Vietnam

Economics Focus

External pressures have intensified

- We expect that inflation will be higher for the remainder of 2018.
- We expect export momentum to ease in the coming quarters.
- Weaker investment goods imports raise concerns about the potential for business expansion and manufacturing capital investment.
- Vietnam G-bond yields may have bottomed out.
- External risks unlikely to abate yet macro stability is here to stay.

Higher inflation expectations for the remainder of 2018

Headline inflation remained benign in Apr 2018 at 2.8% yoy but we expect inflation to accelerate on the back of higher hog (pork) and oil prices. Our forecast for inflation in 2018 remains at 4.6%. Given the strong upward movement in food and fuel prices, we believe that government price controls will be crucial in ensuring that inflation remains at a manageable level.

We expect export momentum to ease in the coming quarters

1Q was a remarkable quarter on the trade front, with yoy export growth averaging over 24.3% per month, a marked acceleration from the 21.6% growth seen in 2017. However, this heady pace is finally beginning to show signs of cooling and we expect export growth to decelerate from 1Q18 levels. The high base of electronic product exports in the final three quarters of 2017 may weigh on annual export growth for 2018.

Weaker investment goods imports

Although growth of intermediate goods imports remained solid, machinery equipment and steel imports were both negative in the first 4 months of the year (-6.4% yoy). This is a concern because it indicates that the private sector may not engage aggressively in business expansion and could also be a lead indicator of a possible weakening in the pace of foreign direct investment disbursements into the country.

Vietnam G-bond yields may have bottomed out

Rising US rates and a resurgent US$ currency have shaken emerging and frontier markets, including Vietnam. This resulted in increased pressure on Vietnam G-bond rates and the stock market in recent months. Vietnam G-bond yields dipped considerably in 1Q18 due to abundant liquidity in the banking system but we think bond yields may have bottomed out amid rising US yields and failing government bond auctions recently.

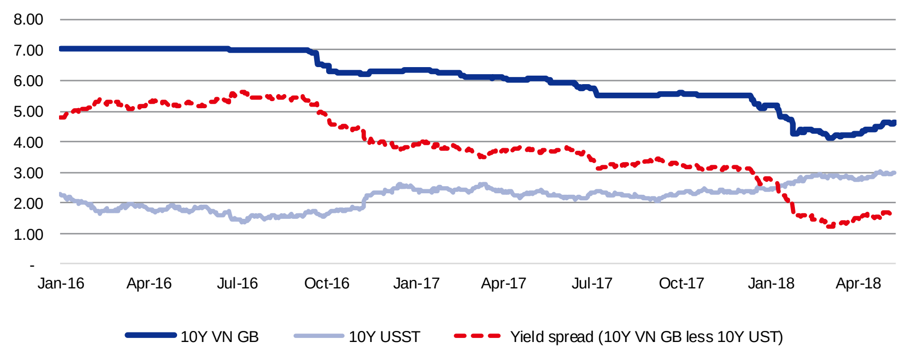
External volatilities may yet persist

There are several global factors to watch out for that may impact Vietnam. Surging inflation in the US could prompt the Fed to raise rates more aggressively. However, we hold the view that there will only be two more interest rate increases this year as wage pressure is not strong enough to trigger a change in the Fed rate hike trajectory. On the other hand, the rising US 10-year Treasury yield may continue to act as a drag on global equity market sentiment. Other key developments to monitor are the progression of trade negotiations between the US and China and the scrapping of the Iranian nuclear deal.

Macro stability is here to stay

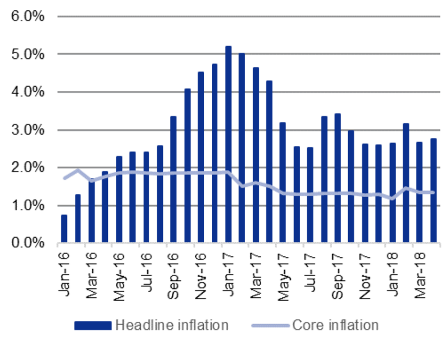
Vietnam's macroeconomic fundamentals remain stable despite external risks, such as the US rate hike cycle and US-China trade tensions. We expect inflation to increase towards the end of 2018, though it will remain at a manageable level. In 1Q18, we forecast a positive current account and capital account, thanks to the trade surplus and continued foreign investment inflows. In addition, Fitch Ratings recently upgraded its rating for Vietnam to BB and risk indicators seem to be contained for now.

Figure 1: 10Y Vietnam G-bond yield vs. 10Y US Treasury yield (%)

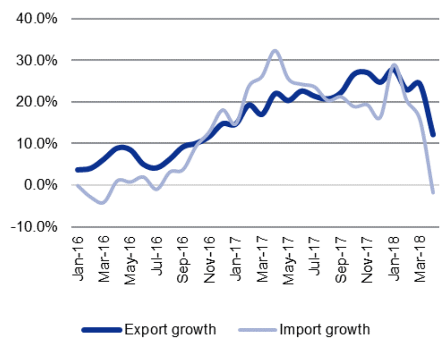


SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Inflation remained benign



Decelerating trade growth (3mma, yoy chg)



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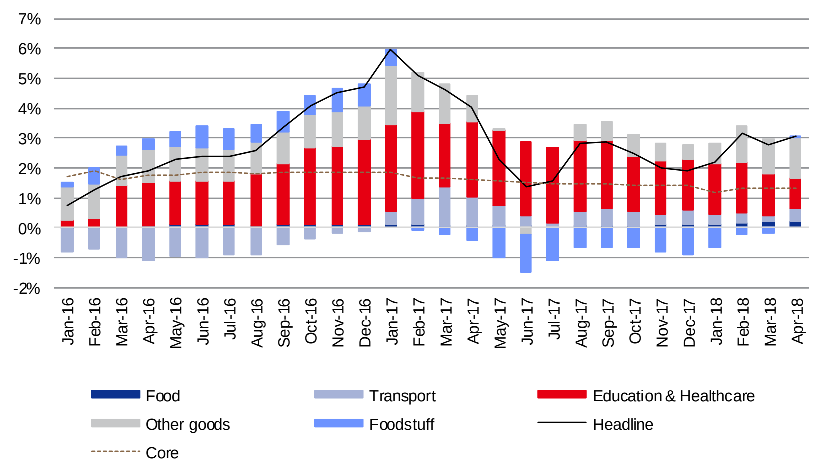
External pressures have intensified

Higher inflation expectations for the remainder of 2018

Apr 2018 CPI inflation remained low at 2.80% yoy, lower than 2.82% in Mar and 4.80% in the same period the previous year. The food & foodstuffs component continued to decline and this was underpinned by the foodstuffs (-0.33% mom vs. -1.53% mom in Mar) sub-component, in particular due to its high weighting. Meanwhile, a sharp increase in domestic fuel prices led the transport component to rise 1.18% mom in Apr vs. -0.77% mom in Mar.

Figure 2: Inflation breakdown by component (yoy chg, Jan 16 to Apr 18)



SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

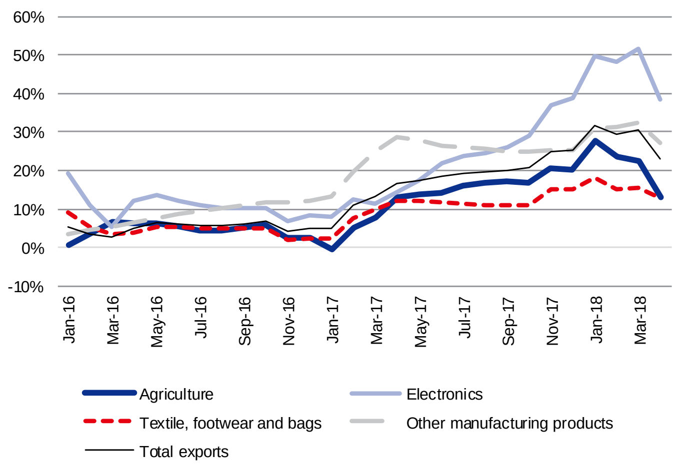
We expect both the food and transport components to rise further on the back of increasing hog and petrol prices. Domestic live hog prices surged recently to VND45,000/kg (+32.4% since Jan 2018). This is attributed to 1) the closure of around 30% to 40% of pig-breeding households and small-scale breeders in 2017, and 2) rising raw material prices in the first 4 months of 2018. Meanwhile, oil prices spiked to the highest level since 2014 after the US president abandoned a nuclear deal with Iran and announced the highest ever level of sanctions against this country in the beginning of May. The re-imposition of US sanctions on Iran may lead to a removal of more than 1 mbd of crude oil supplies, equivalent to 1.4% of global oil demand, which will consequently trigger a strong upward movement in oil prices.

Given our expectation of food and fuel price pressures to rise, we believe the government's policy of not changing administered prices will be crucial to keeping inflation within the target of 4.0%. We maintain our inflation forecast of 4.6% for 2018.

Exports momentum to ease slightly

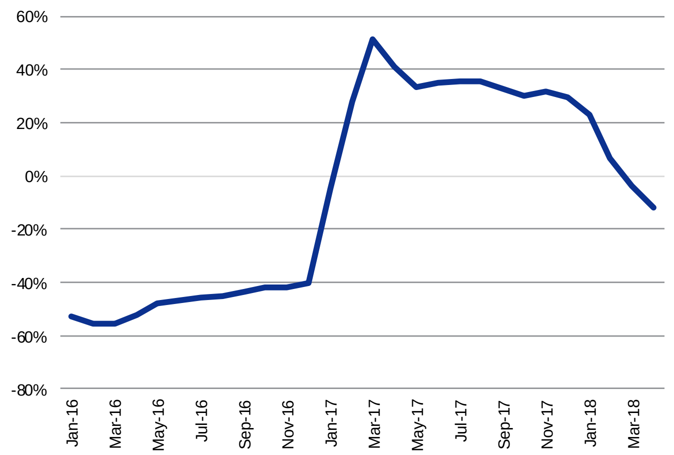
1Q was a remarkable quarter on the trade front, with export growth averaging over 24.3% per month, higher than the average growth of 21.7% in 2017. However, we expect export momentum to ease slightly in the coming quarters and we are beginning to see some signs of cooling. According to Vietnam's Customs, gross exports only rose 4.8% yoy in Apr 2018, the lowest pace seen since Aug 2016. The yearly growth in exports sequentially lost momentum during the first 4 months of 2018, reaching 19.0%. Exports of smartphones, computers and electronic components expanded 26.6% yoy in Apr 2018, which was slower than the growth rate of 43.4% in 1Q18. Meanwhile, minerals exports continued to trend downwards (-16.6% yoy) while agriculture and textile exports grew at a moderate pace of 11.0% yoy and 11.6% yoy, respectively, during the first 4 months of 2018.

Figure 3: Exports growth lost momentum in Apr 2018 (3m average yoy chg)



SOURCES: CGS-CIMB RESEARCH, VIETNAM CUSTOMS

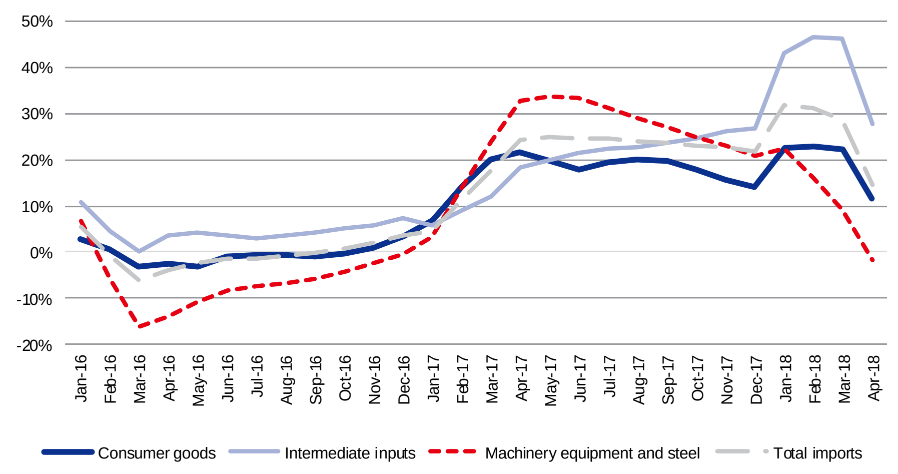
Figure 4: Minerals exports growth continued to decline (3m average yoy chg)



SOURCES: CGS-CIMB RESEARCH, VIETNAM CUSTOMS

The imports of electronics products remained firm, growing 21.9% yoy, which was the result of the combination of component inventory build-up efforts and the strong sustained demand for electronics exports. However, investment goods (machinery equipment and steel) import growth was negative in the first 4 months of the year (-6.4% yoy). According to Vietnam's General Statistics Office (GSO), FDI disbursement still increased 6.3% yoy but registered FDI decreased sharply (-23.9% yoy) as there was a lack of billion-dollar projects as compared to the previous year. This is a concern because it indicates that the private sector may not engage aggressively in business expansion and could also portend a tempering of FDI flows into Vietnam.

Figure 5: Imports growth declined sharply in the first 4 months of 2018 (3m average yoy chg)



SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

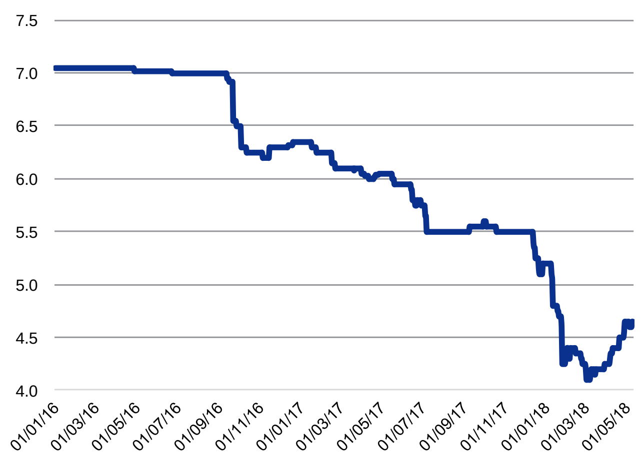
Due to the weaker growth in imports, Vietnam experienced a trade surplus of US$1.2bn in Apr 2018, following a record high trade surplus of US$2.3bn in Mar. In the beginning of May 2018, the government announced a second consecutive monthly rise in FX reserves, which expanded from US$52bn in 2017 to US$63bn. The current FX reserves are now able to cover 3.5 months of the country's imports, the highest level since 2008. In our view, the growing reserves will support the dong's stability amid the strengthening of the US$.

Vietnam G-bond yields have bottomed out, though this is not a major source of concern at the moment

Data from the Labour Department pointed to a steady build-up of inflation in the US, with the core personal consumption expenditures (PCE) price index accelerating to 1.9% yoy in Mar 2018. As the Fed's favourite inflation metric is now nearly hitting its 2.0% target, investors are beginning to anticipate higher inflation, which drove the yield on 10Y Treasuries above 3.0% in the previous month.

Rising US rates and a resurgent US$ currency have shaken emerging and frontier markets, including Vietnam. There was increased pressure on Vietnam G-bond rates and the stock market in recent months; 10Y G-bond yields have risen to 4.7%, rebounding from a record low of 4.1% in the beginning of Mar 2018. Meanwhile, the 5Y credit default swap (CDS) has increased to a 10M high of 151.8pts while Vietnam's stock market experienced a plunge during the same period. Global equity market volatility has led to net outflows in portfolio investment since Mar 2018, though the YTD net foreign investment in equities was still up 43.1% yoy due to the strong inflows during the beginning of the year.

Figure 6: Vietnam 10Y G-bond yield has bottomed out (%)

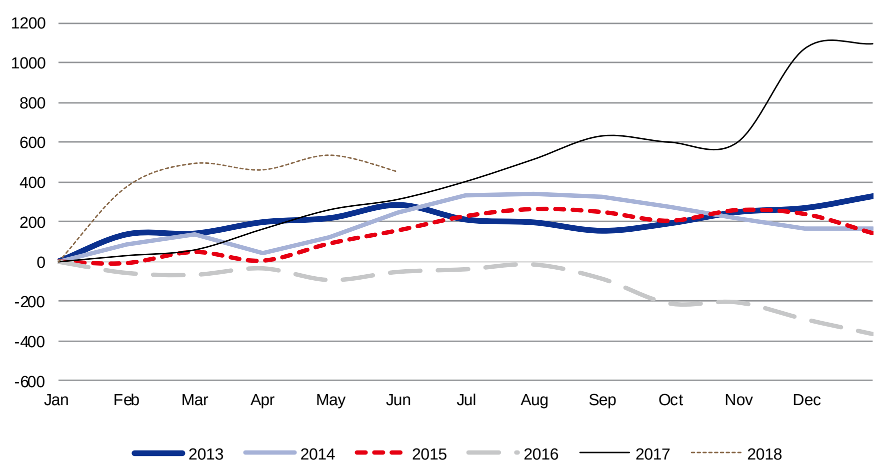


SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 7: The 5Y CDS also rebounded (pts)

SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 8: YTD net foreign investment in equities (US$ m)



SOURCES: CGS-CIMB RESEARCH, FIINPRO

In Apr 2018, G-bond auctions were poorly received with a low absorption ratio of only 39.3% as bids demanded higher yields. We think Vietnam G-bond yields may have bottomed out due to rising US rates and failing bond auctions recently. Rising bond yields could challenge equity valuations, in our view, especially without stronger earnings growth.

Despite these concerns, we believe the fundamentals of Vietnam's economy and stock market are strong and that there are no immediate risks. Macroeconomic fundamentals remain stable amid external risks, such as the US rate hike cycle and US-China trade tensions. Headline and core inflation remain benign, at 2.8% and 1.3% yoy in Apr, respectively, well within the government's target of 4.0% for 2018. We expect inflation to accelerate towards the end of 2018, though it will still stay at a manageable level. In 1Q18, we expect a positive current account and financial account, thanks to the trade surplus and continued foreign investment inflows, despite a slowdown in registered FDI. In addition, Fitch Ratings recently upgraded its rating for Vietnam to BB, noting rising FX reserves and strong economic growth. Risk indicators seem contained for now, in our view.

Investors should stay vigilant as external risk factors persist

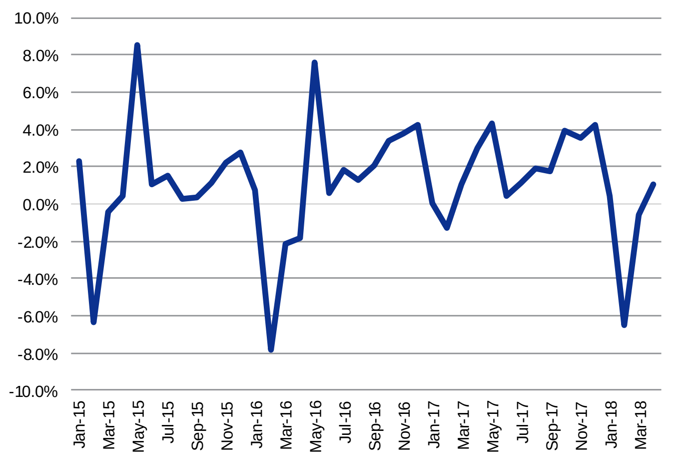
On the external front, there are several factors to watch out for. Surging inflation in the US will prompt the Fed to raise rates more aggressively. However, wage growth remains sluggish even as labour markets tighten. The latest data show that unemployment in the US has fallen to 3.9% for the first time since 2000 but wages grew 2.6% yoy in Apr, which was the same as Mar and below the market expectation of 2.7%. Therefore, we maintain our outlook for two more interest rate increases this year as the wage pressure is not strong enough to trigger a change in the Fed rate outlook.

On the other hand, the rising US 10-year Treasury yield may continue to act as a drag on global market sentiment. Other key events to monitor include ongoing trade tension between the US and China as this could intensify further and catalyse a return in investor risk aversion.

Finally, continued oil price rises could also accelerate the return of global inflation and accelerate the interest rate upcycle.

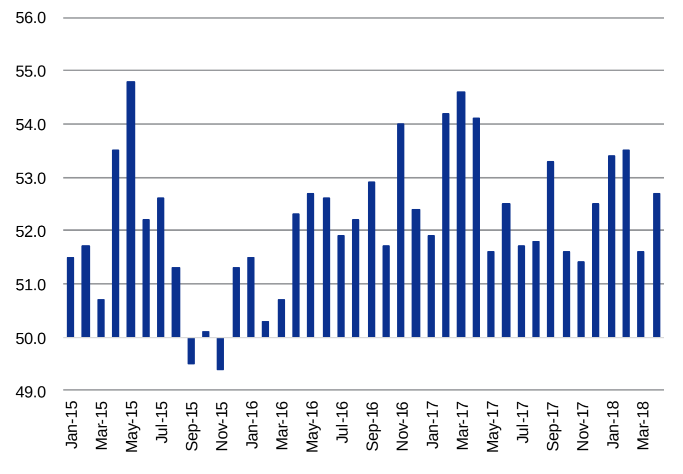
Macro indicators in Apr 2018 »

Figure 9: Vietnam's industrial production growth (mom % chg, 3-month moving average) from Jan 15 to Apr 18



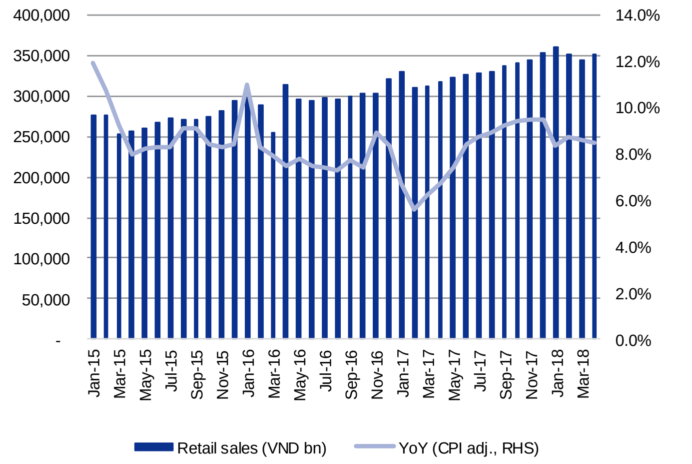
SOURCE: CGS-CIMB RESEARCH, GSO

Figure 10: Vietnam PMI from Jan 15 to Apr 18



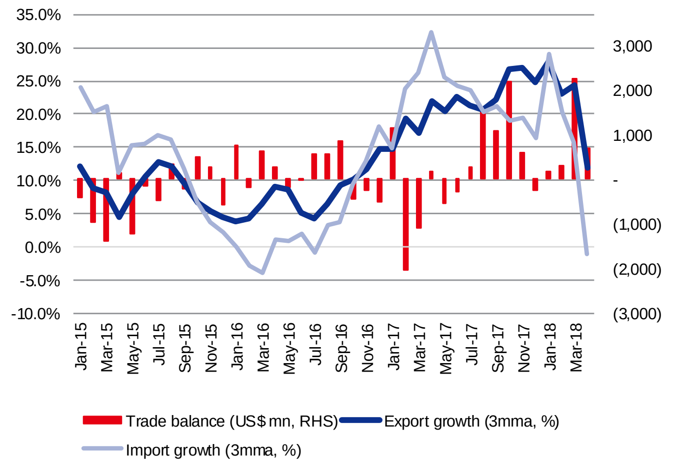
SOURCE: CGS-CIMB RESEARCH, NIKKEI

Figure 11: Retail sales from Jan 15 to Apr 18



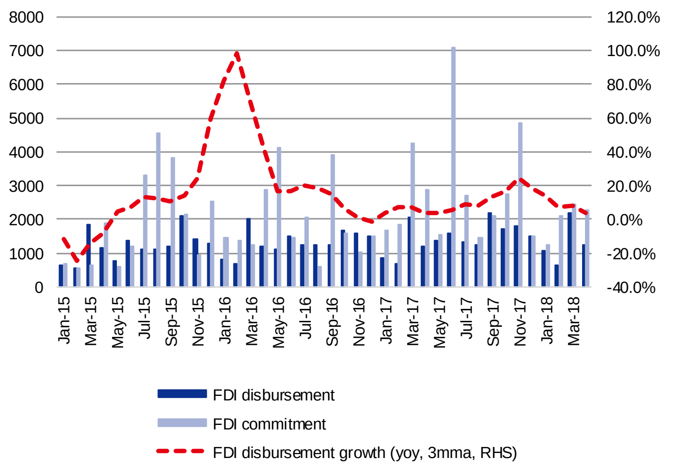
SOURCE: CGS-CIMB RESEARCH, GSO

Figure 12: Vietnam's trade balance, import and export growth from Jan 15 to Apr 18



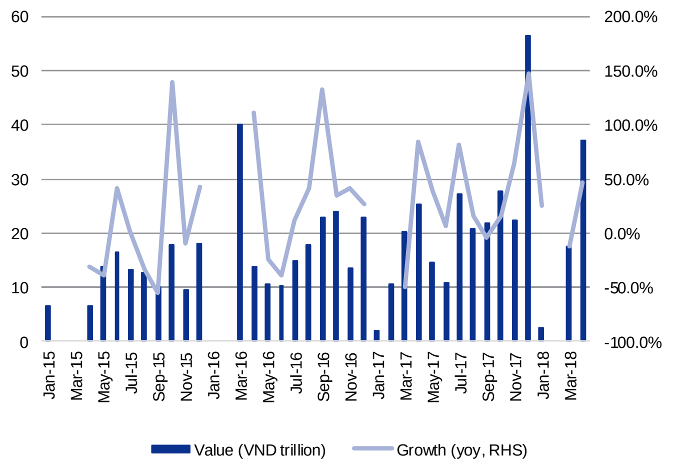
SOURCE: CGS-CIMB RESEARCH, GSO

Figure 13: FDI disbursement & commitment (US$ m) from Jan 15 to Apr 18



SOURCE: CIMB RESEARCH, GSO

Figure 14: Public investment from Jan 15 to Apr 18



SOURCE: CGS-CIMB RESEARCH, GSO

Figure 15: Commodities prices by industry (Apr 2018)

	Unit	Current	+/- YTD (%)	Apr 2018 average	+/- YoY (%)	+/- MoM (%)
Oil&Gas						
Brent	US$/barrel	78.4	17.8%	71.8	33.6%	7.6%
WTI	US$/barrel	71.3	18.1%	66.3	29.9%	5.6%
Transportation						
Baltic Dry Index		1,468.0	-22.5%	1,128.6	-7.7%	-1.7%
Baltic Clean Tanker		532.0	-18.8%	539.4	-17.7%	-5.6%
Baltic Dirty Tanker		667.0	-4.7%	642.1	-19.1%	-1.5%
Steel inputs						
HRC	US$/tonne	607.0	7.4%	603.0	35.1%	-3.3%
Scrap	US$/tonne	398.0	5.6%	390.8	62.5%	-3.0%
Iron ore	US$/tonne	65.4	-10.1%	62.6	-9.2%	-5.9%
Hard coal	US$/tonne	182.4	-4.6%	188.8	-14.3%	-7.5%
Graphite	US$/tonne	12,453.7	11.9%	15,134.4	669.3%	-3.3%
Agriculture						
Rice	US$/tonne	431.0	11.7%	429.8	19.8%	6.0%
Corn	US$/tonne	146.8	15.1%	138.9	3.4%	1.2%
Wheat	US$/tonne	181.3	13.8%	174.8	12.8%	0.6%
Chemical						
Urea	US$/tonne	336.0	-3.2%	327.2	32.8%	-1.6%
Natural Rubber	US$/tonne	1,604.9	-12.2%	1,634.9	-33.3%	-3.3%
Textile						
Cotton	US$/tonne	800.0	5.3%	795.3	7.5%	0.0%
Metal						
Lead	US$/tonne	2,348.0	-8.6%	2,355.7	6.6%	-1.4%
Steel	US$/tonne	625.7	-5.2%	595.4	19.3%	-1.8%
Zinc	US$/tonne	3,062.0	-8.6%	3,194.9	21.8%	-2.2%
Copper	US$/tonne	6,808.0	-5.5%	6,879.1	20.7%	0.7%
Gold	US$/oz	1,290.5	-0.9%	1,334.0	5.1%	0.5%

SOURCE: CGS-CIMB RESEARCH, BLOOMBERG, PRICE AS OF 15 MAY 2018

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