Vietnam

Economics Focus

Exports spur strong economic growth in 1Q18

- External demand drove strong 1Q18 GDP growth.
- The dong showed some weakness in 1Q18 due to transitory factors.
- We expect a maximum depreciation of 2% against the US$ in 2018.
- Vietnam's exports could benefit in the long run in the event of a trade war, in our view.
- We think that construction materials, beverage, banking, retail and tourism are poised to see strong 1Q earnings against the macroeconomic backdrop.

Exports drove 1Q18 GDP growth

Vietnam's economy continued to expand in 1Q18 with GDP growth of 7.4%, the highest first quarter increase experienced in 10 years. In our view, the FDI-driven growth model has resulted in a stronger correlation between Vietnam's GDP growth and the growth in electronics exports, especially in the past two years. Net exports constituted 1.2% points of the increase in GDP, after making a negative contribution in 2017.

The dong showed some weakness in 1Q18

The dong had depreciated 0.4% versus the US$ in the spot market by the end of March despite a 0.1% depreciation in the official central bank rate. This could be attributed to the US-led trade tensions and a mildly hawkish Fed rate hike outlook. However, we think the dong's weakness was really on display following the plunge in the spread between the overnight VND and US$ lending rates to -0.79% from 1.3% before the Tet holiday due to high interbank liquidity; this led to a hoarding of US$ by banks and pressured the dong.

We expect a maximum depreciation of 2% against the US$ in 2018

We believe that the recent dong weakness was a function of high interbank liquidity and is therefore transitory in nature. However, Vietnam's record high FX reserves, trade surplus and sustained strong momentum of FDI inflows, along with a weak dollar, could support the exchange rate this year, barring a huge shock to global trade.

Escalating concerns over a global trade war

Broader concerns over the risks of a global trade war have intensified recently. For now, we think the trade tensions will not have a significant negative impact on global economic growth as: 1) actions from the Trump administration and reactions from China have been limited mostly to rhetoric, and 2) the intricate interdependencies between the US and Chinese economies will act as a deterrent for either party to take extreme measures. Ultimately, both parties will arrive at a face-saving compromise to limit collateral damage.

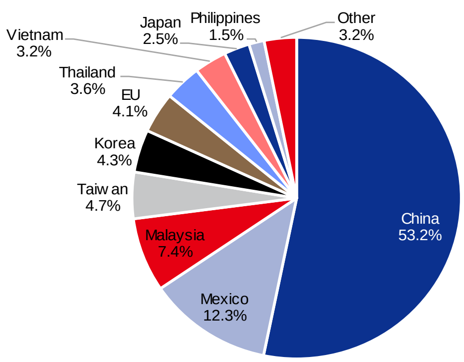
Vietnam's exports could benefit from trade tensions in the long run

Vietnam relies heavily on high-tech exports; ICT products accounted for nearly 35% of total exports in 2017. However, as the US's trade measures are targeted mainly at China, Vietnam's exports could be less affected compared to a scenario whereby a blanket tariff hike is applied on all exporters. Manufacturers will be incentivised to move their facilities out of China with Vietnam being the most preferred destination for relocation due to its geographical proximity to China and its emerging export manufacturing clusters.

Select sectors could ride the strong macroeconomic performance

From a macro perspective, we are positive about the furniture, construction materials, beverages and paper industries. We also expect financial service, tourism and retail companies to announce strong earnings results for 1Q18. We believe earnings will be the key driver of stocks this year as valuations look stretched at the moment and early signs are appearing of rising global risk aversion, which is bound to impact Vietnamese equities.

Figure 1: Share of global ICT goods exports to the US by source country (2017)



SOURCES: CGS-CIMB RESEARCH, VIETNAM CUSTOMS

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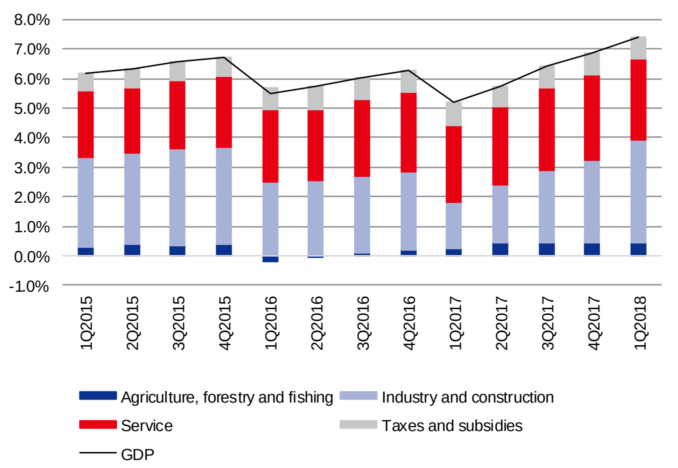
Exports were the key driver of strong economic growth in 1Q18

Exports drove 1Q18 GDP growth

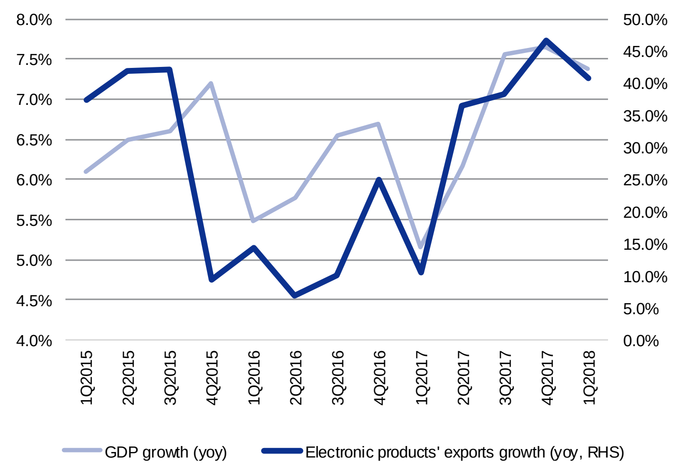
Vietnam's economy continued to expand in 1Q18 with GDP growth of 7.4%, the highest first quarter increase experienced in 10 years. Manufacturing activity was strong, posting a 7-year record high growth of 13.6%, which was mainly driven by electronic product manufacturing. In our view, the FDI-driven growth model has resulted in a stronger correlation between Vietnam's GDP growth and the expansion of electronics exports, especially in the past two years. In 1Q17, the negative growth of phone exports (due to the Samsung Galaxy Note 7 scandal) led to a low GDP growth rate of 5.1%. However, in 1Q18, electronics products' exports surged by 40.8% yoy, and phone exports gained momentum with an increase of 58.8% yoy, benefiting from a strong recovery since 2Q17. This provided a major tailwind to GDP growth. The breakdown of GDP growth by component also shows that net exports played an important role in driving economic growth. Net exports constituted 1.2% points of the 7.4% increase in GDP growth, after making a negative contribution in 2017.

Figure 2: Robust GDP growth in 1Q18



SOURCES: CGS-CIMB RESEARCH, GENERAL STATISTICS OFFICE (GSO)

Figure 3: Rising correlation between GDP growth and electronic products export growth



SOURCES: CGS-CIMB RESEARCH, GSO, VIETNAM CUSTOMS

A rebound in mining activity, a strong recovery in the agricultural sector and the continued expansion in services activity also coincided to push GDP growth to a decade-long high. Agriculture, forestry and fishery production rose 4.1%, the highest quarterly increase in 13 years. Mining growth turned positive after eight consecutive quarters of negative growth. Services rose 6.7%, which was supported by the strong recovery of the financial sector (+7.7% yoy) and buoyant domestic demand, as evinced in food and catering services and retail sales growth of 7.6% and 7.5%, respectively.

Although there was robust economic growth in 1Q18, we are concerned that growth might have peaked. As GDP growth accelerated during the second half of 2017, high base effects might dampen growth to the level of around 6.7-6.8% in 2H18. Our 2018 economic growth forecast remains unchanged at 6.8%.

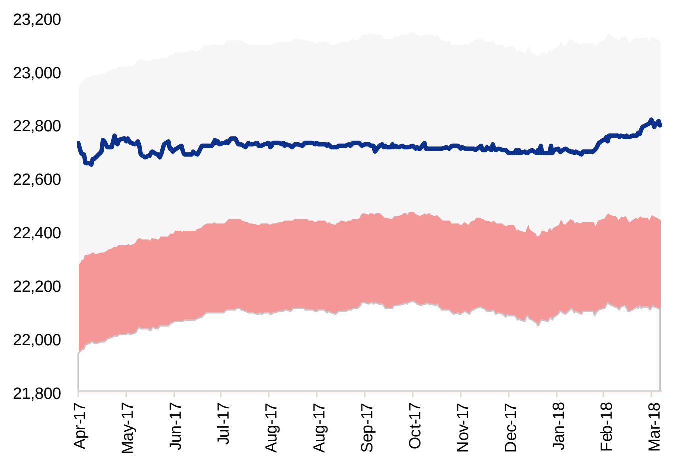
The silver lining is that Vietnam's economy remains buoyed by strong domestic capacity expansion and closer trade integration. In the second half of this year, we expect the debut of a second blast furnace at Formosa's Ha Tinh Steel integrated mill and Nghi Son Refinery and Petrochemical complex to be the key growth drivers for industrial production. Exports and tourism will continue to benefit from external demand, especially in the Asia-Pacific region despite lingering concerns over a possible trade war. Vietnam's newly-signed free trade agreements with South Korea and the EU will also help compensate partly for any slowdown in global trade.

Meanwhile, we expect domestic demand to remain strong with sustained high consumer confidence on the back of rising wage growth and still rising asset prices.

The dong showed some weakness in 1Q18

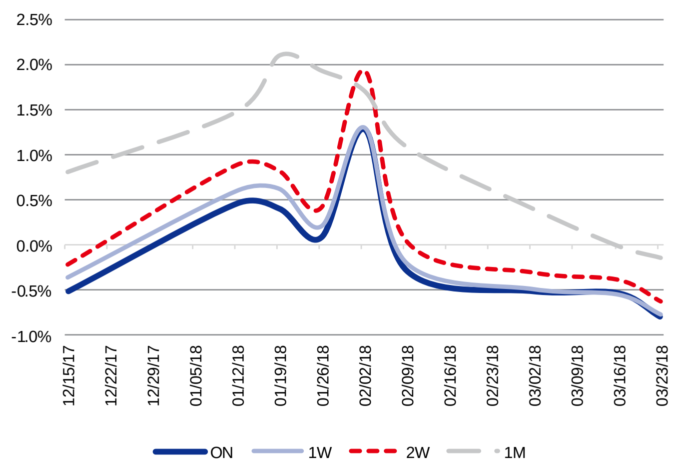
The spot dong rate had depreciated by 0.4% versus the US$ as of the end of March despite a 0.1% depreciation in the official central bank rate. This could be attributed to the US-led trade tensions and a mildly hawkish Fed rate hike outlook. However, we think the dong's weakness was displayed in the negative interest rate gap between VND and US$. At the end of Mar 2018, the overnight interest rate spread between VND and US$ declined to -0.79% from 1.3% in early-Feb 2018 due to high dong interbank liquidity. In our view, the compression in the spread between the VND and US$ interest rate stimulated banks to hoard US$, thereby spurring weakness in the dong.

Figure 4: The US$/VND edged up higher in Mar 2018



NOTE: RED/GRAY shaded areas are LOWER/UPPER OF OFFICAL TRADING BAND
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 5: The spread between VND and US$ interbank rates turned negative after the Tet holiday

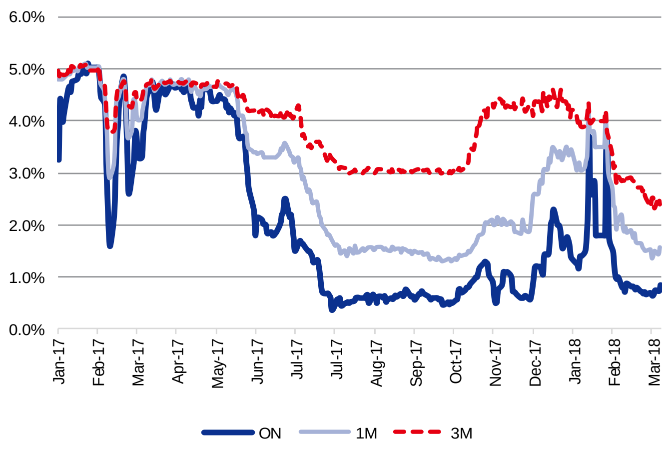


NOTE: High demand for the dong during the Tet holiday pushed VND interbank rate and widened the interbank rate spread.
SOURCES: CGS-CIMB RESEARCH, STATE BANK OF VIETNAM (SBV)

Taking a broader view, continued abundant liquidity in the banking system could lead to higher volatility in the exchange rate. As of 20 Mar 2018, the Vietnam General Statistics Office estimated that the total loan stock increased by 2.2% YTD vs. 2.8% in the same period last year and money supply grew faster at 3.2% YTD vs. 2.9% in the same period last year. Commercial banks still hold a large amount of deposits from the State Treasury as public investment remained sluggish in the first quarter even as the windfall from large SOE divestments continued to generate cash proceeds for the state. Because of weak credit growth and slow public investment disbursement amid rising money supply, it became cheaper for banks to lend money between themselves, pushing interbank rates to low levels at the end of 1Q18. In addition, Vietnam's banks are increasing their activities in the bond market, purchasing more 30-year G-bonds as they are awash in liquidity. At the end of Mar 2018, the overnight rate was down 0.4% pts compared to the end of 2017 while the 1Y and 5Y G-bond yields decreased sharply to 2.4% and 3.2% from 3.6% and 4.4% at the end of 2017, respectively. We think the very low VND interbank rate and the pace of capital investment (both public and private) in the economy need to be monitored as both of these factors might compromise exchange rate stability in the near term.

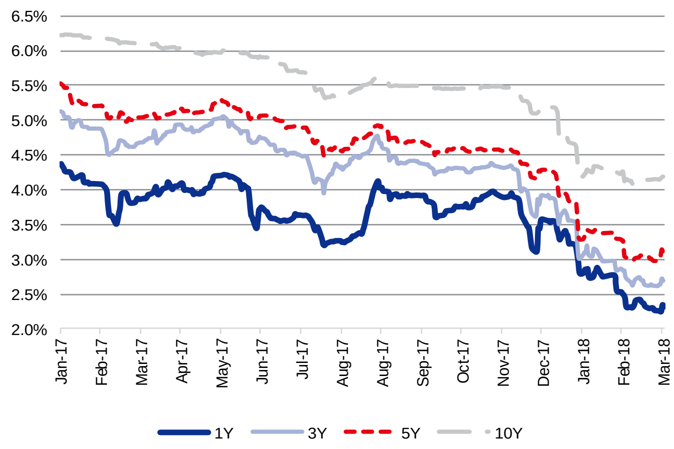
However, we believe that the record high FX reserves, trade surplus and strong FDI inflows along with a weak dollar could support the exchange rate for the full year. We hold the view that the dong will continue to be relatively stable with a maximum depreciation of 2% against the US$ in 2018. In its latest report, HSBC Bank Vietnam forecast the exchange rate to be stable at VND22,900 per US$ by the end of 2018.

Figure 6: Interbank interest rates declined to low levels in Mar 2018



SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 7: Bond yields declined sharply in 1Q18



SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

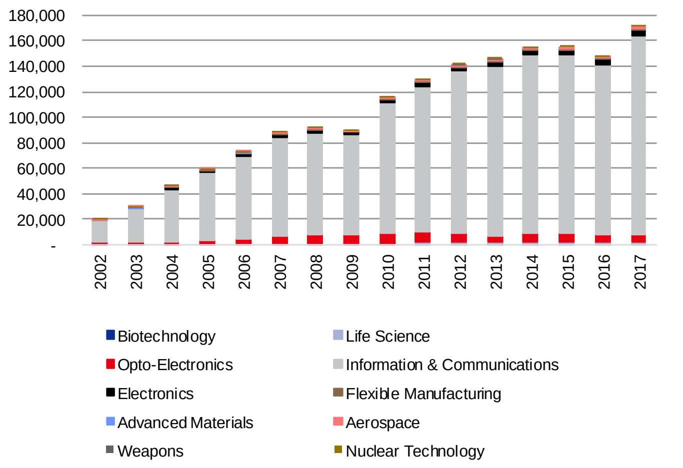
Escalating concerns over a global trade war

Broader concerns over the risks of a global trade war have intensified recently. On 22 Mar 2018, President Trump signed a memorandum directing the US Trade Representative (USTR) to impose at least US$50bn in tariffs on Chinese goods over intellectual-property violations based on the USTR Section 301 investigation. The tariffs' specifics are to be published by the USTR within 15 days and industries will be granted a 30-day window to provide feedback. Shortly after these announcements, China announced a direct retaliation against President Trump's tariffs. On 2 Apr 2018, China's Customs Tariff Commission raised the tariff rate on eight imported US products (including pork and aluminium scrap) to 25%. It also imposed a new 15% tariff on 120 other imported US goods (including items such as wine, fresh fruit, dried fruit and nuts, steel pipes, modified ethanol and ginseng).

China is the largest exporter of information and communications technology (ICT) goods to the US, accounting for 44% of all US imports of these goods in 2015. The full details of the US tariffs have yet to be released, though we think the impact of new tariffs will be more wide-ranging compared to the earlier steel sector measures. The final list will likely target 10 sectors based on the Made in China 2025 industrial plan, including ICT, aerospace, electronics, robotics, new energy vehicles, and medical technology. The Trump administration will also step up restrictions on Chinese investment in the same sectors. According to the US Census Bureau, total advanced technology products import value from China was US$171bn in 2017 and 91% of this was categorised as ICT products, including smartphones, computers, servers, routers, and computer chips.

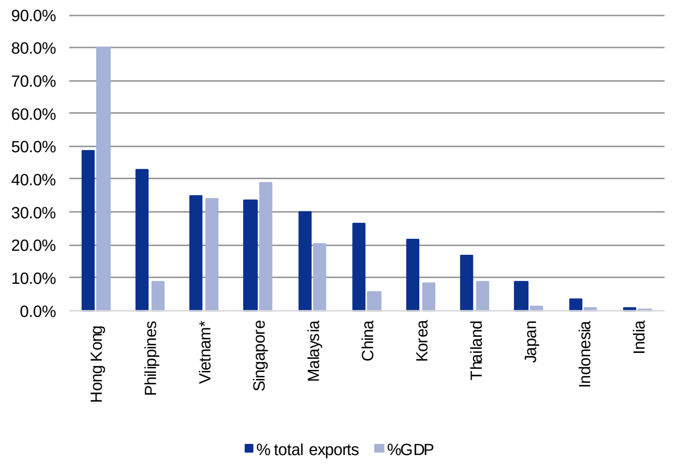
Tariffs targeted at Chinese-made ICT goods could actually benefit Vietnam's ICT exports in the long term. Vietnam relies heavily on high-tech exports. ICT products accounted for nearly 35% of Vietnam's total exports or 34% of its GDP in 2017. However, as the US's trade measures are mainly targeted at China, Vietnam's exports could be less affected compared to a scenario whereby a blanket tariff hike is applied across the board on all exporters. According to the US Census Bureau, total advanced technology products imported from Vietnam was relatively small at around US$11bn in 2017. We think this actually presents an opportunity for Vietnam as China-based manufacturing firms may consider migrating production to Vietnam to avoid the US tariffs. Given Vietnam's tiny share of total US imports of ICT products relative to China, even a sliver of production leaving Chinese shores could lead to a deluge of inbound FDI into Vietnam. In fact, given China's dominance in component supply, Vietnam has the opportunity to attract upstream FDI, which will help it move up the electronics value chain from low-end assembly work to component production.

Figure 8: US total advanced technology products imports from China (2002-17, US$ m)



SOURCES: CGS-CIMB RESEARCH, US CENCUS BUREAU

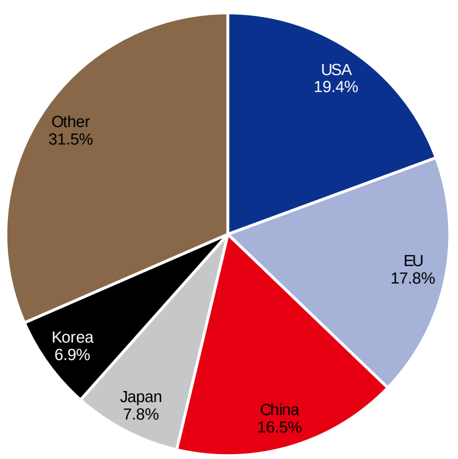
Figure 9: Dependence on ICT exports by Asian country (2015)



* Vietnam data is based our estimates in 2017
SOURCES: CGS-CIMB RESEARCH, UNCTAD

For now, we think the trade tensions will not have a significant negative impact on global economic growth as: 1) actions from the Trump administration have been limited in scope (2-3% of total US imports in 2017 based on our estimation, including trade measures on steel and aluminium), 2) reactions from China are restrained. In fact, China is targeting US imports worth US$3bn, which is a drop in the ocean given the size of the bilateral trade relationship of US goods exported to China. China has announced retaliatory measures on only around 2.3% of the value of US's goods exports to China as of 201, and 3) given the heavy interdependence of the US and Chinese economies, we think both parties will reach a 'face-saving' compromise and avoid risking an all-out trade war. Nevertheless, a trade war between two global economic giants – if it actually happens - will have negative externalities on all major exporters to the US. Vietnam would be particularly vulnerable due to the high share of its total exports that go to the US. Investors should closely watch how the US-China trade spat evolves as any further deterioration could trigger a reversal of the current positive sentiment in the Vietnam stock market as well as spur US$/VND exchange rate volatility.

Figure 10: Vietnam exports by destination country (2017)

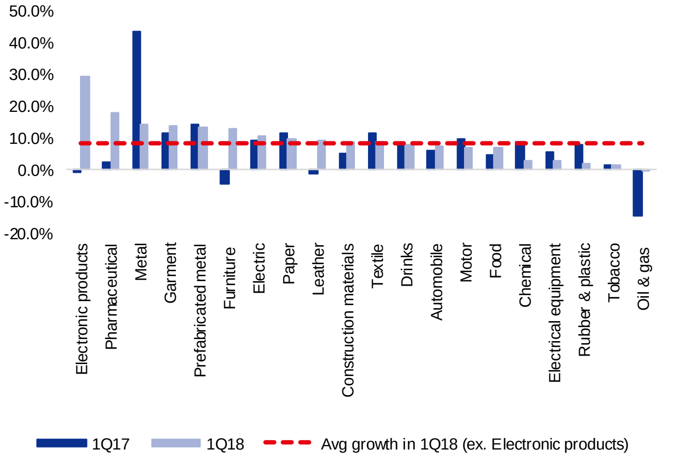


SOURCES: CGS-CIMB RESEARCH, VIETNAM CUSTOMS

We think that construction materials, beverage, banking, retail and tourism are poised to see strong 1Q earnings ›

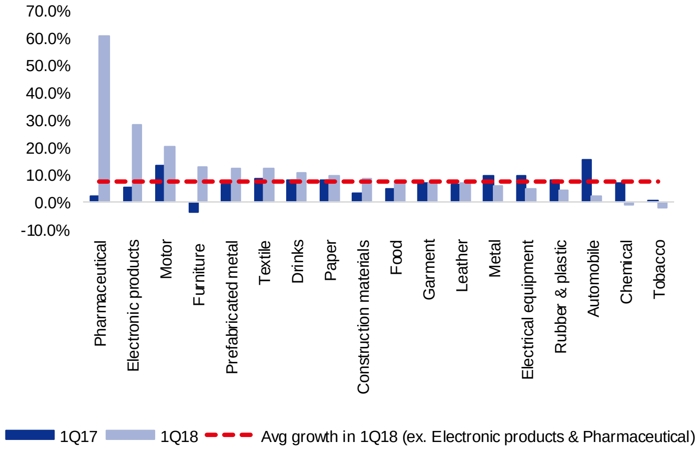
Apart from the manufacturing of electronic products, which is mainly driven by the FDI sector with no representation on the stock market, we see pockets of strength in inward-facing 'old economy' manufacturing industries. We are positive on 1Q earnings for furniture, construction materials, textile, beverages and paper companies. In the first quarter of 2018, the production of pharmaceutical, construction materials, garments, furniture, electronic and paper products performed better than in the same period the previous year and also outperformed average industrial production growth. In 1Q18, there was a sudden spike in pharmaceutical production and consumption growth, which is rather inexplicable to us.

Figure 11: Industrial production growth by sector (yoy change)



SOURCES: CGS-CIMB RESEARCH, GSO

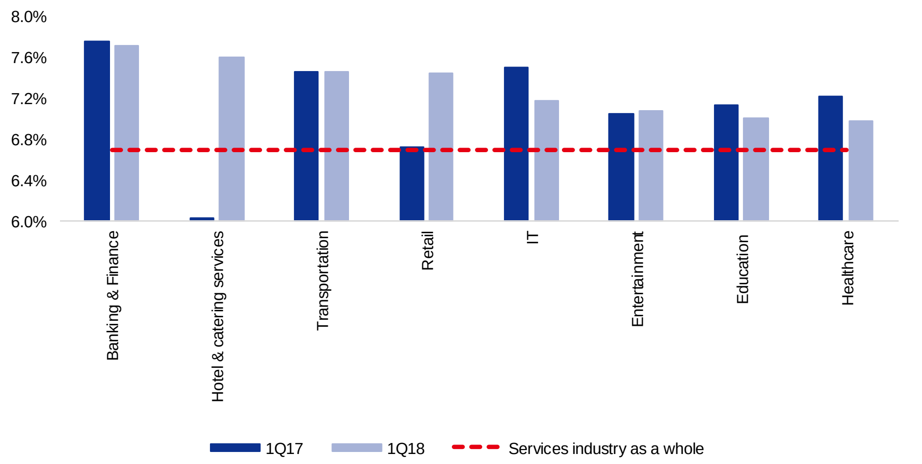
Figure 12: Consumption index growth by sectors (yoy change)



SOURCES: CGS-CIMB RESEARCH, GSO

The breakdown of GDP growth by industries also showed that services performed well in 1Q18 with value growth of 6.7% yoy, which was better than in the same period the prior year. Growth of the financial sector was stable at 7.7%, making it a continued bright spot within the service economy. There was a notable improvement in hotel and catering services as well as retailing on the back of sustained tourism growth and buoyant domestic demand. Therefore, we expect financial services, tourism and retail companies to see strong earnings growth in 1Q18.

Figure 13: GDP growth breakdown by service category (yoy change)



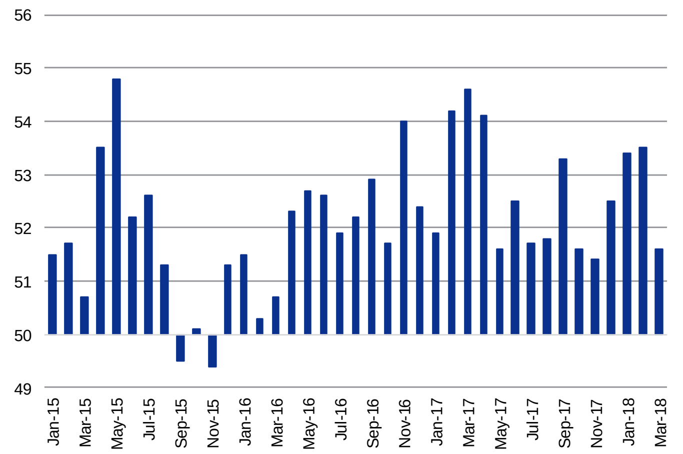
SOURCES: CGS-CIMB RESEARCH, GSO

Macro indicators in Mar 2018

Figure 14: Vietnam's industrial production growth (mom % chg, 3-month moving average) in 2015-18

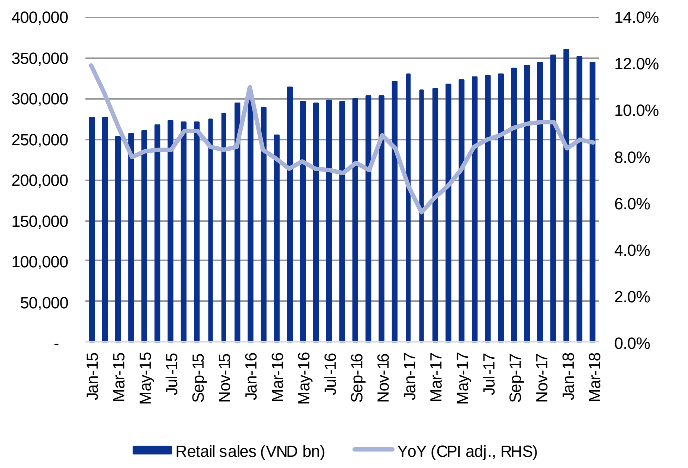
SOURCE: CGS-CIMB RESEARCH, GSO

Figure 15: Vietnam's PMI in 2015-18



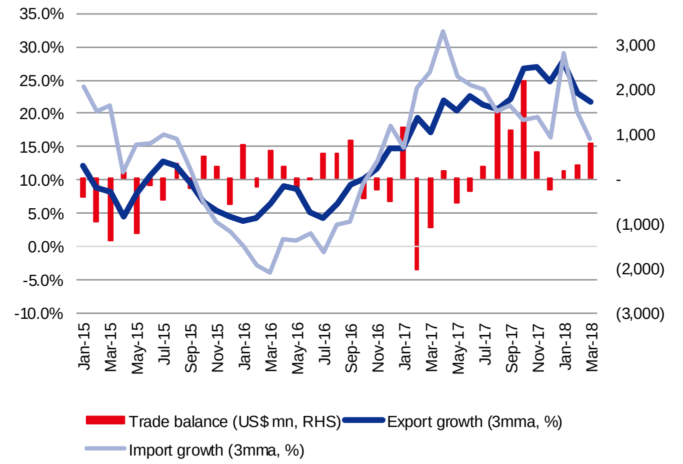
SOURCE: CGS-CIMB RESEARCH, NIKKEI

Figure 16: Retail sales in 2015-18



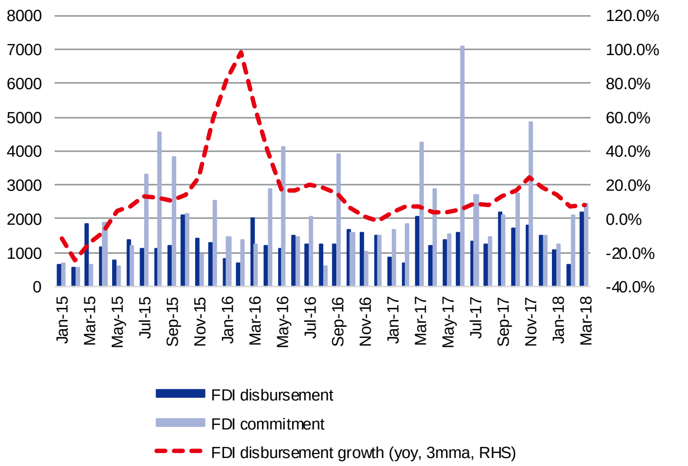
SOURCE: CGS-CIMB RESEARCH, GSO

Figure 17: Vietnam's trade balance and import and export growth in 2015-18



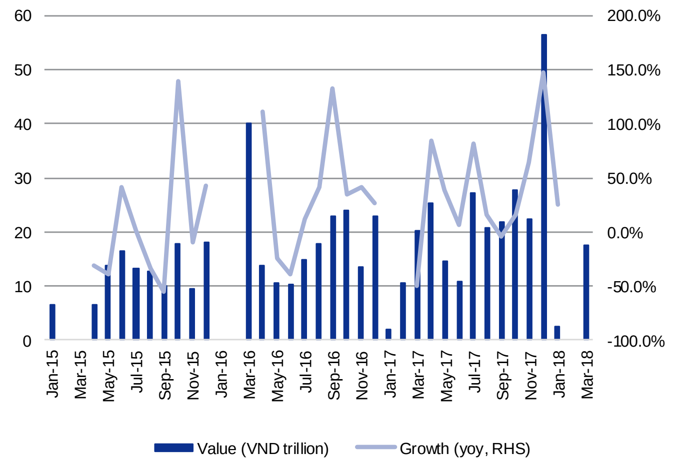
SOURCE: CGS-CIMB RESEARCH, GSO

Figure 18: FDI disbursement & commitment (US$ m) in 2015-18



SOURCE: CGS-CIMB RESEARCH, GSO

Figure 19: Public investment in 2015-18



SOURCE: CGS-CIMB RESEARCH, GSO

Figure 20: Commodities prices by industry (Mar 2018)

	Unit	Current	+/- YTD (%)	Mar 2018 average	+/- YoY (%)	+/- MoM (%)
Oil&Gas						
Brent	US$/barrel	70.3	5.6%	66.8	27.1%	1.5%
WTI	US$/barrel	64.9	7.6%	62.8	26.6%	1.0%
Transportation						
Baltic Dry Index		1,055.0	-22.5%	1,082.8	-5.1%	-3.6%
Baltic Clean Tanker		560.0	-14.5%	536.2	-23.8%	-13.6%
Baltic Dirty Tanker		661.0	-5.6%	609.6	-26.3%	-5.9%
Steel inputs						
HRC	US$/tonne	605.0	7.1%	623.8	24.4%	2.9%
Scrap	US$/tonne	378.0	0.3%	402.8	52.6%	3.3%
Iron ore	US$/tonne	75.6	3.9%	64.5	-24.8%	-13.3%
Hard coal	US$/tonne	197.3	3.2%	204.0	28.0%	4.4%
Graphite	US$/tonne	15,834.8	42.3%	15,652.1	791.3%	-1.2%
Agriculture						
Rice	US$/tonne	414.0	7.3%	364.6	1.7%	-10.6%
Corn	US$/tonne	139.0	9.0%	137.3	2.3%	3.0%
Wheat	US$/tonne	165.7	4.0%	173.7	10.8%	4.0%
Chemical						
Urea	US$/tonne	325.0	-6.3%	332.5	28.6%	-3.2%
Natural Rubber	US$/tonne	1,641.6	-10.2%	1,691.2	-32.9%	0.2%
Textile						
Cotton	US$/tonne	770.0	1.3%	795.2	7.2%	6.0%
Metal						
Lead	US$/tonne	2,395.0	-6.8%	2,234.2	-2.2%	-13.3%
Steel	US$/tonne	540.8	-18.1%	606.1	13.6%	-2.8%
Zinc	US$/tonne	3,274.0	-2.2%	3,055.6	9.6%	-12.7%
Copper	US$/tonne	6,714.0	-6.8%	6,389.6	9.4%	-9.4%
Gold	US$/oz	1,325.5	1.8%	1,327.4	7.8%	-0.4%

NOTE: PRICE AS OF 31 MAR 2018
SOURCE: CGS-CIMB RESEARCH, BLOOMBERG

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