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How bad is Vietnam's debt crisis?

ELISABETH ROSEN, contributing writer

A bank staff carries bundles of Vietnamese dong banknotes in Hanoi. © Reuters

HANOI -- The Vietnamese government could be close to approving the first-ever sale of a local bank to foreign buyers. The size of this deal would likely be negligible, but the deal would still go down as a major moment in the country's efforts to clean up Southeast Asia's most precarious banking sector.

According to reports in state-owned media, Singapore's United Overseas Bank wants to buy GP Bank, which is in such dire straits that the government is set to allow a takeover through new rules introduced in February. Strategic foreign investors can now own as much as 20% of banks that are deemed to be performing well, up from 15% before.

The relaxation in foreign ownership is part of a three-pronged approach to shore up capital at Vietnamese banks, which are struggling under non-performing loans amounting to 15% of total bank assets, according to Moody's Investors Service. The central bank has placed the figure at 9%, which is still high compared with most of Asia.

The other reforms are the establishment of Vietnam Asset Management Co. (VAMC) and a state-led consolidation of the banking sector.

VAMC has purchased around $2 billion in non-performing loans from around 35 banks so far. Local media reports say that VAMC plans to sell the first batch of bad debt in the third quarter.

Slow burnoff

This debt problem has in part been caused by the proliferation of loans from the real estate asset bubble of the late 2000s. Many banks relaxed their lending requirements and property buyers and developers were able to get credit easily. When the real estate sector froze in 2010, borrowers were unable to pay back their loans.

Another contributor has been the bailouts made to save inefficient state-owned enterprises.

Vinashin, a state-owned shipbuilder, almost collapsed in 2010 with billions of dollars of debt. Rather than letting Vinashin go bankrupt, the government transferred some of its loss-making projects to another state-run rival, Vinalines, despite it having similar debt issues. In 2012, Vinalines also nearly collapsed with about $3 billion in debt. Last December, the former chairman and the general director of Vinalines were sentenced to death for corruption.

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Like China, Vietnam's government has started letting state-owned enterprises fail. According to the Ministry of Finance, more than 400 state-owned enterprises declared bankruptcy or were dissolved in 2013. Agribank accounts for 25% of bad debts. Other banks with high ratios of non-performing loans include Asia Commercial Bank, Saigon Hanoi Commercial Joint Stock Bank and Military Commercial Joint Stock Bank.

Meanwhile, the debt that state-owned enterprises could not repay had to be supported by private sector

lenders who were charged higher interest rates by the banks.

This has resulted in slower growth, according to the founder of Vietnam Capital Partners, an advisory firm based in Ho Chi Minh City. Vietnam's gross domestic product growth reached a high of 8.46% in 2007, but is set for its seventh consecutive year of growth under 7%. The government expects the economy to grow 5.8% this year.

The government lowered the benchmark interest rate on May 18 from 5% to 4.5%, continuing a trend of rate cuts since commercial lending rates hit a high of around 15% in 2012.

The founder of Vietnam Capital Partners said that the reform of the banking sector was a slow plan rather than a one-off cleanup. "From a pure economics view, it's a bad approach because you're not punishing those who made the bad investments," he said. "But I think it's the right approach in the sense that it's not going to cause a lot of chaos."

Continued delays

Setting up asset management companies, or bad banks, to take over non-performing loans is common practice in Asia. China, for example, set up asset management companies in 1999 to take over toxic assets from the four major state-owned banks, which were all successfully listed on the stock market a few years later.

Chad Ovel, a partner at the private equity firm Mekong Capital, however, is worried that Vietnam's standards for categorizing loans are less exacting than other countries.

Ovel said Vietnam's central bank should be stricter in holding banks accountable for bad loans. While the central bank has set deadlines for banks to re-categorize loans in a way that adheres more closely to international standards, the implementation of these deadlines has been pushed back twice from the original date set for 2013.

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"They're trying to give banks a little more time to work through their bad credit portfolio and find solutions before they're forced to re-categorize," Ovel said. "But until the central bank puts their foot down and holds banks accountable, we're just going to see more delays."

The government is hoping to start a regulated market for trading bad debt in which foreign investors can participate, but Vo Tri Thanh, head of the Central Institute for Economic Management, said the legal framework for that was still a work in progress.

Ultimately, solving the bad debt crisis will create a new economic framework in a country long dominated by state-owned enterprises.

Private companies generally have very little debt and are seeing strong profit growth in contrast to the public sector, with high-tech companies, some of whom have foreign investors such as Intel and Samsung, performing especially well.

Ovel said that while there remains an overhang of the bad debt crisis that has been mostly linked with the state-owned sector, this has been counterbalanced by an extremely vibrant private sector that would continue to underpin economic growth.

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