

The Flying Dutchman

Vietnam: Resilient and powered by locals

Free to View
Asia

- ◆ Vietnam's export story has turbo-charged the domestic stock market, which recently exceeded USD1bn a day in turnover
- ◆ The country also has a home-grown economic engine, driving a shift in the local market to Financials and Real Estate
- ◆ Potential EM inclusion creates buzz, but funds have already bought Vietnam stocks

Resilient story. Vietnamese earnings have been remarkably resilient in the past few years, growing even in 2020 when COVID-19 hit. EPS growth was 35% in 2021. And daily trading recently crossed the USD1bn mark, 10x the level two years ago, which makes it the second-most liquid market in ASEAN after Thailand.

Not just an export story. Vietnam does very well on education scores, leading to a well-educated and well-trained work force. That's allowed it to gain market share in export markets. It also has a home-grown economic engine, driving a shift in the composition of Vietnam's stock market away from Consumer Staples towards Financials and Real Estate, encouraging locals, who now dominate trading, to invest. Still, it's not without risks. A recent series of high-profile corporate arrests (*Reuters*, 29 April 2022) has rattled the market and helped push it into negative territory.

Potential EM Index inclusion. There is a lot of excitement about Vietnam's potential inclusion in EM indices, but many funds already have Vietnam on their radar. If the inclusion weight for Vietnam in EM Asia is 2%, inflows would be USD8-9bn. That is 1.4x the current allocation by foreign funds and close to eight days of trading.

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On a roll

- ◆ Vietnam's export story has fuelled growth in the domestic stock market...
- ◆ ...transforming the local index and allowing for highly resilient earnings growth.
- ◆ Potential EM inclusion is creating buzz but funds have already bought stocks

On a roll

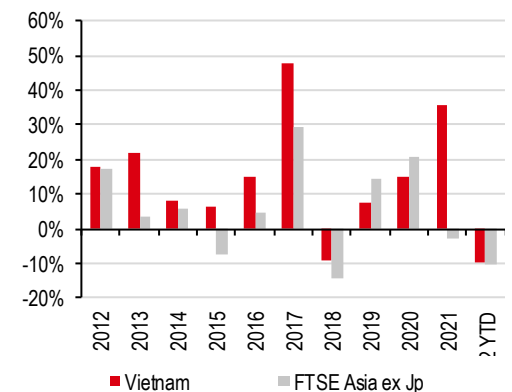
Vietnam has outperformed all the major regional indices in the last 10 years and the market has nearly quadrupled in size since the start of 2012, with trading recently exceeding USD1bn a day. There are good reasons for all this – amongst others, being able to eke out earnings growth during the global pandemic in 2020 when others markets faced a decline in profits. In 2021, the capitalization of the stock market surpassed USD350bn, exceeding 120% of the country's GDP.

Vietnam equities have broadly outperformed Asia ex-Japan in the last 10 years...



Source: Refinitiv Datastream, HSBC

...except in 2019 and 2020



Source: Refinitiv Datastream, HSBC

So far this year however, the Vietnamese market is down 10%, although that still means it is marginally a relative outperformer. The reasons for this muted performance lie not just in higher USD bond yields and lockdowns in China. A series of high-profile corporate arrests has also had an impact on sentiment ¹.

But the message is that when it comes to growth and profits, Vietnam has been on a roll.

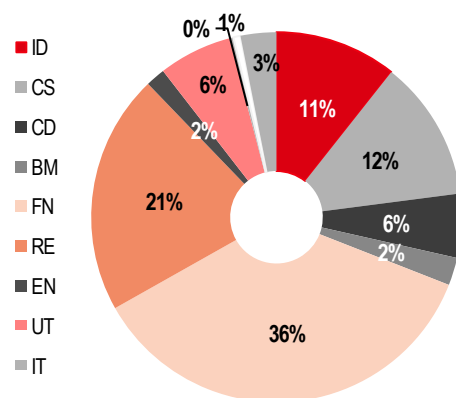
¹ "Vietnam's 'blazing furnace' crackdown burns \$40 bln off stocks' case" Reuters, 29 April 2022

And there is much to like about Vietnam's growth story – strong economic growth in the midst of a series of reforms that are underway, a strong currency with stable FX reserves, an economy that's well integrated in the global value chain and many Vietnamese companies benefiting from increasing infra spending and rising domestic consumption. But more about that later.

Big changes in the stock market

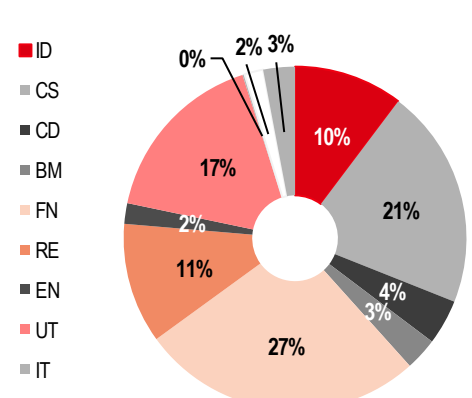
As people found employment in new factories dotted around the nation, they got a steady salary, higher wages and a bank account, credit card or mortgage. That's why the stock market saw a remarkable change in its make-up; while Consumer companies dominated in 2015, these days it is Financials and Real Estate that make up the largest portion in this market.

Financials and Real estate are c57% of the VNINDEX in 2022



ID = Industrials, CS = Consumer Staples, CD = Consumer Discretionary, BM = Basic Materials, FN = Financials, RE = Real Estate, EN = Energy, UT = Utilities, IT = Tech
 Source: Refinitiv Datastream, HSBC

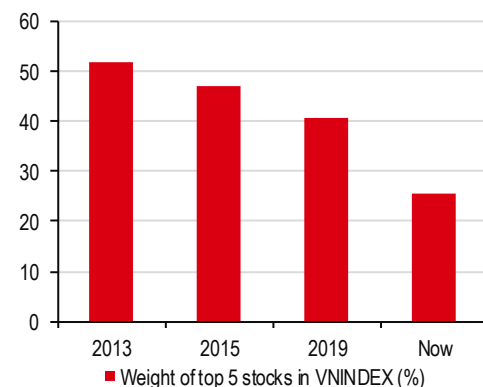
Consumer Staples and Financials were the largest sectors in 2015



ID = Industrials, CS = Consumer Staples, CD = Consumer Discretionary, BM = Basic Materials, FN = Financials, RE = Real Estate, EN = Energy, UT = Utilities, IT = Tech
 Source: Refinitiv Datastream, HSBC

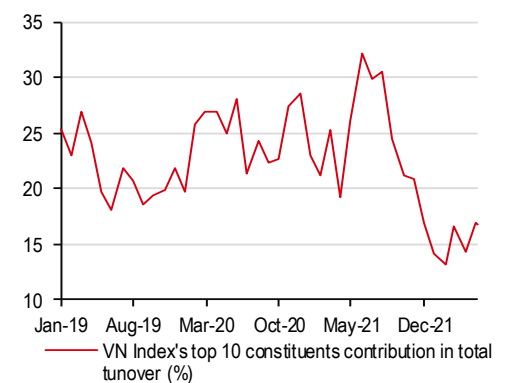
The stock market in Vietnam was in the past highly concentrated around a few large stocks. But those days are over too. In 2013, the top-5 accounted for 52% of total market cap; in 2022, it stands at 25%. The top-10 market caps now account for less than 20% of overall turnover. That is low.

Concentration of the top-5 stocks in total market cap has fallen significantly, from 52% in 2013 to 25% now...



Source: Refinitiv Datastream, HSBC

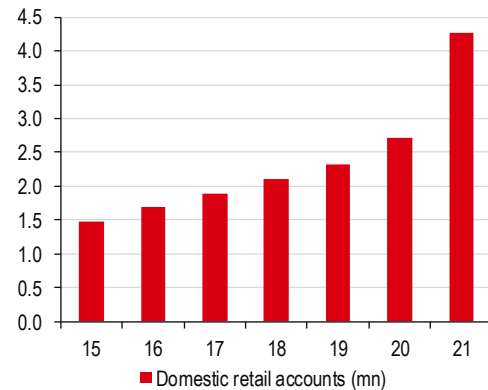
...and so has the proportion of liquidity in the overall market, with a rising focus on smaller caps



Source: Bloomberg, HSBC

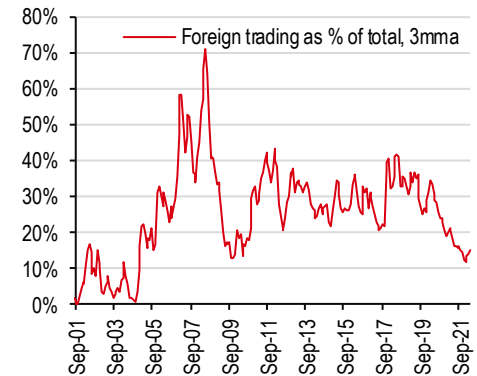
But contrary to what many believe, the investors that pushed this market higher were not foreign, but local. The stock market has seen a surge in retail investors and the number of retail accounts more than doubled between December 2018 and 2021.

In 2021, c1.5m new retail trading accounts were opened



Source: SSC Vietnam, HSBC

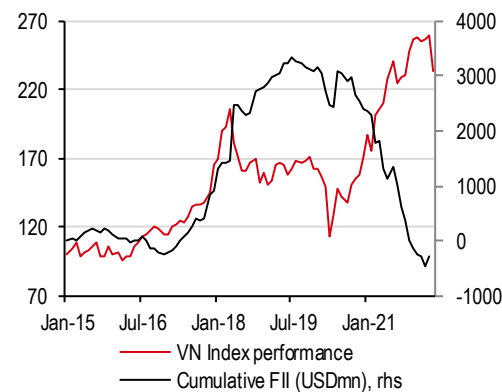
Foreign investor activity has fallen significantly since 2018



Source: CEIC, HSBC

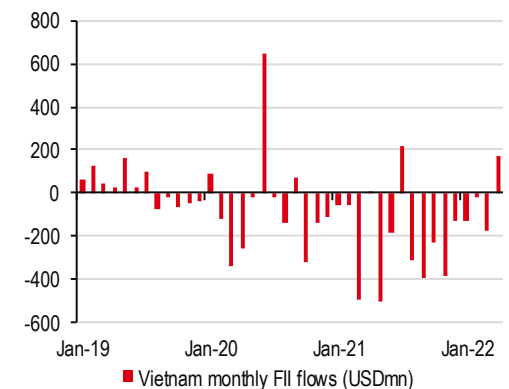
These local investors account for as much as 87% of all trading in the market, while foreigners make up the remaining c13%. In fact, as these retail investors came into the market, foreign investors withdrew (and that is still the case, at least in the last 27 of the last 33 months). In the past few weeks, foreign investors have started to dip their toes into this market again.

VN index reached a record high, but FIIs have seen net outflows since 2015 with record selling in 2022



Source: CEIC, HSBC

Foreign investors have maintained a net-selling strategy since August 2019

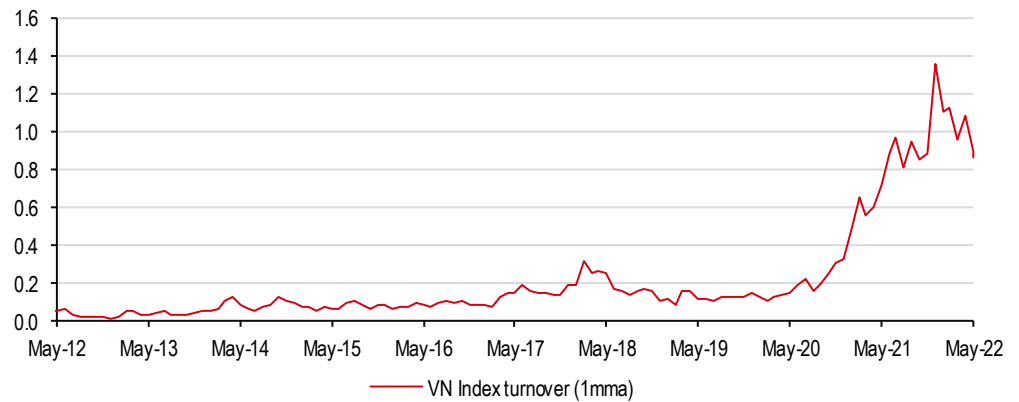


Source: Bloomberg, HSBC

Trading liquidity is up, a lot

The result of this influx of local investors has been a tenfold rise in the average daily turnover on the Ho Chi Minh Stock Exchange, which recently crossed the USD1bn mark. That is 10x the average of USD100m (in daily trading) seen in early 2020.

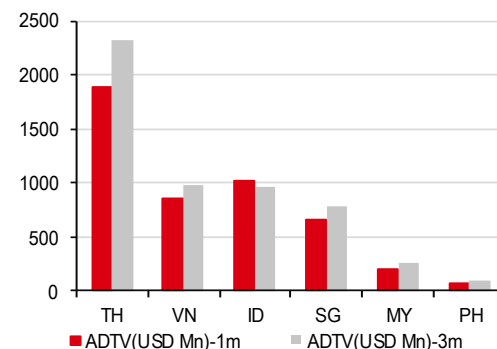
Turnover has grown ten-fold since 2020



Source: Bloomberg, HSBC

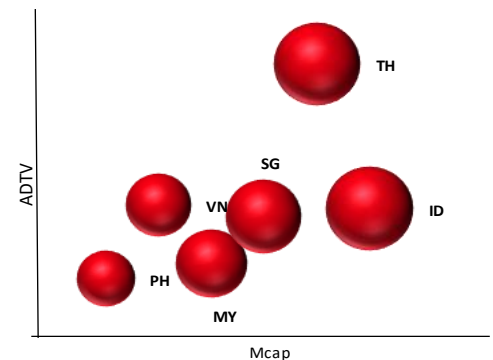
This is quite remarkable for a market that is generally considered very small and illiquid. In fact, the Vietnam market has the second highest liquidity in ASEAN, now surpassing even Singapore and Indonesia.

Vietnam is now as liquid as Indonesia and more so than Singapore...



Source: Bloomberg, HSBC

...in fact, it is the second most liquid in ASEAN after Thailand



Source: Bloomberg, HSBC

Foreign ownership limits are not a limit, really

One question that regularly pops up in discussions on Vietnamese equities are foreign ownership limits (FOL). If foreign investors buy up to the allowed quota, they can only trade amongst themselves and a foreign price will be established, independent of the local price.

Overall the VN Index has a FOL of 44%, while current foreign holdings are less than half the limit, at c20%.

“ The result of this influx of local investors has been a tenfold rise in the average daily turnover on the Ho Chi Minh Stock Exchange – it has recently crossed the USD1bn mark.

Obviously, this ignores the possibility that foreign investors might not be interested in certain stocks –maybe they are too small or too illiquid – and that might explain why foreign ownership levels have not yet been reached.

But this might not necessarily hold up. Of the 30 stocks in the VN30 Index, seven have reached their foreign ownership limits, while 12 have market caps above USD5bn and 14 have liquidity of more than USD10m a day. Eight companies have increased their foreign ownership levels since 2019. In short, foreign ownership levels in most cases no longer limit foreign investors from buying.

Local ETFs also enable foreign investors to gain exposure to FOL-restricted companies. But ETFs trading on the Ho Chi Minh City Stock Exchange (HOSE) reported a turnover of only USD600m for the whole of 2021, followed by USD275m so far in 2022. This is hardly 0.5% of total market turnover.

Foreign ownership by sector

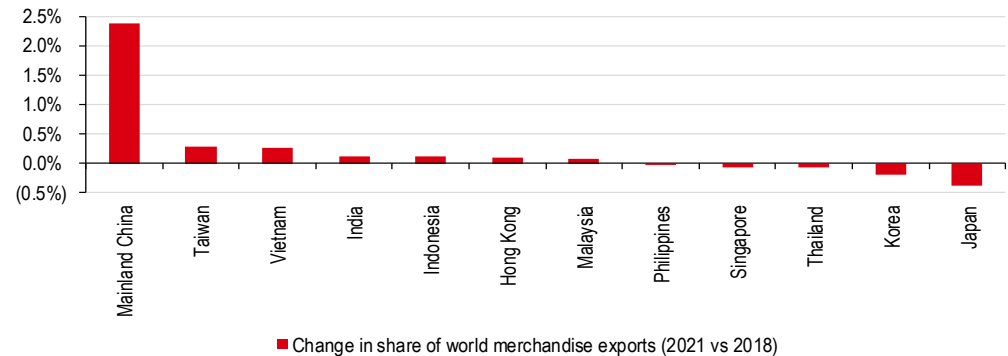
VN Index	Wt in Index	Foreign ownership limit (%)	Current foreign holdings (%)
Real Estate	21.6	48.5	14.9
Financials	33.9	31.5	21.0
Consumer Staples	10.0	74.5	37.5
Utilities	6.5	49.1	4.9
Industrials	9.5	44.3	13.6
Materials	9.9	40.2	11.7
Energy	1.7	27.1	14.4
Consumer Discretionary	3.9	51.0	37.3
Health Care	0.7	74.4	36.8
Information Technology	2.3	49.1	45.4
VN Index		44.1	19.9

Source: Bloomberg, HSBC

Resilient story

At the start of the report we mentioned that Vietnam benefits from a vibrant export sector. Its role in global supply chains has been increasing for years and is set to expand further. In recent years, the country has seen multiple inward relocations of manufacturing facilities to get access to cheaper labour and land, and hence stands out in terms of grabbing market share of global exports. Its share moved from c0.5% in 2010 to c1.6% in 2020 just over 3x. In fact, in March 2022, Vietnam's export value reached USD34.7bn, greater than the exports of USD18.3bn from Shenzhen (the biggest exporter city in China). Total exports from Vietnam in the first three months of 2022 have been cUSD89bn, whereas those from Shenzhen have been USD62bn. Vietnam export values have been surpassing Shenzhen since 2019, with low-value manufacturing industries gradually migrating from China to Vietnam.

Change in share of world merchandise exports



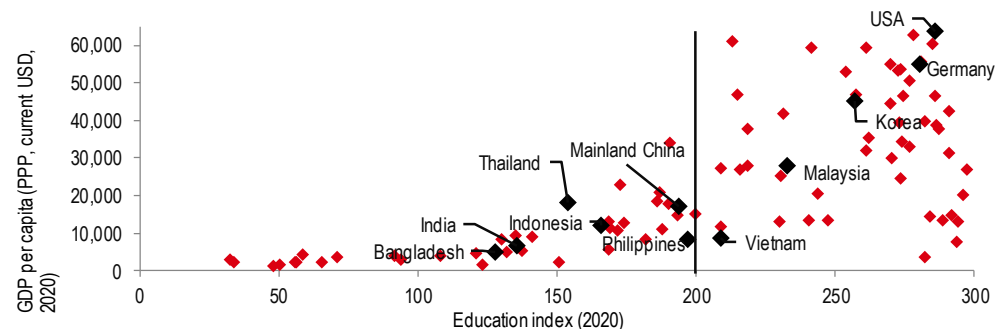
Source: UNCTAD, HSBC

Foreign direct investments have been a key driver of Vietnam's economic growth: 3/4 of exports are from sectors with strong foreign investment. In the past few years, Vietnam has made it easier to set up a business and has simplified land registration and loan processes. This, along with a low cost of production, has made it the place to set up a new factory.

But there is more. The population is young and the country enjoys an adult literacy rate of more than 95%. On education scores – such as in the chart below – Vietnam does better than other ASEAN markets and even China. In short, it's got a young, well-educated labour force, which goes to the cities to look for jobs.

That's why Vietnam is gaining export market share over nearby exporters located in Thailand or Malaysia. But it's not just exports. Infrastructure spending and investments in logistics has supported a flurry of activity in industrial, commercial and residential real estate.

Vietnam scores well on an education index compared with Asian peers



Note: This education index takes the proportions of pupils that finish either primary, lower secondary, higher secondary or tertiary education in each country. It assigns scores to each education level (primary =0, tertiary =3). If everybody in a country has tertiary education, the score would be 400. A score of 200 suggests that half of the population has an education level that exceeds upper secondary education. The data is from the World Bank.

Source: World Bank, HSBC

But the Vietnamese consumption story is still underappreciated. The percentage of the country's population that is categorised as upper middle class is set to quadruple, to 20% by 2030² (as per Brookings Institute). That's an acceleration from the rise in capita income of 10% since 2005.

Indeed, Vietnam is set to become the tenth largest global consumer market in 2030. As the chart below illustrates, Vietnamese consumers look set to overtake their Turkish, Thai and British counterparts by the end of this decade. And Vietnam's consumer market will likely be bigger than Germany's by 2030.

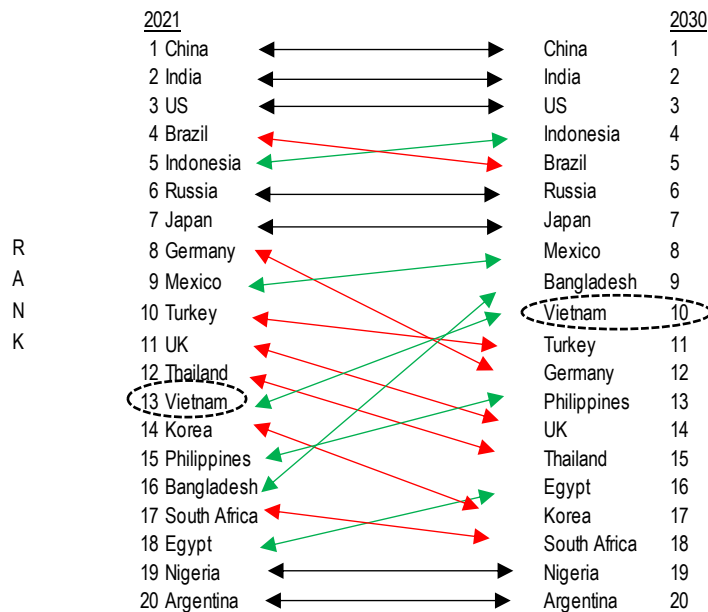
Vietnam will soon enter the list of the largest consumer markets globally

² That's those belonging to the income group that spends USD11-110 per person per day in PPP terms.

These customers want to be online, while retailers and banks are busy enhancing their digital capabilities and offering digital banking programs and tools. It also means that Vietnam is one of the most attractive markets in the region for financial inclusion and the fintech space.

Vietnam is set to become a part of top 10 biggest consumer markets

Daily income of more than USD20 (2011 PPP)



Source: Brookings Institute, HSBC

Industrials (infra, logistics, manufacturing), Real Estate, Consumers and Financial Services are set to benefit

Banks and financial services are also beneficiaries, in different ways. Vietnam has been largely a cash-based economy and a sizeable chunk of the population is yet to become part of the banking system. A total of 52m people who are 15 years old and above do not have a bank account. Vietnam's banks used to have a problem with non-performing loans, but thanks to strong growth and profitability their balance sheets are now stronger than, say, a decade ago. Vietnam's average NPLs as a proportion of total loans outstanding currently stands at around 1.7%, down from 5% in 2012.

“ Vietnam’s consumer market will likely be bigger than Germany’s by 2030.

What does this all mean for earnings growth?

Earnings have remained buoyant in Vietnam, with a CAGR of 10% in the last ten years. Vietnam is among the very few markets globally that saw positive earnings growth in 2020, when COVID-19 hit. As the pandemic eased, earnings growth was as high as 35% y-o-y in 2021.

“ Following the COVID-19 rebound, earnings growth was as high as 35% y-o-y in 2021.

Vietnam's path to emerging market status

For Vietnam to be upgraded to EM status by MSCI and FTSE, it must meet various criteria. Key issues outstanding are the presence of foreign ownership limits, a lack of some disclosures in English, the lack of an offshore currency market and limitations in the onshore currency markets, mandatory registration of accounts, prefunding of trades and restrictions in off-market transfers.

With new securities, investment and enterprise laws being passed, some of these issues should be addressed, albeit gradually. In 2019, Vietnam adopted the Law on Securities 2019³, which seeks to restructure the market. This law came into force in 2021, introducing, among other things, a new settlement and clearing system under the Central Counter Party (CCP) model and Non-Voting Depositary Receipt (NVDR). NVDRs allow foreign investors to gain exposure to the share price performances of stocks that have reached their FOL, without the right to be involved in the companies' decision making.

The new KRX trading system (a new IT system provided by the Korea exchange) is expected to come into operation later this year. This should improve trading, access to information, launch of new instruments such as intra-day trading and NVDRs and allow for more efficient clearing and settlement. The key point is that investors will no longer have to prefund their purchases.

In short, Vietnam is doing its best to reform the securities market and bring it closer to international standards.

“ The key point is that investors will no longer have to prefund their purchases under the new settlement and clearing system

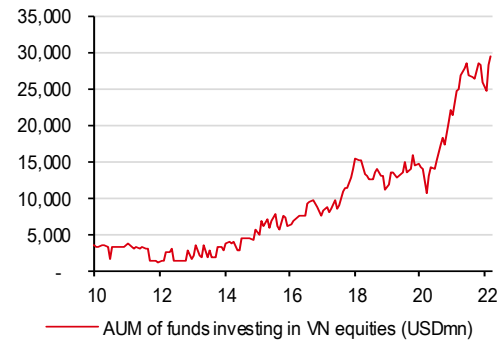
Potential EM index inclusion

Consequently, with all these changes, which could address most of the concerns of the index providers, the FTSE added Vietnam to a watch list in September 2018 for possible reclassification to secondary EM status, due in September 2022. The market is yet to make it onto MSCI's watch list, but if required reforms are implemented, it might meet the necessary criteria ahead of May 2023 (before the next review).

Being added to MSCI's watch list could see increased fund flows into the market. But global funds already have built decent exposure to Vietnam equities.

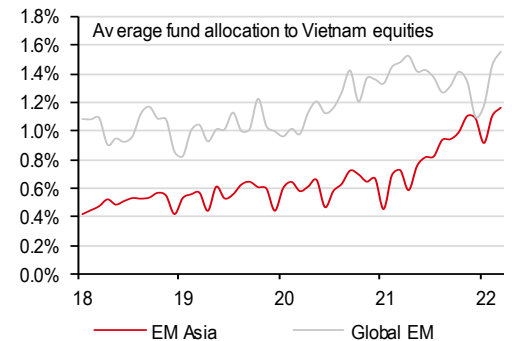
³ It has plans to merge the two Vietnamese exchanges (Hi Chi Minh and Hanoi) into a single Vietnam Stock Exchange (VSE). These laws also regulate the establishment of the Vietnam Securities Depository and Clearance Corporation (VSDC).

AUM invested in Vietnam equities has tripled in the last two years



Source: EPFR Global, HSBC

Emerging funds allocation to Vietnam has been rising



Source: EPFR Global, HSBC

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