Vietnam

Economics Update

Spotlight amidst shadow of the trade war

- A trade deal remains elusive given the re-escalation of the US-China trade war.
- Vietnam has proven to be a beneficiary of the ongoing trade tensions, with solid export growth and robust registered FDI from China.
- Risks include: 1) a potential full-blown trade war; 2) sharper-than-expected Rmb depreciation and 3) upside risks to inflation in 2020F.

The US-China trade war heats up, trade deal remains elusive

Recent developments (tariffs raised on US$200bn of Chinese goods and the US ban on Huawei) suggest that several issues remained unresolved in US-China relations. We also see the possibility of the US moving forward with raising tariffs on US$300bn worth of Chinese goods. A full-blown trade war could deliver strong headwinds to the global economy as well as Vietnam's macro outlook, in our view.

Vietnam economy remains resilient despite external headwinds

Unlike other emerging Asian economies, Vietnam's exports and industrial output have increased in recent months as the country is considered a beneficiary of the US-China trade war. Export growth rebounded sharply in Apr (+10.4% yoy) while industrial production index increased 10.0% yoy in May. Despite the step-up in trade tensions, we maintain our 2019 and 2020 GDP growth forecasts at 6.6% and 6.5%, respectively.

Spotlight on exports and FDI due to the ongoing trade war

In the first four months of 2019, Vietnam's export growth remained positive at 6.5% yoy vs. negative growth for other Asian countries, thanks to strong domestic exports, particularly textile, wooden products and solid growth in exports of tech products. In addition, FDI from China into Vietnam surpassed other major investors' year-to-date and nearly doubled from the same period last year. We see resilient export growth and robust FDI inflows providing the country with a buffer against further escalation in the US-China trade war.

Sharp depreciation of the dong is unlikely

Barring a full-scale trade war, we think this round of Rmb depreciation will be no different compared to last year as we believe a sharper depreciation of the Rmb could add more uncertainty to the trade negotiation process and is unlikely to be in favour of Chinese authorities. We see less depreciation pressure on the dong compared to last year, thanks to: 1) better guidance from the State Bank of Vietnam to the FX market and 2) less funding pressure from a strong US$ given the Fed's dovishness.

Trade penalties from the US will be closely watched

On 28 May, Vietnam was added to the US Treasury's currency watch list for potential currency manipulation. Being added to the watch list is considered as a warning to Vietnam, in our view. We think Vietnamese policy makers will be more cautious on currency management or intervention going forward and the country is becoming more vulnerable to US policy owing to the rising trade surplus with the US because many Chinese businesses have re-routed their goods to the US via Vietnam to avoid tariffs.

Upside risks to inflation in 2020F

Average CPI increased by 2.7% yoy in the first five months of 2019 despite hikes in petroleum prices and electricity prices as the hikes were offset by a drop in pork prices. Although we expect muted inflation in 2019, we still see upside risks in the longer term due to: 1) an anticipated sharp rebound in pork prices if the African Swine Fever is contained and 2) as China's growth stimulus measures are likely to boost the demand for oil and raise oil prices amidst tighter global oil supply.

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Spotlight amidst shadow of the trade war

Renewed trade tensions trigger more uncertainties

Updates on renewed US-China trade tensions

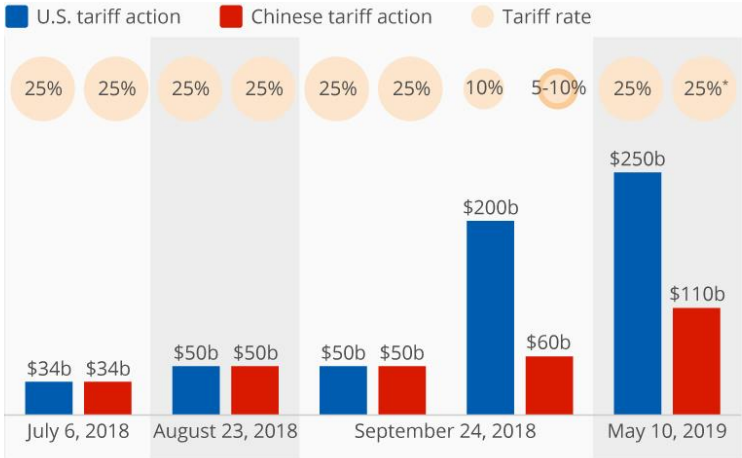
The US-China trade tensions have returned after months of negotiations. To recap, the US has raised tariffs to 25% from 10% on US$200bn worth of Chinese exports, effective 10 May. China has retaliated by announcing plans to raise tariffs on US$60bn worth of US exports, starting from 1 Jun.

On 13 May, the US Trade Representative also proposed a US$300bn list, and a public hearing will be held on 17 Jun to decide on the possibility of raising tariffs on these products by up to 25%. Against the backdrop of a worsening trade war, we are concerned that the recent US ban on Huawei could further escalate the trade war into a tech Cold War.

The latest developments suggest that there are still significant unresolved differences in the negotiation process. Trade discussions between the two countries may happen next month at the G20 Summit on 28-29 Jun, but the chances of an imminent trade deal have reduced considerably, in our view.

We also see a higher possibility that the US will raise tariffs on US$300bn of Chinese goods. In this scenario, a full-blown trade war could deliver strong headwinds to financial market confidence, as well as corporate and consumer sentiment globally.

Figure 1: Cumulative tariffs between the US and China in 2018-19



SOURCES: VND RESEARCH, STATISTA, * Up to 25%, expected

Global financial markets are bracing for more volatility

Renewed trade tensions have reignited market volatility and triggered a risk-off sentiment among investors. This triggers a feeling of déjà vu from Jun in 2H18. However, we see some differences this time around: 1) the global economy is not growing as fast compared to 12-18 months ago and global growth forecasts have been downgraded due to the prolonged US-China dispute; 2) a dovish view from the Fed was not the case last year and 3) there are signs that the trade conflict is spilling over into other areas, especially technology. We note that if there is no positive newsflow on further trade negotiations, things could further deteriorate and uncertainties over China-US relations could continue to linger.

Can Vietnam ride out the trade-war storm?

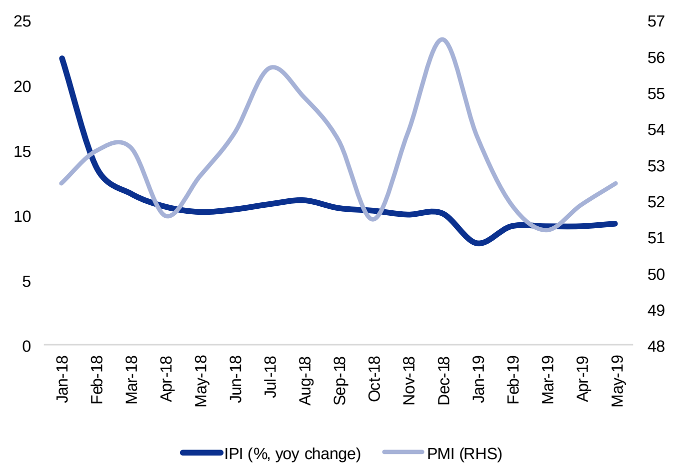
Near-term growth outlook remains resilient

In our view, tariffs on US$200bn Chinese exports are not new. Tariffs on these products were initially raised to 10% in Sep 2018 and scheduled to be raised further to 25% in Jan 2019, but were then delayed due to hopes for a trade deal. Therefore, the belated implementation of these tariffs does not affect our macroeconomic projections for now. Furthermore, unlike other emerging economies in Asia, Vietnam's exports and industrial output have increased in recent months. This can be attributed to benefits from the US-China trade tensions as many companies have been diverting trade from China through Vietnam to avoid US tariffs as well as shifting their supply chains to Vietnam, supporting exports as well as manufacturing growth.

To be specific, manufacturing growth is in good shape with manufacturing PMI at a four-month high of 52.5 in Apr 2019, thanks to a rise in new orders and exports. Industrial production index (IPI) increased 10.0% yoy in May, supported by solid growth in the manufacturing sector (+11.6% yoy). In addition, export growth rebounded sharply in Apr (+10.4% yoy).

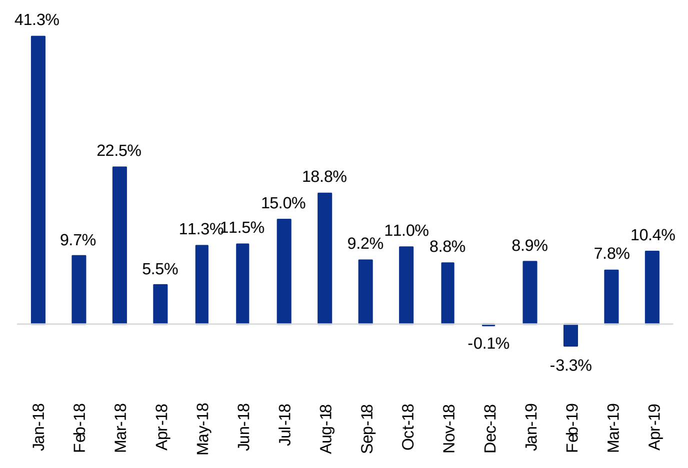
Despite the step-up in trade tensions, we maintain our 2019 and 2020 GDP growth forecasts at 6.6% and 6.5%, respectively. Risks are skewed to the downside, given the potential for a full-blown trade war and global recession.

Figure 2: Vietnam manufacturing sector remained solid (Jan 2018-May 2019)



SOURCES: VND RESEARCH, VIETNAM GENERAL STATISTIC OFFICE, NIKKEI

Figure 3: Vietnam exports continued to grow (Jan 2018-Apr 2019)



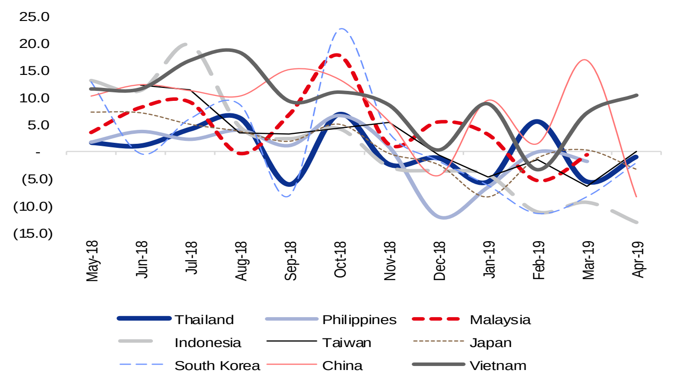
SOURCES: VND RESEARCH, VIETNAM CUSTOMS

Vietnam has started to benefit from the US-China trade war

The US-China trade war has cast a shadow on the global outlook for over a year, but we see some economic benefits in terms of trade and capital inflows for Vietnam. To be specific, Vietnam's exports have been relatively resilient vs. other Asian countries. In the first four months of 2019, Vietnam's exports growth remained positive at 6.5% yoy vs. negative growth for other Asian countries. This was on the back of strong domestic exports, particularly textile, wooden products and solid growth in exports of tech products. Although Vietnam's exports to China decreased by 5.0% yoy in the first four months of 2019, this was offset by a 29.1% yoy surge in Vietnam's exports to the US.

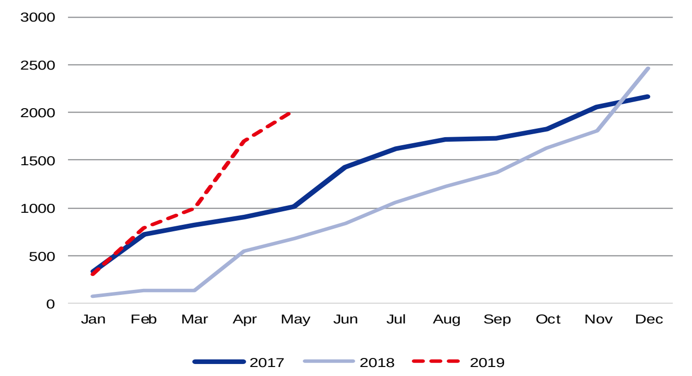
There are also clear signs that Chinese manufacturers are trying to relocate to Vietnam to avoid US tariffs. In the first five months of this year, Chinese companies committed to invest US$2bn in Vietnam, nearly double vs. the same period last year. Besides China, we see Vietnam is attracting more interest from other major investors (i.e. Hong Kong, Korea and Singapore) with an increase of more than 30% in registered foreign direct investment in the first five months of 2019 (excluding contributed capital relating to Sabeco's divestment). We see resilient export growth and robust FDI inflows providing a buffer against further escalation in the US-China trade war in the medium term.

Figure 4: Vietnam's exports vs. other Asian countries (% yoy growth)



SOURCES: VND RESEARCH, CEIC

Figure 5: Registered FDI inflow from China to Vietnam in 2017-19 (US$ m)



SOURCES: VND RESEARCH, FOREIGN INVESTMENT AGENCY

A pick-up in uncertainty and vulnerability

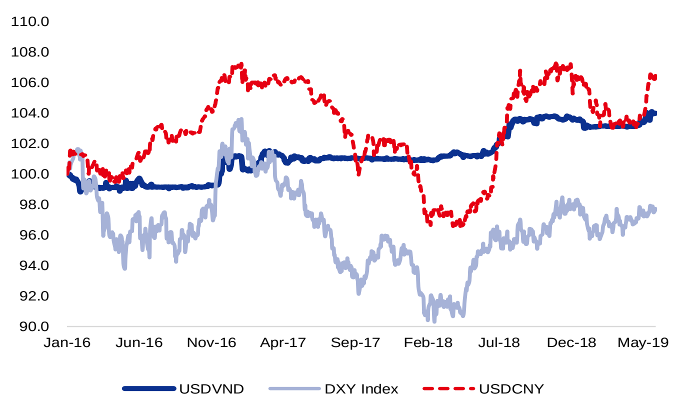
The dong trends weaker when uncertainties rise

The Rmb has depreciated to 6.9 from 6.7 against the US$ on renewed trade tensions in May. However, the Rmb so far has only given up the appreciation in the first quarter of this year. The 7.0 to the US$ is currently seen as an important threshold for the US$/Rmb as this was the level it defended successfully in 2016 and 2018. Although a weaker Rmb could help to offset the increased costs of the tariffs, it could in turn fuel capital flight and undermine China's economic stability. In addition, the PBoC could use foreign exchange intervention and monetary policy tools to control volatility in the Rmb. Therefore, barring a full-scale trade war, we think this round of Rmb depreciation will be no different compared to last year.

With the latest re-escalation of the trade war, the dong has depreciated in accordance with the depreciation in the Rmb. However, we see less depreciation pressures compared to last year because: 1) the SBV has guided the market by continuously adjusting the central exchange rate from the beginning of the year and 2) given the Fed's dovishness, the SBV also has more flexibility as it brings less funding pressure from a strengthening US$. As a result, the dong has only depreciated by about 0.5% during the last month, versus c.0.2-1.9% depreciation in other Asian emerging currencies.

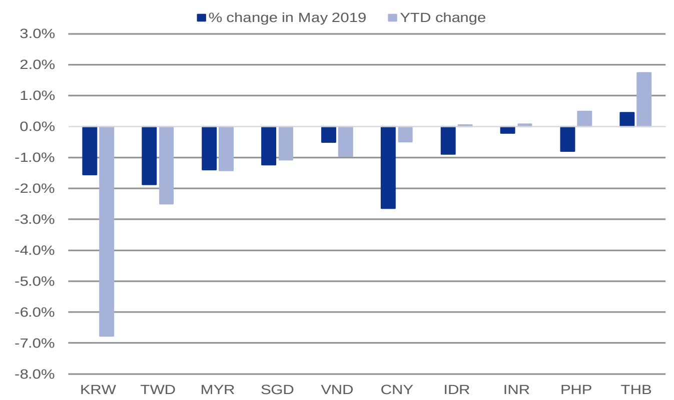
In our view, currency stability has helped to create macro stability and the SBV will work towards this target by preventing any sharp depreciation of the dong in the medium term. We reiterate our expectation of 2% depreciation of the dong in 2019 for the time being. A risk to our view is a full-blown trade war which could lift US$/Rmb above 7.0, then the spillover effect on the dong would be considerable.

Figure 6: Dollar index vs. VND and CNY exchange rate (Jan 2016 - May 2019)



SOURCES: VND RESEARCH, BLOOMBERG

Figure 7: Asian currencies movement in the first five months of 2019



SOURCES: VND RESEARCH, BLOOMBERG NOTE: +/-: appreciation/depreciation

Watch out for potential trade penalties from the US

Recently, Vietnam was added to the US Treasury's currency watch list for potential currency manipulation as the country was cited for its large current account surplus of more than 5% of GDP in four quarters through Jun 2018 and its trade surplus with the US of US$40bn in 2018. This news came on the back of a proposal by the US Department of Commerce that would allow the government to slap penalties (i.e. tariffs) on countries with undervalued currencies, resulting in a subsidy to their exports. Indeed, the US Treasury Department has never labeled a country a currency manipulator; however, being added to the watch list is considered as a warning to Vietnam, in our view. As a result, we think policy makers will be more cautious on currency management or intervention going forward.

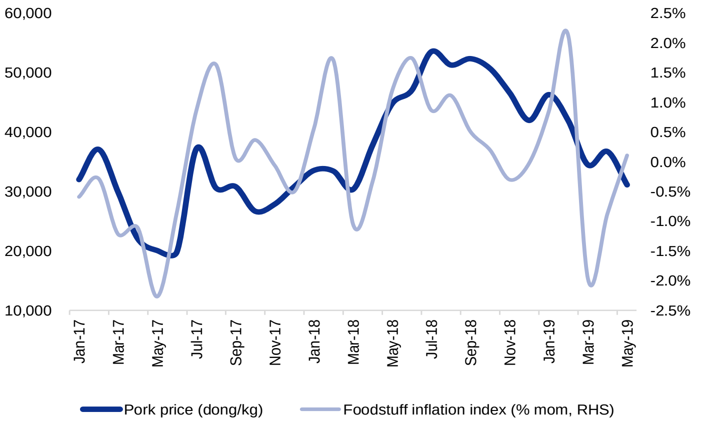
For now, we do not expect immediate penalties on Vietnam but the country is becoming more vulnerable to US policy owing to the rising trade surplus with the US because Chinese exporters are re-routing their goods to the US via Vietnam to avoid tariffs. In the first four months of this year, Vietnam's imports of tech products from China increased by 25.8% yoy while exports of these products to the US surged by 85.0% yoy. As a result, Vietnam's trade surplus with the US expanded to US$13.5bn in the first four months of 2019 (vs. a surplus of US$10.2bn in the same period last year).

We still see upside risks to inflation in 2020F

Vietnam's consumer price index (CPI) recorded an increase of 0.5% mom in May 2019. As the country is struggling to contain the African Swine Fever (ASF) outbreak, domestic pork prices have declined sharply in recent months, offsetting the impact of higher petroleum prices on the inflation rate. Average CPI increased 2.7% yoy in the first five months of this year, the lowest growth rate for a five-month period over the last three years despite hikes in petroleum prices and electricity prices. Although we expect Vietnamese authorities to achieve their target of below 4% inflation this year, we still see upside risks in the medium term due to the following:

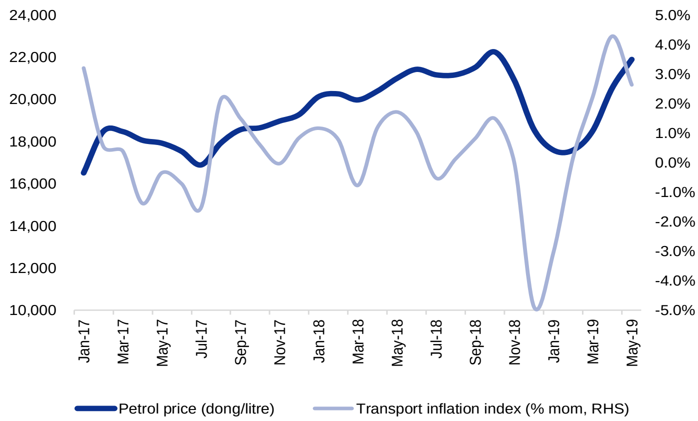
1) The consequences of production cuts on pork prices: As of end-May, ASF cut Vietnamese pig numbers by 1.7m, or 5% of the country's herd, according to Vietnam's Agriculture Ministry. If ASF is contained, we think pork prices could rebound dramatically and present risks to inflation.
2) Oil price volatility: We see the fundamental backdrop of the oil market is now in conflict with a simultaneous rise in supply-side risks and concerns over demand weakness. As the trade war re-escalates, China is under pressure to boost its economy. Therefore, China's growth stimulus measures are likely to boost the demand for oil and bring oil prices higher amidst tighter global oil supply, in our view.

Figure 8: Foodstuff inflation index vs. pork price



SOURCES: VND RESEARCH, VIETNAM GENERAL STATISTIC OFFICE, AGRIMONITOR

Figure 9: Transport inflation index vs. petrol price



SOURCES: VND RESEARCH, VIETNAM GENERAL STATISTIC OFFICE, PETROLIMEX

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Score Range:	90 - 100	80 – 89	70 - 79	Below 70 or	No Survey Result
Description:	Excellent	Very Good	Good	N/A	

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Stock Ratings	Definition:
Add	The stock's total return is expected to reach 15% or higher over the next 12 months.
Hold	The stock's total return is expected to be between negative 10% and positive 15% over the next 12 months.
Reduce	The stock's total return is expected to fall below negative 10% over the next 12 months.

The total expected return of a stock is defined as the sum of the:(i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings	Definition:
Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings	Definition:
Overweight	An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
Underweight	An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.

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