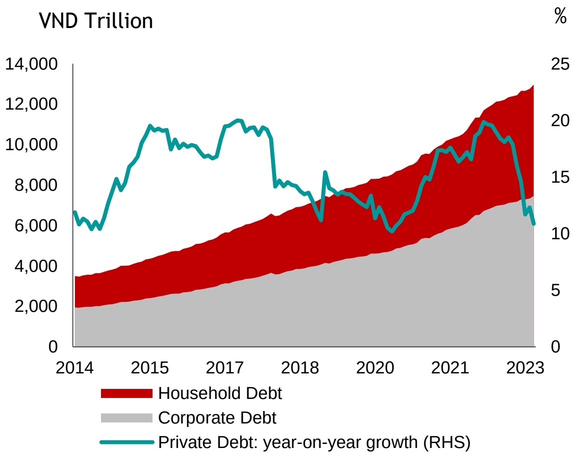
2. Vulnerabilities in Corporate Debt Landscape[52]

1. **Corporate debt in Vietnam has steadily increased over the past few years.** Debt held by companies is estimated to be three to four times what it was a decade ago (Figure 2.1). Compared with GDP, corporate debt has also risen in the same period (Figure 2.2). Vietnam's corporate debt-to-GDP ratio in 2022 is found to be high relative to peers with similar economic development in the ASEAN+3 region (Figure 2.3). The low interest rate environment and increased opportunities in a fast-growing economy could have led to more corporate debt.

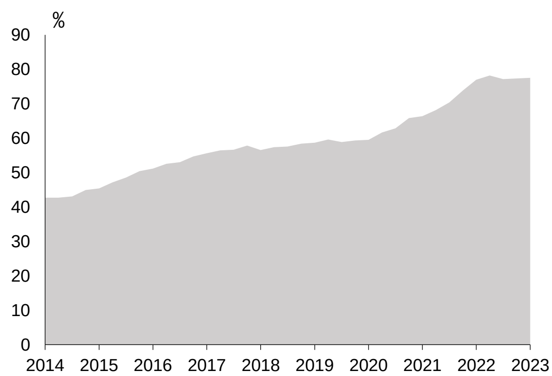
2. **The current selected issue assesses the nature of vulnerabilities in the corporate sector, as higher leverage is often associated with the risk of a financial crisis.** The nature and profile of corporate borrowers are examined using firm-level data from Moody's Orbis database. One caveat about the analysis is that the data quality, particularly of less readily available information about small and medium-sized enterprises (SMEs), would depend on the effectiveness of Moody's data gathering exercise. The Orbis dataset is compiled through local information providers, telephone research, company websites, newswires, private correspondence and other avenues, and the data availability and completeness vary by economy.

Figure 2.1. Outstanding Private Debt, 2014-23



Source: AsianBondsOnline; SBV; Haver Analytics; AMRO staff calculations
Note: Overall private-sector debt comes from both bank lending and bond financing. As the breakdown of corporate and household debt is not publicly available, this note gives an estimate. Out of all banking loans, 55 percent are assumed to be provided to corporations, based on information obtained from the annual reports of the largest banks in Vietnam. All bond financing is assumed to be channeled toward the corporate sector.

Figure 2.2. Corporate Debt-to-GDP Ratio, 2014-23



Source: AsianBondsOnline; SBV; Haver Analytics; AMRO staff calculations
Note: Corporate debt is based on AMRO's estimation, in line with Figure 1.

3. **In addition to debt exposure, borrowers' capacity to fulfill their debt obligations is evaluated using a commonly used solvency metric, the interest coverage ratio (ICR).** An ICR of less than 1.25 means that the company has speculative ratings, analogous to S&P's "CCC" rating and below (Domodaran 2016). This analysis is crucial, given that the COVID-19 pandemic may have lasting scarring effects on corporate-sector balance sheets. Furthermore, Vietnam's high dependence on trade makes the economy susceptible to external challenges, such as weakened demand and adjustments in the monetary policy

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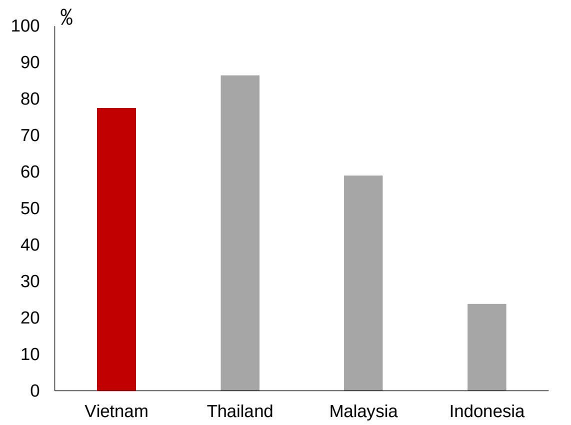
stance of major economies, as well as supply chain disruptions. Additionally, the country faces domestic downside risks related to the real estate market.

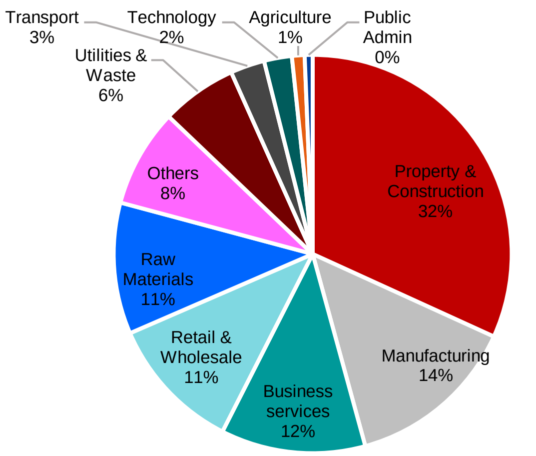
4. **Debt appears to be concentrated in certain sectors**. One-third of corporate debt is held by companies engaged in real estate development and construction, followed by manufacturing and business services (Figure 2.4). Notably, property-related companies experienced a liquidity crisis during the pandemic (Barnes 2023). Corporate debt could be largely accumulated by the bigger firms, which are categorized as "Listed" or "Unlisted-Other" in the note. While SMEs do receive credit, of about 35 percent of overall corporate debt (Figure 2.5), the share is less than proportionate to the 96 percent by firm count in the economy (OECD 2021). The lack of accounting transparency and inadequate pledging of collateral are commonly cited as reasons for the insufficient financing access.

Figure 2.3. Corporate Debt-to-GDP Ratio by Economy, 2022



Sources: AsianBondsOnline; SBV; Haver Analytics; and AMRO staff calculations.
Note: The corporate debt-to-GDP for Vietnam is an estimation, in line with Figure 1.

Figure 2.4. Corporate Debt by Sector, 2022



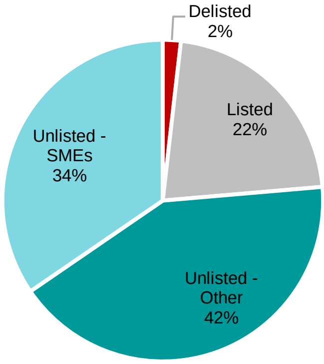
Sources: Orbis of Moody's Analytics; and AMRO staff calculations.

5. **A single distressed listed firm could be of concern.** While less than 10 percent of listed firms are expected to be vulnerable in terms of their cash buffers (Figure 2.6), spillover risks, if any, could be pronounced (Figure 2.7). It might also be worrying that the share of at-risk listed firms appears to have increased in the past year, while the share of unlisted firms has remained quite constant (Figure 2.8). However, a blessing in disguise is that the listed firms' debt mostly resides in sectors that are less risky or assessed to have rather adequate cash buffers in place (Figures 2.9, 2.10).

6. **In comparison, SMEs might be riskier individually but are less likely to pose systemic risk**. Almost 80 percent of SMEs could encounter difficulties in using their profits to service their debts, the highest percentage among firm types (Figure 2.6). When their full cash reserves are considered, assuming no haircuts or currency adjustments, the share of at-risk SMEs decreases significantly, but almost half remain at risk. Smaller companies often contend with technology and skilled labor deficiencies, along with challenges in achieving economies of scale (Yoshino and Taghizadeh-Hesary 2016), leading to lower profitability and ICRs. Additionally, SMEs typically exhibit lower transparency and weaker corporate governance compared to their listed counterparts. That said, among the various types of firms, the potential for spillover risks in the event of a single or a few SME insolvencies is expected to be negligible

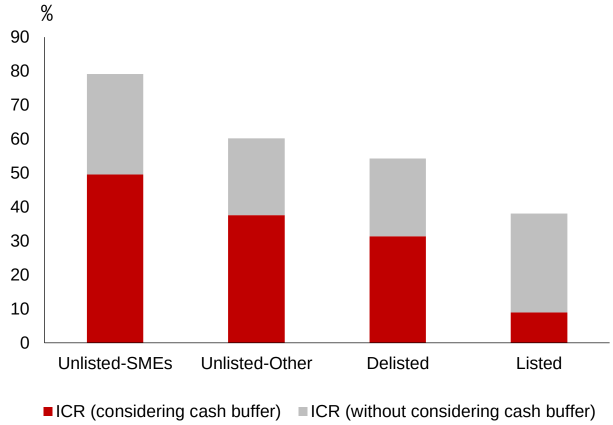
(Figure 2.7), though their collective inability to service debt could affect upstream and downstream counterparts.

Figure 2.5. Corporate Debt by Firm Type, 2022



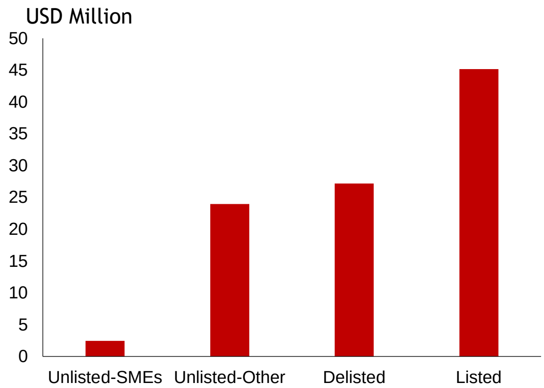
Source: Orbis of Moody's Analytics; SBV; AMRO staff calculations
Note: The estimated share of unlisted SMEs is derived from the share of SME loans announced by the SBV (SBV 2023a).

Figure 2.6. Debt at Risk by Firm Type, 2022



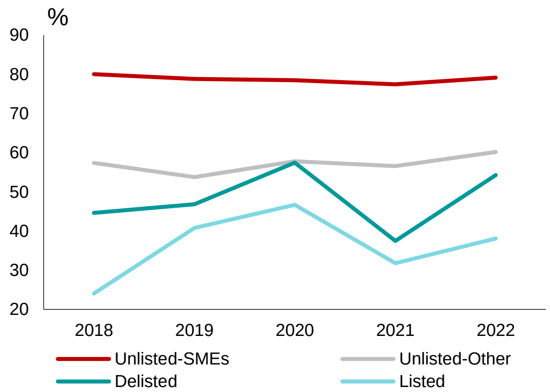
Source: Orbis of Moody's Analytics; AMRO staff calculations
Note: A company with an ICR of less than 1.25 is identified to be at risk.

Figure 2.7. Average Debt per Borrower by Firm Type, 2022



Source: Orbis of Moody's Analytics; AMRO staff calculations

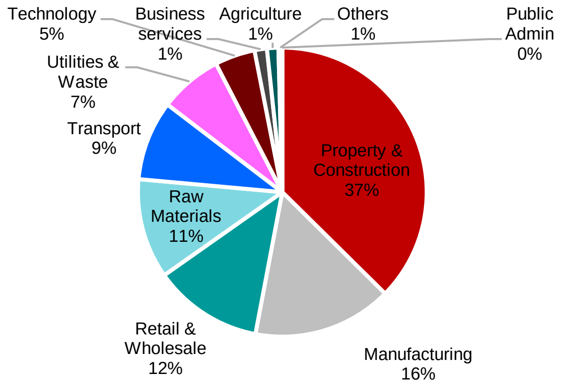
Figure 2.8. Share of Debt at Risk by Firm Type, 2018-22



Source: Orbis of Moody's Analytics; AMRO staff calculations
Note: A company with an ICR of less than 1.25 is identified to be at risk.

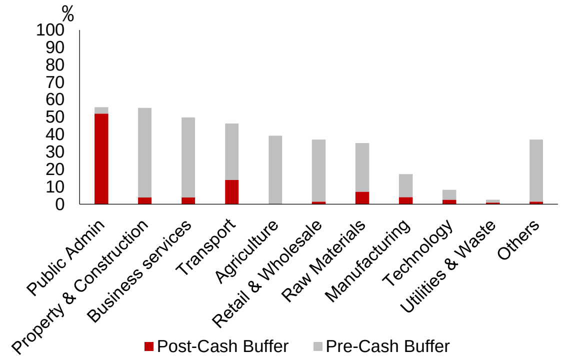
7. **That said, boosting the resilience of unlisted firms as a whole remains a top priority, in particular considering the higher concentration of such firms in riskier segments.** SME debt is heavily concentrated in the property and business sectors, which have lower ICRs and higher risk profiles than their counterparts (Figures 2.11, 2.12). Moreover, while the debt of manufacturing and raw material firms among unlisted entities appears less vulnerable, business service firms, the next major category, face significant risk (Figures 2.13, 2.14). Reducing costs for these firms can assist in bolstering profits, thereby reinforcing their resilience. One way to achieve this could be to lower borrowing costs by simplifying procedures for interest rate support applications and strengthening credit guarantee funds. Such efforts could also lessen the need for physical collateral, which is a challenge to unlisted smaller firms. In addition, state-owned commercial and social policy banks could play a role by maintaining ample capital reserves to facilitate easier financing for unlisted firms.

Figure 2.9. Listed Firm Debt by Sector, 2022



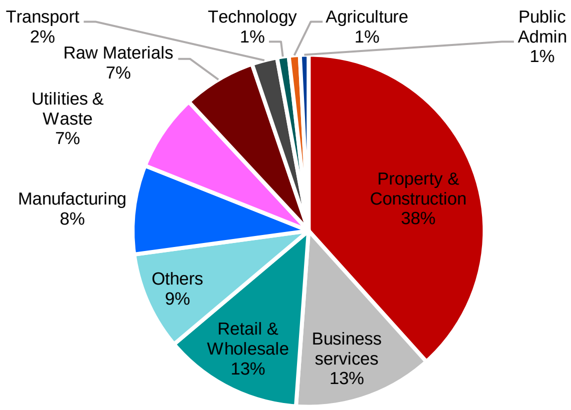
Source: Orbis of Moody's Analytics; AMRO staff calculations

Figure 2.10. Listed Firm Debt at Risk by Sector, 2022



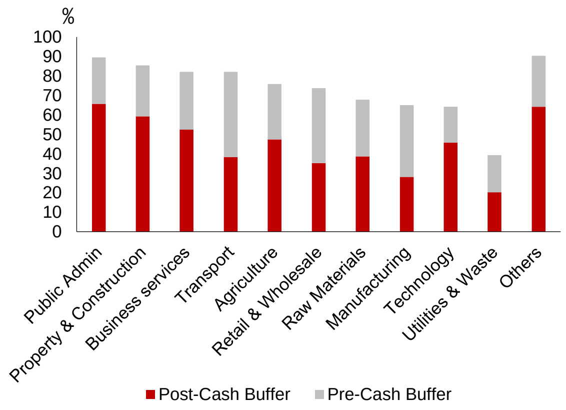
Source: Orbis of Moody's Analytics; AMRO staff calculations
Note: A company with an ICR of less than 1.25 is identified to be at risk.

Figure 2.11. SME Debt by Sector, 2022



Source: Orbis of Moody's Analytics; AMRO staff calculations

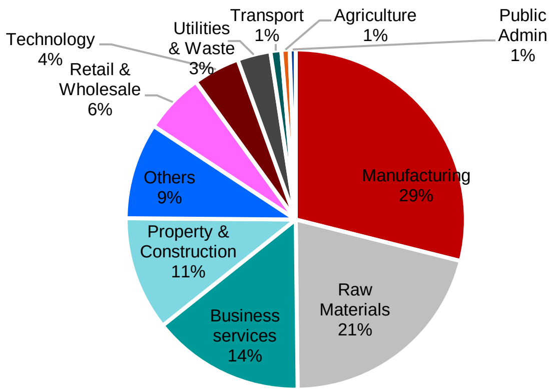
Figure 2.12. SME Debt at Risk by Sector, 2022



Source: Orbis of Moody's Analytics; AMRO staff calculations
Note: A company with an ICR of less than 1.25 is identified to be at risk.

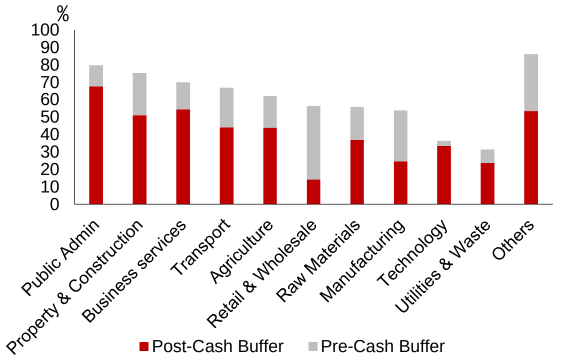
8. **While bank loans remain the primary source of corporate financing, it is essential to recognize the close connection between bond financing and bank lending.** In the past decade, corporate debt in the form of bonds as a share of total corporate debt more than doubled (Figure 2.15). The growth in bond issuances typically outpaced the expansion of bank financing, a trend particularly pronounced during the pandemic (Figure 2.16). The escalation in bond issuances could be attributed in part to a tightening of bank lending standards and stronger demand associated with investors' searching for yield in the low interest rate environment. It is worth recognizing that most of the investors in the bond market are domestic financial institutions, including the banks (AMRO 2022). Besides the direct relationship, there are also indirect ties between bond financing and bank lending. For instance, the bond market's confidence suffered in 2022 due to disorderly market conduct by some property developers (AMRO 2022), which subsequently raised concerns about potential challenges for banks' borrowers to refinance and roll over debts as market liquidity dried up. Borrowers from certain market segments also found it more difficult to obtain financing from banks.

Figure 2.13. Unlisted Other Firm Debt by Sector, 2022



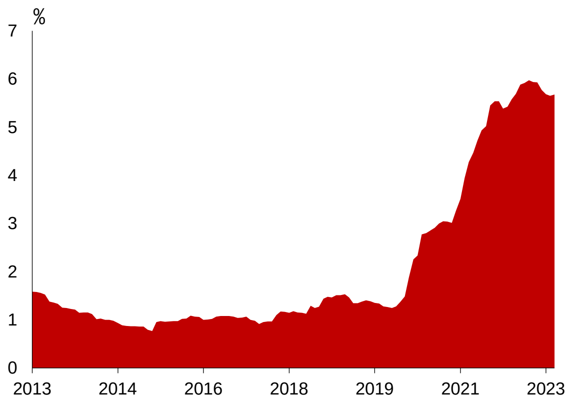
Source: Orbis of Moody's Analytics; AMRO staff calculations

Figure 2.14. Unlisted Other Firm Debt at Risk by Sector, 2022



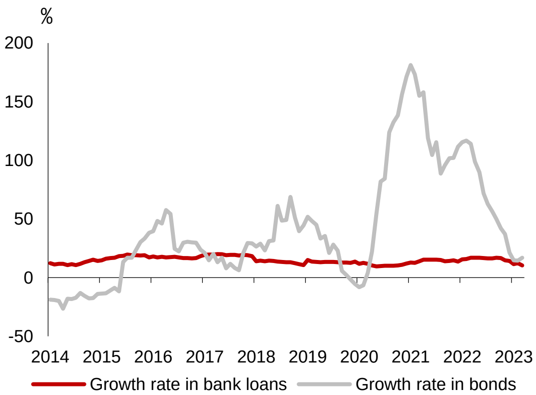
Source: Orbis of Moody's Analytics; AMRO staff calculations
Note: A company with an ICR of less than 1.25 is identified to be at risk.

Figure 2.15. Share of Corporate Debt in the Form of Bonds, 2013-23



Source: AsianBondsOnline; SBV; Haver Analytics; AMRO staff calculations
Note: Corporate debt (denominator) is based on AMRO's estimation, in line with Figure 1.

Figure 2.16. Growth in Different Corporate Debt, 2020-23



Source: AsianBondsOnline; SBV; Haver Analytics; AMRO staff calculations
Note: The growth rate of bank loans encompasses loans that banks have provided to households, which may also be used for business purposes.

9. **The SBV has taken measures to moderate leverage and concentration risks associated with corporate debts**. First and foremost, the SBV has stepped up the appraisal and surveillance of loans, including those granted to the corporate sector (SBV 2018), especially since Vietnamese corporate debt continues to rise and remains high compared with its ASEAN+3 peers. Second, the central bank has directed banks to reduce credit in risky sectors (SBV 2023b), which will help the banking sector to diversify its lending and reduce concentration risks. This is particularly important given the substantial share of loans extended to property developers. Third, the government has issued Decree 65/2022/ND-CP in an effort to develop a more transparent bond market (Vietnam Bond Market 2022). Greater transparency in corporate balance sheets, aided by credit rating agencies, would enable banks and bond market investors to make more informed decisions.

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