based on rules of law and arm's-length transactions principle will have to be institutionalized (Malesky & Taussig 2009; Bhattacharya 2014; Pincus 2015). That means a departure from the existing system—primarily based on personal relationships, cronyism, and unchecked commercial interests—with cross-holdings of banks' equity as a manifestation (Sarath & Pham 2015).

#2: The clumsiness of local monetary policy in troubled times (Tra & Riedel 2012) is related to the complexity, and most probably the impossibility, of its multi-objective macro decision-making framework, thus a reform need is well beyond just fixing the "clumsy policy behavior" (Nguyen & Nguyen 2009; Nguyen, Cavoli & Wilson 2012; Kalra 2015). The two bouts of 2-digit inflation during 2008-2012 remind policymakers of the "impossible trinity" doctrine, in several variants (Das 2006; Grenville 2011).

The concept "reforming the reform" may be particularly useful as Vietnam's transitions would shortly enter unchartered waters of the unprecedented pace of regionalization and globalization (Stiglitz 2016). While complications and uncertainties prevail, the sociocultural system with its well-built mindset finds them uncomfortable to cope with (Yu 2008; Vuong & Napier 2015; Vuong, Vu, and Vuong 2016.). Public debts reaching the dangerous limit, vulnerable financial system, constantly constrained budgets coupled with large deficits will certainly put Vietnamese leadership at a serious stress test, where the dichotomy of policy choice is as simple as:

a) moving forward with reformist political economy principles; or,
b) moving backward to stricter control for the illusion of independence and autonomy bearing the immeasurable cost of foregone opportunities (Kokko 1998; Presbitero 2008; Volz 2013).

#3: The weaknesses that prevent the economy from attaining its optimal balance between growth and sustainability include:

a) inadequate speed of institutional reforms, macro institutions and entrepreneurial ecosystem included; and,
b) the lack of an autonomous central bank with effective policy-making and efficient set of policy implementation tools, which has the skills, rules, resources, and capabilities of balancing between stability-oriented interventions and profitable risk-taking (Carmen 2006; Kraay & Nehru 2006; Leung 2009; Volz 2013).

In the age of indebtedness and deficits, SBV's relative independence will even be more critical as compromising on the quality of policy-making will ultimately lead to uncontrollable risks and failures to plan even in the short run. As the monetary and capital markets have already been strongly connected and very sensitive even to a vague sign of failures (Bellocq & Silve 2008), monetary policy quality will have far-reaching effects—positive or negative—on the whole economy and its future. Toward such a reform, the value of increasing central bank's autonomy should ultimately be for public interests and national sustainable prosperity (Stiglitz 2016).

Analysts may have different views about Vietnam's financial economy, but all agree that it has evolved and grown fast over the past three decades in transition. The next course of development will depend on how Vietnamese society views *raison d'être* of VFS. Failure to support a sustained growth puts VFS's existence at risk as economic growth helps mitigate higher risk-taking behavior and contain instability in less competitive markets (Soedarmono, Machrouh & Tarazi 2011).

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Notes

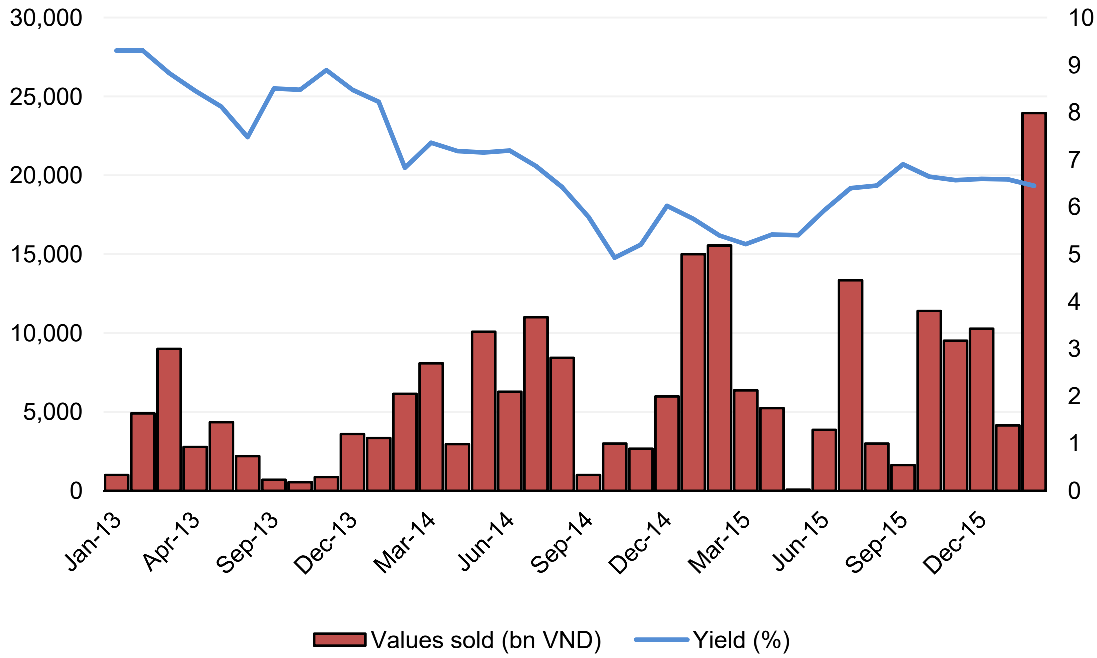
[1] Financials reported in US$ are for comparison while actual reporting of Vietnamese national accounts and market transactions is stipulated by laws to use the Vietnamese Dong (VND).
[2] ADB/ARIC <https://aric.adb.org/macroindicators/userdefined>, (accessed: 20/2/2016); WDI <http://data.worldbank.org/indicator/DT.DOD.DECT.CD>.
[3] ADB/NewsBrief (5/7/2012). <http://www.adb.org/news/briefs/viet-nam-microfinance-development-program>

Appendix

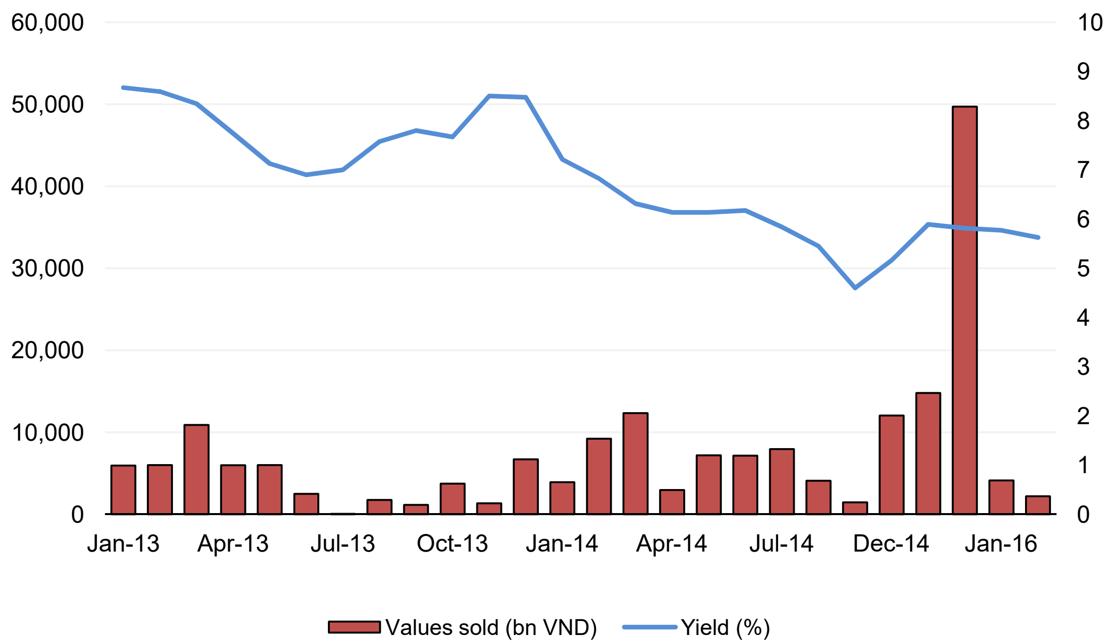
A1. Inflation and GDP Growth, 1986-2015

Year	Inflation (%)	GDP Growth (%)	Year	Inflation (%)	GDP Growth (%)	Year	Inflation (%)	GDP Growth (%)
1986	748.00	2.84	1996	4.50	9.34	2006	6.60	6.98
1987	223.00	3.63	1997	3.60	8.15	2007	12.60	7.13
1988	394.00	6.02	1998	9.20	5.77	2008	19.89	5.66
1989	34.70	4.68	1999	0.10	4.77	2009	6.52	5.40
1990	67.10	5.09	2000	-0.60	6.79	2010	11.75	6.42
1991	67.50	5.81	2001	0.80	6.89	2011	18.13	6.24
1992	17.50	8.70	2002	4.00	7.04	2012	6.81	5.25
1993	5.20	8.08	2003	3.00	7.24	2013	6.04	5.42
1994	14.40	8.83	2004	9.50	7.79	2014	1.84	5.98
1995	12.70	9.54	2005	8.40	7.55	2015	0.63	6.68

A2. 5-Year Government Bond Issues



A3. 3-Year government bond issues



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