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Sector & Company Insights
Impact of Circular No. 06/2016/TT-NHNN

BSC RESEARCH

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On 27th, May 2016, SBV has officially promulgated Circular 06/2016/TT-NHNN (Circular 06) amending and supplementing a number of articles of Circular 36/2014/TT-NHNN (Circular 36), stipulating prudent ratios in operations of credit institutions and branches of foreign banks.

Significant changes in Circular 06 (see Appendix 01)

- Raise the risk index of receivable lending for real estate from 150% to 200% from Jan 1, 2017, lower than the cap of 250% proposed in the draft amendment to Circular 36.
- Create a roadmap to reduce the maximum ratio of short-term funds used for medium and long-term loans from 60% to 50% in 2017 and to 40% from Jan 1, 2018. Draft amendment to Circular 36 in Feb 2016 required this ratio to be 40%.
- Increase the ratio of purchased, invested G-bonds to average short-term funds of the previous month, with the maximum ratio increases from 15% to 25% for State-owned for commercial banks (SOCBs) and to 35% for foreign bank branches. Draft amendment to Circular 36 raised this ratio from 15% to 35% for foreign bank branches (no increase for SOCBs).
- Add a provision of "Lending and discount of valuable papers for customer to entrust with the task of trading and investing in stocks" inside the categories defined in "Granting credit for securities trading", the same with the draft amendment to Circular 36.

Potential effects of Circular 06 to Vietnam's economy:

In comparison with Circular 36, Circular 06 tightened provisions on medium and long-term loans, loans for commercial real estate and securities. However, compared to harsh provisions in the draft amendment and supplement to Circular 36, Circular 06 displays the neutralization between the aim of tightening risky loans, purifying banking system and the aim of economic growth, lending rate stabilization.

Circular 06 has some positive aspects compared to Draft amendment to Circular 36. The requirements are looser. Roadmap for implementation is lengthened by 6-18 months. More room for credit growth, especially real estate credit, lower pressure to increase interest rate will have more positive impact on performance of banks as well as companies in real estate and related industries, and on the stock market than expected.

- **Interest rate**. Pressure to increase interest rate is not high in short term. In the long-term, lending rate will sustain upward pressure and this may affect cost of capital, reduce demand for investment as well as consumption.
- **Credit.** More room for growth, compared to Circular 36 draft amendment and supplement.
- **Purification of banking activities:** Stabilize liquidity and improve transparency of bad debts.
- **Performance of firms,** including banks will take more benefit than stipulated in Circular 36 draft amendment and supplement.
- **Cash flows into stock market may decline,** although this was already anticipated from Circular 36 draft amendment and supplement.
- **Bond market - Positive:** Increase ratio of purchased, invested G-bonds to average short-term funds of previous month from 15% to 25% for SOCBs and from 15% to 35% for foreign bank branches.

1. Impact of Circular No. 06 on the economy

With the aim of stabilizing and purifying banking activities, SBV has taken comments on Circular 36 draft amendment and supplement, and recently, has promulgated Circular 06. Several long-term positive effects of Circular 06:

- Consolidate liquidity of banks, the prerequisite for stabilization of banking system in the long-term. Medium and long-term credit continually grew since 2013 (43,1% in 2013, 45,4% in 2014 and 29% in 2015). Medium and long-term outstanding loans account for 40-65% total outstanding loans of banks. Up to December 31, 2015, the ratio of short-term funds used for medium and long-term loans is 36,9% at Joint stock commercial banks (JSCBs) and 33,36% at SOCBs (BID, CTG and VCB). The provision for decreasing the ratio of short-term funds used for medium and long-term loans will limit the imbalance in uses of funds, maintain solvency of banks. Banks with high ratio like SHB, EIB will have to rebalance their sources and uses of funds in order to meet the requirements of authorities.
- Improve transparency of bad debts status. Tighter regulation for medium and long-term loans reveal and overdue loans and NPLs sooner. Therefore, ratios of overdue loans and non-performing loans of credit institutions are more accurately. However, this also increases the risk provisions burden for credit institutions. Compared to Circular 36 draft amendment and supplement, the ratio of short-term funds used for medium and long-term loans is higher, so the pressure of setting up of risk provisions for potential bad debts is lower than expected.

Compared to Circular 36 draft amendment and supplement, Circular 06 eases and specifies a roadmap for tightening capital adequacy ratio (CAR), brought some positive effects in the short-term, such as stabilizing interest rate, opening more rooms for credit growth of commercial banks, especially real estate loans. These will bring positively affect on the stock market and the economy through two following factors:

- Reduce pressure to increase interest rate

Banks often raise short-term deposit (accounts for about 70%-85% of capital structure), while dirburse medium and long-term loans (accounts for 40-65% total loans). SBV's decrease of the ratio of short-term funds used for medium and long-term loans will force banks to rebalance their deposits and loans maturity through: (1) attract long-maturity deposits (increase demand for long-term funds); or (2) reduce medium and long-term loans (reduce supply of long-term loans). Both methods will increase market interest rates. Higher interest rate will increase interest expenses, thus negatively affect businesses profit, especially firms with high financial leverage. Simultaneously, increasing interest rate will reduce demand for credit of the economy, reduce new investments, thus will constrain the recovery of the economy.

We realize that, even when SBV took comments on draft amendment and supplement to Circular 36, commercial banks had been gradually restructuring their sources of funds to meet the requirements of the draft, to reduce the ratio of short-term funds used for medium and long-term loans to 40%. Evidently, since the beginning of March 2016, deposit rate, especially rates of 24 month-maturity and 36 month-maturity of many banks such as EIB, OCB, Viet A bank, etc had increased to 8-8,3%.

Circular 06 reduce the ratio of short-term funds used for medium and long-term loans from the maximum level of 60% to 50% in 2017 and to 40% from Jan 1, 2018. Therefore, compared to Circular 36 draft amendments and supplements, Circular 06 specify a roadmap of 18 months, creating time for banks to restructure their funds and loans, avoiding short-term shocks, thus reduce the pressure to increase interest rate. Right before the promulgation of Circular 06, as liquidity is improved, many private JSCBs proactively reduce their deposit rates by 0,1% on average.

Ratio of short-term funds used for medium and long-term loans of listed JSCBs in 2015[1]

Banks	Ratio/ Min-max
SHB	32%
EIB	49%
BID	38%
ACB	20-41%
STB	32-36%
NVB	32-35%
VCB	18%
MBB	7-28%
CTG	15-25%

Source: BSC research

- Opening rooms for credit growth

In the first 5 months of 2016, credit growth has been slowing down. Credit of entire banking system at the end of April had grown by 4% from the beginning of the year, but up to mid-May, credit growth dropped to 3,8%. This may come from the impact of Circular 36 draft amendment and supplement, as commercial banks reduce real estate loans and tighten medium and long-term sources of funds. We suppose that, eased requirements and the roadmap mentioned in Circular 06, will facilitate banks' credit funds in the last months of 2016. Circular 06 does not only create a roadmap to reduce the maximum ratio of short-term funds used for medium and long-term loans to 40% from Jan 1, 2018, but also adjust the risk index of receivable lending for real estate from 150% to 200% from Jan 1, 2017 (lower than the proposed cap of 250% in Circular 36 draft amendment and supplement).

We evaluate that, adjustment of risk index of receivable lending for real estate less than in Circular 36 draft amendment and supplement will unleash the flows of bank credit. Because (1) tightening the credit flows into real estate will indirectly affect construction and material industries. Lending to commercial real estate and construction was VND 934 thousand billion (of which, VND 478 thousand billion of real estate loans, VND 456 thousand billion of construction loans), constitutes 20% of total outstanding loans of the economy at the end of 2015. Growth rate in commercial real estate loans was high, continually growing sharply since 2012, by 14% in 2012, by 15,4% in 2013, by 19,3% in 2014 and by 26% in 2015. (2) Ease the ratio of short-term funds used for medium and long-term loans will expand the sources of funds to disburse for banks due to the characteristic of banks, which is short-term deposits and long maturity loans. However, we evaluate that the credit growth affected by this ease is insignificant because the 6-18 months period is quite short to medium and long-term loans.

Capital adequacy ratio of listed banks

	VCB	CTG	BID	MBB	ACB	STB	SHB	EIB	NVB
CAR	10.70%	10.60%	9.81%	12.85%	12.80%	9.87*	11.40%	16.52%	11.08%

Source: VCB, CTG, BID, MBB ACB, STB, EIB, NVB
**: Data of 2014*

[1] BSC estimates. The maximum value corresponds to the case that banks have no valuable papers used in the transactions with. The minimum value corresponds to the case that balance of valuable papers equal the smallest value between (a) G-bonds, G-bills, SBV-bills, papers are guaranteed by Government and (b) the value of investment securities with a term of over 1 year excluding VAMC bonds' value.

We note that, compared with Circular 36, provisions in Circular 06 are still tighter. Banks having high ratio of short-term funds used for medium and long-term loans like SHB, EIB should rebalance their sources of funds and loans to maintain the safety ratio. Increasing risk index of loans for commercial real estate from 150% to 200% will reduce CAR of Vietnamese banks, especially in the context that banks have to increase capital to meet Basel II requirements. Hence, banks will be more conservative in approval of loans for commercial real estate, especially banks having CAR of near 9%. CAR of the entire credit institutions system is 12,67%, in which, SOCBs' (including BID, CTG, VCB) is 9.27%, JSCBs' is 12.22% at the end of March 2016. Credit and income growth rate of some listed banks might slow down due to high proportion of loans to commercial real estate and construction. We do not evaluate this as a major risk, because this has been partially anticipated from Circular 36 draft amendment and supplement.

Proportion of real estate and construction loans of listed banks

Banks	Commercial real estate	Construction	Growth in real estate and construction loans (yoy)
NVB		38%	109%
SHB	7%	15%	23%
CTG	8%	11%	56%
BID	7%	11%	5%
STB*	13%	N/A	16%
MBB	9%	4%	17%
EIB	N/A	6%	-30%
ACB	2%	4%	22%
VCB	N/A	6%	30%

*(Source: Consolidated FS of banks, *: Consolidated FS Q2/2015)*

2. Evaluate the impact of Circular 06 to the stock market

G-bond market will be more active in the future. Ability to raise capital from issuance of G-bonds is increased. 75% of G-bond value is absorbed by banks. Increasing ratio of short-term funds used for purchasing G-bonds from 15% to 25% for SOCBs and from 15% to 35% for foreign bank branches adds rooms in the G-bond market, increase demand for G-bonds. This helps reduce the impact of increasing medium and long-term interest rate due to harsher requirements on safety ratios of banks. We suppose that, SOCBs hold almost G-bonds while foreign banks and foreign bank branches only trade for approximately 7-11% of trading value in the secondary market.

Stock market. Secondary market is predicted to become more active, supporting listed companies' capital raising. Cash flows to stock market might be more limited, however, we evaluate that the impact of Circular 06 on the stock market has been already reflected in the market when SBV announced draft amendment and supplement to Circular 36. Therefore, we believe that the risk level and its impact on the market are not disturbing.

Cash flows into market may decline. (1) As analyzed above, rising interest rate reduces the returns on stock investments, thus, will negative affect cash flows into stock market. (2) Adding "Lending and discount of valuable papers for customer to entrust with task of trading and investing in stocks", inside the categories defined in "Granting credit for securities trading". As stipulated in Circular 36, "The aggregate balances of all loans of commercial banks, foreign bank branches granted to finance the investment in shares may not exceed 5% of the charter capital of the institutions". Adding borrowers for share trading and investment will shrink the total outstanding loans for 8 groups of borrowers for share trading and investment under the provisions of Circular 36, thus will reduce the cash flows into stock market.

Secondary market will become more active. Tightening of loans to commercial real estate companies and construction companies might force companies who have high capital needs and good projects to seek new financing sources such as issuing shares in the secondary market.

Affected sectors. As we analyzed above, most of negative impact of Circular 06 on the economy, banks and real estate has been shown in draft amendment and supplement to Circular 36, and partially reflected through recent activities of businesses. Circular 06 with easing conditions and 6-18 months roadmap will support growth of economy, banks, real estate, and reduce the cost of capital for most firms. Several sectors that will benefit from changes in Circular 06, as we evaluate, are banks, real estate, construction and construction materials, at least in the short-term.

- Banks. Growth in income of banks may slightly decline due to (1) slower credit growth; (2) NIM drops due to higher deposit rate while SBV lending rates to be kept at low level and possibly reduced by 0,5-1%; (3) increasing risk provisions. Simultaneously, demand for increase of stockholders' equity to offset the declining CAR due to higher risk index of loans for commercial real estate. However, with the relaxation of implementation time for safety ratios in the activities of credit institutions according to Circular 06, banks will have more sources for medium and long-term lending, pressure to increase interest rate and risk provisions is reduced, thus income of banks will be less exposed to short-term pressure.
- Real estate. We divide real estate companies into two groups, residential real estate and industrial real estate. (1) Circular 06 limits the credit provided to projects and investment property (accounts for 20-30% aggregate demand for real estate). This might reduce real estate inventory consumption rate and housing price in the long-term. (2) Meanwhile, Circular 06 does not cause many negative effects on demand for land lease at industrial zones, because these businesses are not heavily dependent on bank loans, main customers are FDI companies who bring stable source of income and usually pay advances of 15-20% contract value (used for infrastructure).

  We note that, such effects on real estate has been anticipated, and Circular 06's loosening of provisions related to real estate loans will have positive impact on credit growth in this field, at least in the short-term, hence, revenue and income of real estate companies are expected to be higher while inventory decreases.
- Construction and construction materials, is indirectly exposed to Circular 06 because these are two industries that are strongly related to demand for real estate projects. We believe that the negative impact will be less than that on real estate companies. Lower pressure will bring better prospect for growth to construction and materials companies. This impact will be more clearly on housing, office, trade center construction companies, and construction materials companies that have high proportion of sales to buildings.

Appendix 01: Some significant changes in Circular 06 compared to Circular 36/2014/TT-NHNN and Circular 36 draft amendment and supplement

<table>
<tr><th>No</th><th>Circular 36</th><th>Circular 36 Draft amendment and supplement</th><th>Circular 06/2016/TT-NHNN</th></tr>
<tr><td>1</td><td>Appendix II.
Risk index of receivable for commercial real estate is 150%</td><td>Appendix II.
Risk index of receivable for commercial real estate is 250%</td><td>Appendix II.
Risk index of receivable for commercial real estate is 200% from 01/01/2017</td></tr>
<tr><td>2</td><td>Clause 5 Article 17:
5. Credit institutions, branches of foreign banks are allowed to use short-term funds for medium and long-term loans with the maximum ratio as following:

a) Commercial banks: 60%;
b) Branches of foreign banks: 60%;
c) Non-bank credit institutions: 200%;
d) Co-operative bank: 60%.</td><td>Clause 14 Article 1:
Amend and supplement Clause 5 Article 17 as following:
“5. Credit institutions, branches of foreign banks are allowed to use short-term funds for medium and long-term loans with the maximum ratio as following:
a) Commercial banks: 40%;
b) Branches of foreign banks: 40%;
c) Non-bank credit institutions: 80%;
d) Co-operative bank: 40%”</td><td>Clause 17 Article 1:
Credit institutions, branches of foreign banks are allowed to use short-term funds for medium and long-term loans with the maximum ratio and the roadmap as following:
<table>
<tr><th>Type of credit institutions</th><th>01/07/2016-31/12/2016</th><th>01/01/2017-31/12/2017</th><th>Từ 01/01/2018</th></tr>
<tr><td>Commercial banks</td><td>60%</td><td>50%</td><td>40%</td></tr>
<tr><td>Branches of foreign banks</td><td>60%</td><td>50%</td><td>40%</td></tr>
<tr><td>Non-bank credit institutions</td><td>100%</td><td>90%</td><td>80%</td></tr>
<tr><td>Co-operative bank</td><td>60%</td><td>50%</td><td>40%</td></tr>
</table></td></tr>
<tr><td>3</td><td>Clause 6 Article 17:
6. Credit institutions, branches of foreign banks are allowed to purchase, invest Government bonds (including entrustment to other organizations of purchasing and investing G-bonds, but not including purchase and investment of G-bonds by funds entrusted by other organizations) with the maximum ratio to short-term funds as following:
a) State-owned commercial banks: 15%;
b) Joint stock commercial banks, joint venture banks, wholly foreign-owned banks: 35%;
c) Branches of foreign bank: 15%;
d) Non-bank credit institutions: 5%;
đ) Co-operative bank: 40%.</td><td>Clause 15 Article 1:
Amend and supplement point c, đ of Clause 6 Article 17 :
“c) Branches of foreign bank: 35%;
đ) Co-operative bank: 35%”</td><td>Clause 18 Article 1:
Amend and supplement Clause 6 Article 17.
Credit institutions, branches of foreign banks are allowed to purchase, invest in Government bonds with the ratio to average short-term funds of the previous month as following:
a. Maximum ratio:
(i) State-owned commercial banks: 25%
(ii) JSCBs, joint venture banks, wholly foreign-owned banks: 35%
(iii) Branches of foreign bank: 35%
(iv) Non-bank credit institutions: 5%
(v) Co-operative bank: 35%
b. Balance of purchased G-bonds used to determine the maximum ratio provided at point a of this Clause includes all balance of G-bonds possessed by credit institutions, foreign bank branches, including entrustment to other organizations of purchasing and investing G-bonds, and not including purchase and investment of G-bonds by funds entrusted by individuals, organizations whom credit institutions, foreign bank branches do not bear the risk.
c. Short-term funds is determined as stipulated at Clause 4 of this Article;
d. Credit institutions, branches of foreign banks which do not have short-term funds are allowed to purchase, invest G-bonds with the maximum ratio as stipulated at point a of this Clause to charter capital or allocated capital.</td></tr>
<tr><td>4</td><td></td><td>Supplement point i Clause 18 Article 3:
“Lending and discount of valuable papers for customer to entrust organizations and individuals of share trading and investment”, inside the categories defined in “Granting credit for share trading and investment”.</td><td>Supplement point i Clause 18 Article 3:
“Lending and discount of valuable papers for customer to entrust organizations and individuals of share trading and investment”, inside the categories defined in “Granting credit for share trading and investment”.</td></tr>
<tr><td>5</td><td>Clause 5 Article 21 :
5. Credit institutions, branches of foreign banks (except financial firms and finance lease firm) must maintain the loan-to-deposit ratio as following:
a) State-owned commercial banks: 90%;
b) Co-operative bank: 80%;
c) Joint stock commercial banks, joint venture banks, wholly foreign-owned banks: 80%;
d) Branches of foreign bank: 90%;
For credit institutions, branches of foreign banks established within last 3 years, the Governor of the State Bank stipulates specific ratio that is different from ratios above for each credit institutions, branches of foreign banks.</td><td>Clause 17 Article 1:
Amend and supplement Clause 5 Article 21 as following:
“5. Credit institutions, branches of foreign banks (except financial firms and finance lease firm) must maintain the loan-to-deposit ratio as following:
a) State-owned commercial banks: 90%;
b) Joint stock commercial banks owned more than 50% charter capital by the State: 90%
c) Commercial banks (exceot commercial banks stipulated at point a and point b of this clause): 80%;
d) Branches of foreign bank: 90%
đ) Co-operative bank: 80%“</td><td>None</td></tr>
</table>

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