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WISDOM TO SUCCESS

Economics Note

Vietnam September 6, 2019

Vietnam

Economics Update

On solid ground

- We expect Vietnam's GDP growth to remain strong at 6.6-6.7% yoy in 3Q19.
- We think trade and investment diversion benefits from the US-China trade war could compensate for the negative effects of China's slowdown, for now.
- A strong currency could damage Vietnamese exporters' competitiveness.

More downside risks to global growth after the latest round of tariffs

The US-China trade war continued to escalate in Aug 2019 with the announcement of new tariffs on Chinese goods (15% tariffs on US$112bn in Chinese goods took effect on 1 Sep and tariffs on US$250bn will be raised from 25% to 30% on 1 Oct). This leads to a consensus view that trade tensions are more likely to escalate than be resolved, casting a shadow on the global economic outlook.

Industrial and retail activity holding ground

Vietnam's economic activity maintained its growth momentum in 8M19, with a rise of 9.5% yoy in industrial production index, combined with solid growth in retail sales (+9.0% yoy, ex-inflation). Despite the escalating US-China trade war, we expect Vietnam's economy to remain resilient, with an economic growth of 6.6-6.7% yoy in 3Q19.

Lower exports to China offset by gains in exports to US

Vietnam's total exports grew by 7.9% yoy in 7M19, which was lower than the growth rate of 16.6% in the same period last year. Exports to China fell marginally (-0.8% yoy) while exports to the US jumped 23.7% yoy in 7M19. As the US remains Vietnam's largest export partner (7M19 share: 22.7% vs. 2018 share: 19.9%), gains in US exports have been more than sufficient to offset the decline in China exports.

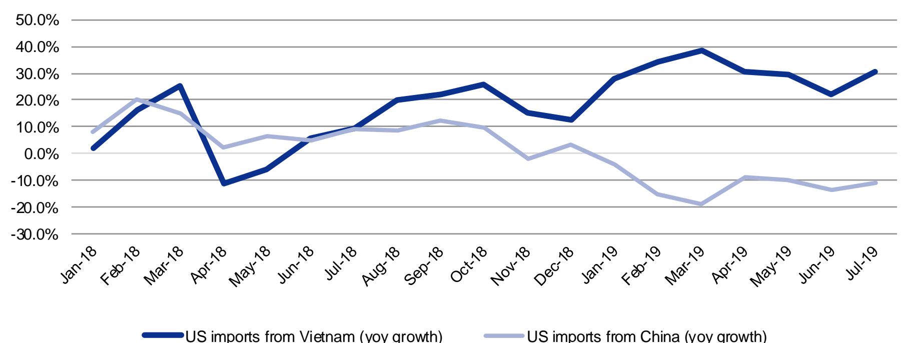
Production shift to Vietnam: steady growth rather than a big leap

Registered FDI declined by 7.1% yoy in 8M19, reflecting the smaller scale of FDI projects coming to Vietnam. It is important to note that FDI inflows to the manufacturing sector remained strong, up 10.8% yoy in 8M19 (which does not include a US$3.85bn ThaiBev investment). We expect a steady growth of FDI inflows, which will create a moderate positive impact on exports growth as well as economic growth in the coming years.

A strong currency comes at an inopportune time

In the past few months, the dong had been relatively immune to the impact of the Rmb depreciation against the US$. Although the SBV had aimed to weaken the dong by adjusting the central rate, the dong weakened by only 0.1% YTD against the greenback, even as the central rate increased by about 1.4% YTD. As we believe a further escalation in the US-China trade war will put more pressure on the yuan, the SBV will likely need to put more efforts into nudging the dong weaker, given that a strong currency at this time could damage the country's export competitiveness.

Figure 1: Trade diversion between Vietnam and China



SOURCES: VNDIRECT RESEARCH, USITC

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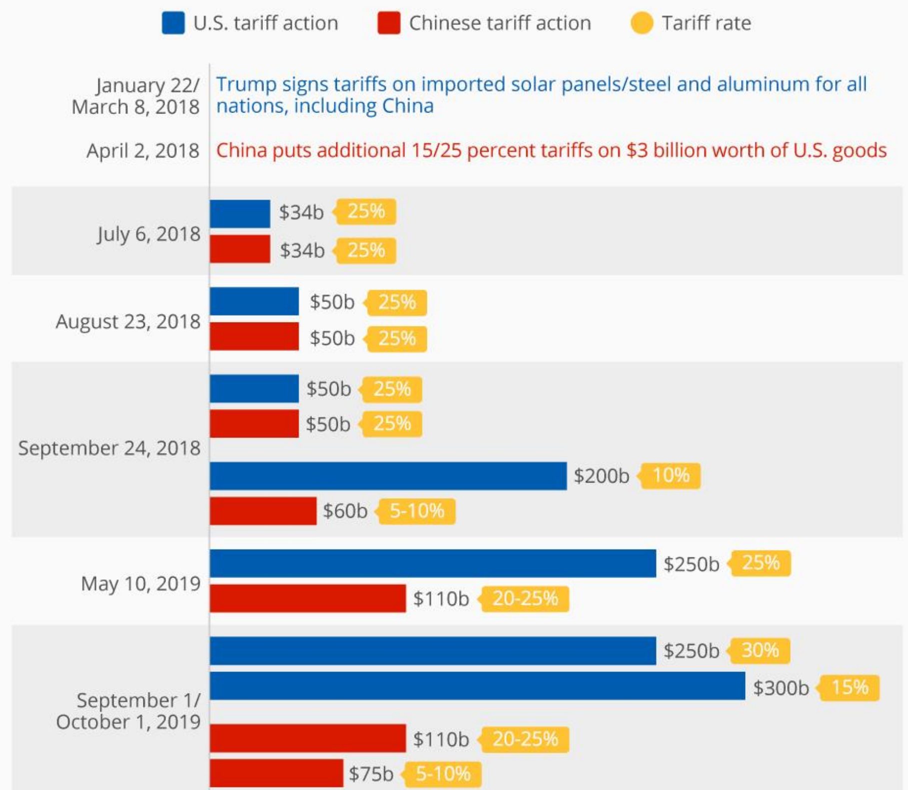
On solid ground

The latest salvo in the US-China trade war

In early-Aug, the US announced a 10% tariff on an additional US$300bn of imports from China, going into effect in two tranches on 1 Sep (US$112bn) and 15 Dec (US$160bn). According to the Peterson Institute for International Economics (PIIE), the 1 Sep tariffs hit a lot of clothing and shoes and the 15 Dec tariffs will hit toys and consumer electronics. In response, China retaliated with new 5-10% tariffs on US$75bn of US imports and a 25% tariffs on US auto and auto parts effective on the same dates.

In late-Aug, US President Trump raised existing tariffs on US$250bn of Chinese goods from 25% to 30% (starting on 1 Oct), and upped the ante on the aforementioned tariffs from 10% to 15%. On 1 Sep, 15% tariffs on US$112bn in Chinese goods took effect, and as a result, more than two-thirds of the consumer goods the US imports from China now face higher taxes. In early-Sep, a representative of the Chinese Commerce Ministry said China would sue the US through the WTO over the latest round of tariffs.

Figure 2: How the US-China trade war has escalated



SOURCES: VNDIRECT RESEARCH, STATISTA

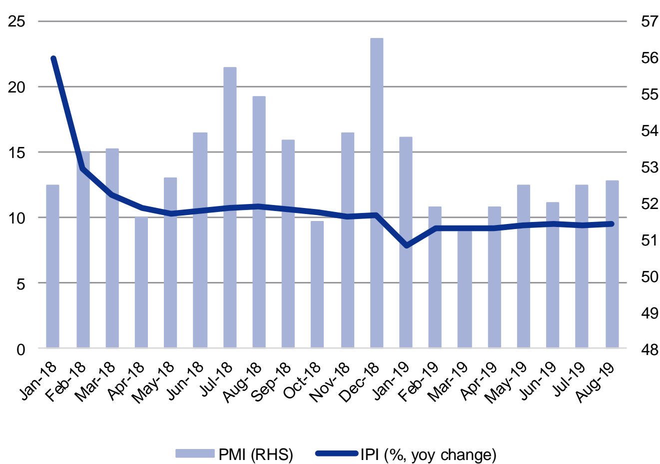
It is clear that the additional tariffs have increased downside risks to the global economy. In response to these negative pressures, we expect the US Federal Reserve to deliver an additional 50bp rate cut by year-end, and China to ease either monetary or fiscal policy.

Vietnam's economic growth set to be solid in 3Q19

Vietnam's PMI fell from 52.6 in Jul to 51.4 in Aug 2019 due to weaker business sentiment amid intensifying US-China trade tensions. Even so, the manufacturing sector remained in expansionary territory for the 45th straight month. In addition, the industrial production index (IPI) continued to expand by 10.5% yoy in Aug 2019 (vs. 9.7% yoy in Jul), thanks to the positive recovery of the mining sector (+14.4% yoy in Aug).

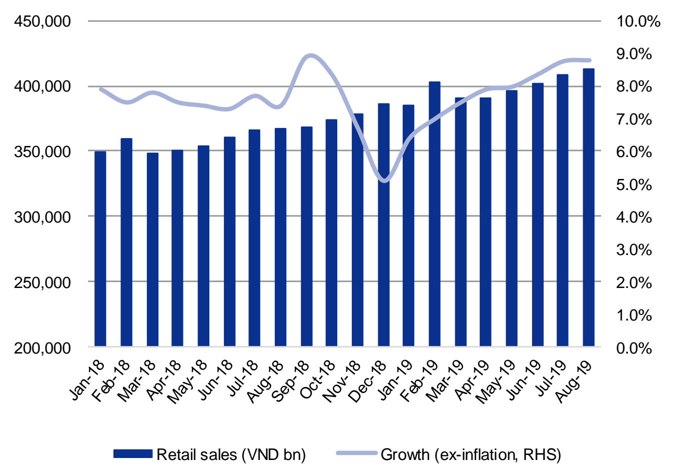
In the first eight months of 2019, the IPI posted a growth of 9.5% yoy, unchanged vs. 1H2019, suggesting industrial activity has kept its growth momentum. In addition, retail sales also showed a solid performance with a positive growth of 9.0% yoy (ex-inflation), unchanged vs. the same period last year. As growth in retail sales and industrial production were positive, we expect Vietnam to post a GDP growth of 6.6-6.7% yoy in 3Q19 (vs. 6.76% yoy in 1H19).

Figure 3: Vietnam's manufacturing sector remained solid



SOURCES: VNDIRECT RESEARCH, GSO

Figure 4: Strong performance in retail activity



SOURCES: VNDIRECT RESEARCH, GSO

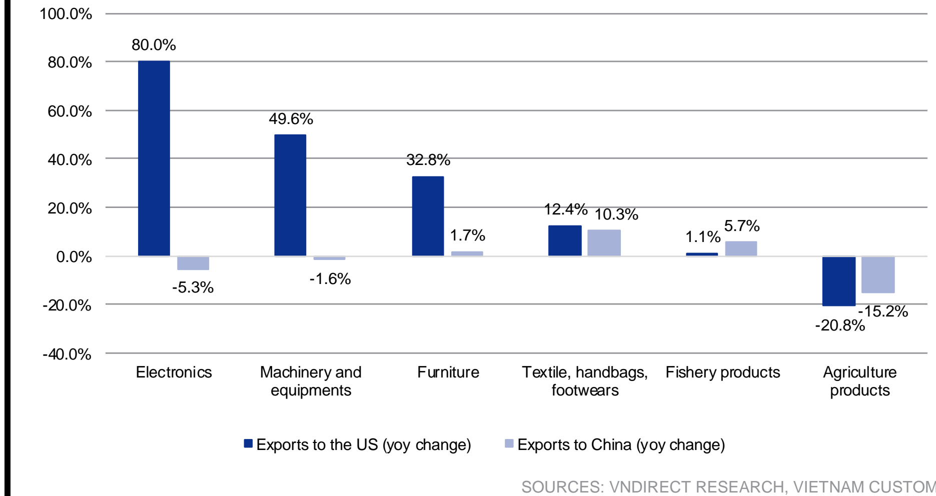
Benefits from trade diversion enough to compensate for weakening demand from China

Lower exports to China offset by gains in exports to US

Vietnam's total exports are estimated to expand by 7.4% yoy in 7M19. Exports to EU and China decreased marginally (-1.4% yoy and -0.8% yoy, respectively). In contrast, exports to the US grew at a strong 23.7% yoy in 7M19. Because the US remains Vietnam's largest export partner (7M19 share: 22.7% vs. 2018 share: 19.9%), gains in the US exports have been sufficient to offset the decline in China exports.

Until now, the impact of the US-China trade war has started to surface in varying degrees for the Vietnamese manufacturing sector. There were sharp increases in exports of electronics, machine and furniture to the US, while exports of textiles, footwear and handbags showed moderate growth. On the other hand, agricultural exports recorded a negative growth in both the US and China markets, mainly driven by a sharp drop in rice exports.

Figure 5: Vietnam's export growth to the US and China by major products in 7M19



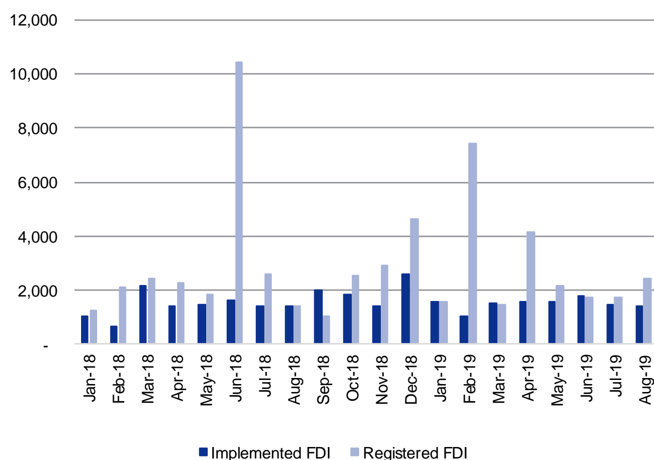
SOURCES: VNDIRECT RESEARCH, VIETNAM CUSTOMS

Although the weaker Chinese yuan, which has depreciated 8.4% against the greenback since Jun 2018, has partly offset the impact of US tariffs, we think a further increase in US tariffs to 30% will be a burden for Chinese exporters. As the tariffs are unlikely to be reversed anytime soon, the latest escalation could result in more trade diversion away from China. As such, we believe Vietnamese exports will continue to outperform those of other Asian countries in the medium term.

Production shift to Vietnam: steady growth rather than a big leap

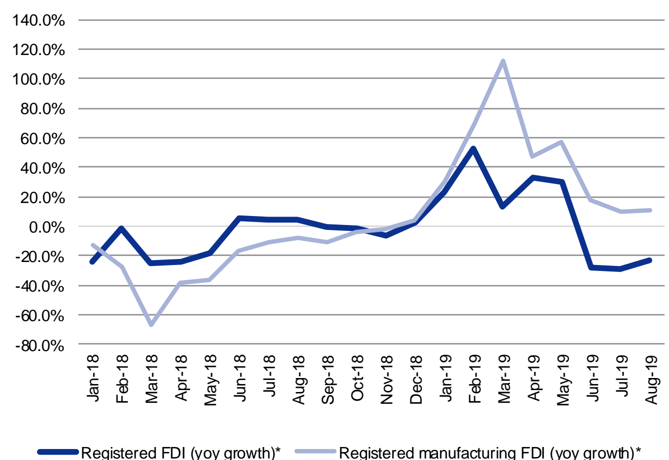
In 8M19, implemented FDI rose by 6.3% yoy to US$11.9bn, while registered FDI declined by 7.1% yoy to US$22.6bn. In our view, a decline in registered FDI does not mean a slowdown in FDI inflows as we see a rising number of FDI projects coming to Vietnam, but at a smaller scale compared to the previous year. In 8M19, 2,406 new projects were licensed, up 25.4% yoy. In addition, out of 19 sectors receiving capital, manufacturing and processing came out on top with US$15.7bn, accounting for 69.6% of total FDI and up 10.8% yoy (excluding the ThaiBev investment of US$3.85bn).

Figure 6: Implemented and registered FDI (US$ m)



SOURCES: VNDIRECT RESEARCH, FII

Figure 7: Registered FDI into manufacturing outpaced the growth of total FDI inflows



SOURCES: VNDIRECT RESEARCH, FII * excluding the ThaiBev investment in Feb 2019

Sources of FDI to Vietnam are diversified, but China's position has been increasing rapidly. To be specific, Hongkong leads all FDI inflows at US$5.6bn, mainly due to the transaction of ThaiBev. South Korea and Singapore were the second- and third-largest investors in 8M19. The rapid growth of Chinese

investments is especially notable; China moved up from the seventh-largest investor in Vietnam in 2017 to fifth in 2018, and is now standing at fourth place, accounting for 12.0% of total FDI in 8M19.

While it is true that Vietnam is benefiting from supply chain migration from China, it must be noted that because of Vietnam's less mature manufacturing ecosystem and infrastructure, Vietnam is likely to miss out on the opportunity to attract huge capital inflows for now. We expect a steady growth of FDI inflows, which will create a moderate positive impact on export growth as well as economic growth in the coming years.

A strong currency comes at an inopportune time

In the past month, the sharp Chinese yuan depreciation against the greenback has triggered a board-based depreciation vs. the US$ across most Asian currencies, including the won, rupiah, NT$, S$ and ringgit. However, the dong has been relatively immune to the impacts of the Rmb depreciation. Although the SBV had aimed to weaken the dong in order to narrow the gap between the dong and other currencies in the region by adjusting the central rate, the dong weakened by only 0.1% YTD against the US$, even though the central rate depreciated by about 1.4% YTD. This underscores a continually rising FDI inflow and relatively firm trade surplus, backed by trade and investment diversion amid the US-China trade tensions.

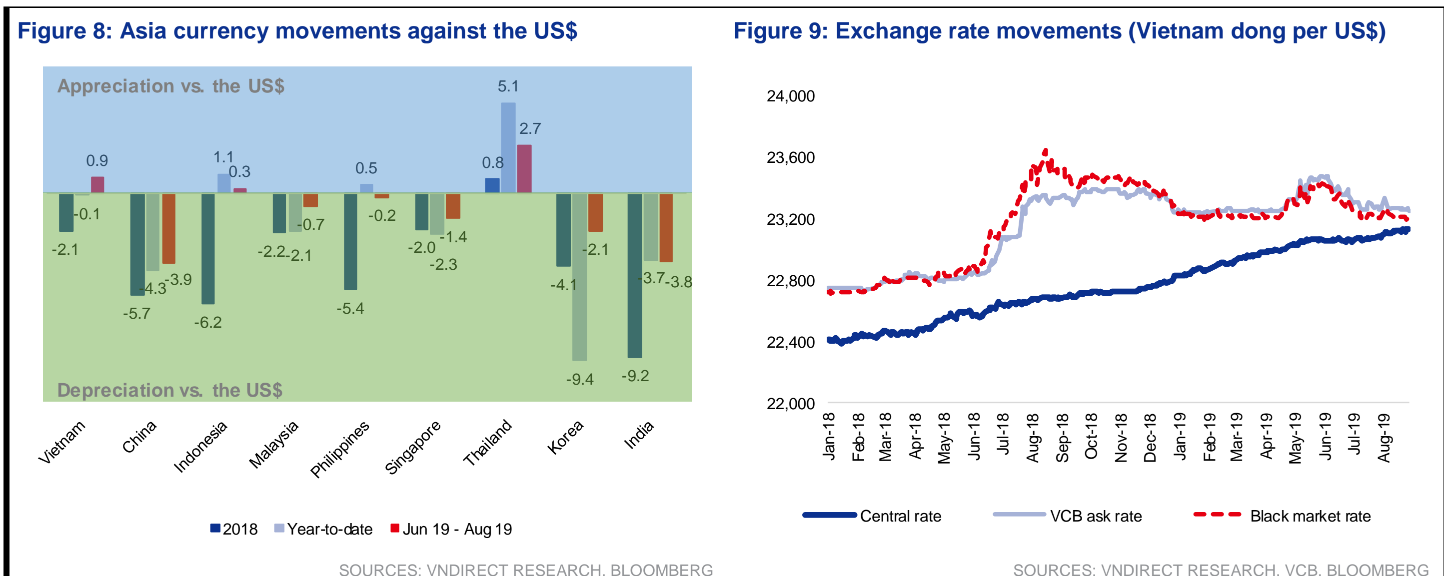


Figure 8: Asia currency movements against the US$

SOURCES: VNDIRECT RESEARCH, BLOOMBERG

Figure 9: Exchange rate movements (Vietnam dong per US$)

SOURCES: VNDIRECT RESEARCH, VCB, BLOOMBERG

As we believe a further escalation in the US-China trade war will put more pressure on the Rmb, the SBV will likely need to put more effort in order to nudge the dong weaker as a strong currency could damage the country's export competitiveness at this time. However, the SBV's ability to intervene in the currency market by FX reserves accumulation has become limited due to the risk of being labelled a currency manipulator by the US. Therefore, to avoid this risk, we expect the SBV to keep monitoring the dong's strength and prioritise financial stability in a challenging global landscape.

In the interim, a few measures have been initiated. In the past two weeks, the SBV net injected a large amount of the dong (VND55,112bn/US$2.3bn) via the OMO market to ease the interbank interest rate. At the end of Aug 2019, the SBV also threatened to sanction banks offering high interest rates on dong-denominated deposits, amid concerns that an interest rate race could destabilise the currency market.

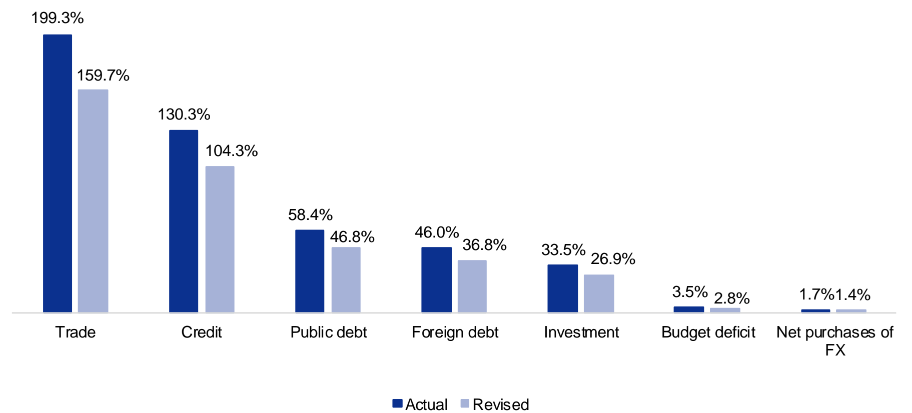
How does the economy look after a surprise GDP revision?

According to the General Statistics Office (GSO), Vietnam's GDP during the 2010-17 period could be revised by 25.4% per year after the periodic GDP reassessment with specific details to be released this month. This could lead to

changes in other indicators relative to GDP such as public debt to GDP, budget deficit to GDP, credit to GDP, etc. Hence, the revision offers latitude to increase public spending or raise debt borrowing. However, we adopt a cautious view with this data-correction surprises as the change in GDP calculation does not imply any improvements on the macro fundamentals.

One thing to note is that the US Treasury department recently added Vietnam to a watch list for currency manipulation. One criterion is net purchases of foreign exchange of at least 2% of GDP, and Vietnam is on thin ice with net purchases of foreign exchange of 1.7% of GDP in 2018. The revision, thus, could be a move to reduce the risk of being labelled a currency manipulator and offer room for currency intervention to avoid excessive volatility in the currency market.

Figure 10: Key macro indicators before and after the GDP revision (% GDP, 2018)



SOURCES: VNDIRECT RESEARCH, GSO

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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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