

WHAT A TRADE WAR MEANS FOR VIETNAMESE EQUITIES

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Trade tensions are here to stay

Despite the recent announcement of low-level trade talks between the US and China, a “slow-burn” trade war is likely to persist. Following the Trump administration’s first wave of tariffs against US\$34bn worth of Chinese goods in July, China immediately responded with a similar scale of tariffs targeting US imports. A tit-for-tat ensued with the US extending tariffs to US\$50bn worth of Chinese goods (with the additional US\$16bn due to take effect by the end of this month), China threatening to match the US escalation and, finally, President Trump’s threats to target up to US\$200bn worth of Chinese imports.

China just announced that it intends to resume negotiations with the US later this month, boosting market sentiment and vastly reducing the likelihood of further escalation. But, even if President Trump’s threats to extend tariffs to US\$200bn worth of Chinese imports do not materialize, a breakthrough agreement might not be on the anvil just yet because these are low-level talks and several thorny issues such as alleged Chinese theft of US intellectual property are beyond the realm of the Chinese commerce ministry to resolve.

Also, the two governments ended June talks without an agreement so there is a precedent of failed negotiations. With China unlikely to concede too much ground – partly to avoid “loss of face” – the Trump administration might not be satisfied enough to retract tariffs anytime soon. Furthermore, the Trump administration can easily point to evidence that their “hard-ball” tactics are working with China – the stock market there has tanked, the Yuan is trading water and capital investment is starting to tangibly slow. With the US economy still strong and China clearly showing signs of weakness, we expect the US to crank up the pressure and try to eke out big concessions, something which China can ill-afford for reasons both political and economic.

A new period of heightened uncertainty

Based on the Global Economic Policy Uncertainty Index (GEPU Index), the world has entered a new period of heightened uncertainty, following on the heels of Brexit and the 2016 US Election.

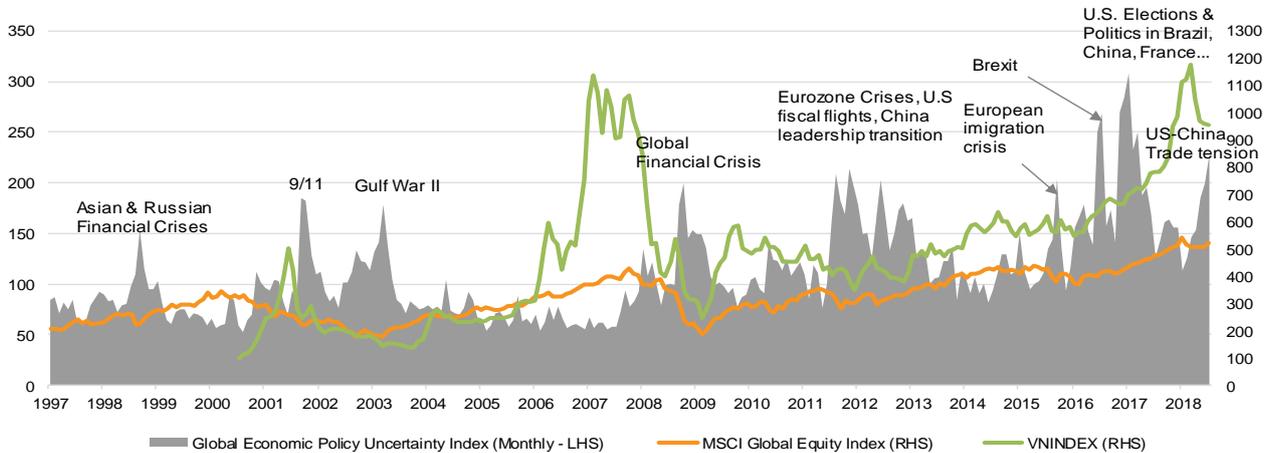
As shown in Figure 1 below, global equity markets usually fall in tandem with a rising GEPU Index and rise very soon after the GEPU index peaks.

If we assume that the recent global market correction reflected heightened trade tensions, we can hope for a sharp re-rating of company valuations when the trade storm is over. For all we know, President Trump may change his trade policy after the US mid-term election in November 2018 or once there is clear evidence that the tariffs are starting to pinch US consumers’ wallets. But we think a total roll-back of protectionist measures is unlikely.

Look closely at the recent market correction and you will see that it is just a minor blip in the context of past macro uncertainty-driven market dislocations. Even with a Turkish economic crisis coinciding with the specter of a full-blown Sino-US trade war, the market correction has been relatively mild. This might well be due to the fact that this particular spike in uncertainty has coincided with unusually strong economic data coming out of the US and the tail-end of a boom in technology stocks in the US. With US growth possibly being driven by the one-time impact of tax reform, a slowdown is widely expected.

Once the market realizes that the US economy is losing steam, you might see the impact of trade war-related uncertainties bearing down on equity valuations. In summary, another market correction could well be on the cards unless the new round of Sino-US negotiations produces a breakthrough.

Figure 1: Global Economic Policy Uncertainty versus Equity Markets (monthly)



Global Economic Policy Uncertainty Index:

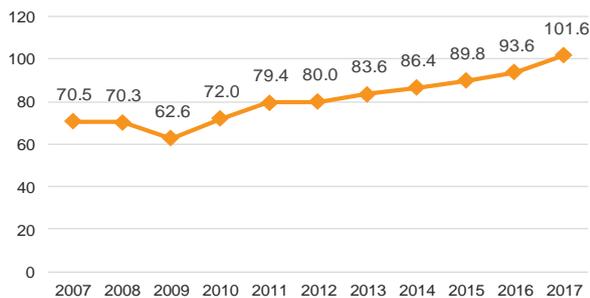
To measure policy-related economic uncertainty, PolicyUncertainty.com constructs an index from three types of underlying components. One component quantifies newspaper coverage of policy-related economic uncertainty. A second component reflects the number of government tax code provisions globally, that are set to expire in future years. The third component uses disagreement among economic forecasters as a proxy for uncertainty.

Source: VNDIRECT

What does a “slow burn” trade war mean for Vietnam?

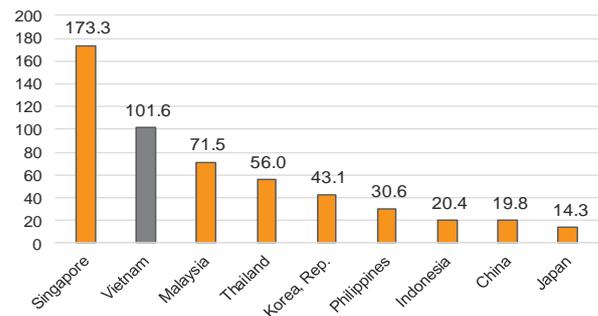
Vietnam, as an open economy with an import-export turnover almost double that of GDP (2017), will be unable to avoid the fall-out from these global trade tensions.

Figure 2: Vietnam export value to GDP 2007-2017 (%)



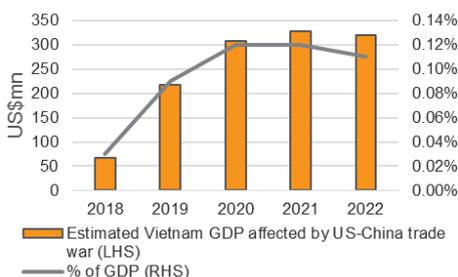
Source: Worldbank

Figure 3: Export value to GDP (%) of Vietnam and regional peers



Source: Worldbank, VNDIRECT calculation

Figure 4: Estimated effect of trade war on Vietnam GDP (only accounts for the first wave of US tariffs on US\$34bn of Chinese goods)



At a recent summit, the National Center for Socio-Economic Information and Forecast (NCIF) analysed the effects of a US-China trade war on Vietnam. According to NCIF, Vietnam’s GDP could be lowered by only 0.03% versus base case forecasts in 2018 (equivalent to US\$60m in terms of absolute output) when the first wave of tariffs becomes effective but this figure will increase to 0.12% per year in 2020-2021. Even if we doubt the validity of this forecast, Vietnam’s international trade will be tangibly impacted over 2020-2021.

Source: NCIF **Figure 5: Estimated impact of first phase of tariffs (US\$34bn) on GDP of select countries (%)**

	China	Japan	US	Korea	Singapore	Eurozone	Vietnam
2018	0.00	0.00	-0.03	0.00	-0.06	0.00	-0.03
2019	-0.04	-0.03	-0.09	-0.02	-0.24	-0.03	-0.09
2020	-0.10	-0.06	-0.13	-0.08	-0.38	-0.05	-0.12
2021	-0.15	-0.06	-0.15	-0.12	-0.37	-0.05	-0.12
2022	-0.17	-0.05	-0.14	-0.14	-0.28	-0.05	-0.11
2023	-0.17	-0.05	-0.13	-0.13	-0.20	-0.04	-0.09
2024	-0.15	-0.04	-0.11	-0.12	-0.13	-0.03	-0.08
2025	-0.12	-0.04	-0.09	-0.10	-0.07	-0.03	-0.05
2026	-0.08	-0.03	-0.07	-0.09	-0.02	-0.02	-0.03
2027	-0.04	-0.03	-0.05	-0.08	0.01	-0.02	-0.01
2028	0.00	-0.02	-0.03	-0.07	0.01	-0.02	0.00
2029	0.02	-0.02	-0.02	-0.06	0.01	-0.01	0.01
2030	0.03	-0.02	-0.01	-0.06	-0.01	-0.01	0.01
2031	0.03	-0.02	0.00	-0.06	-0.02	-0.01	0.01
2032	0.03	-0.01	0.01	-0.06	-0.02	-0.01	0.00

Source: NCIF, Vnexpress.net

Selected sectors could actually benefit from the trade war.

Every cloud has a silver lining, and we see some potential beneficiaries from this trade war. Here are some of the sectors that we think could benefit:

- **Agriculture and fishery:** China's counter-slapping of tariffs on US agricultural products may actually enable Vietnamese competitors to penetrate China's gigantic consumer market. It would be a stretch to compare the quality of Vietnamese produce with American produce, but with Vietnam's geographical advantage over the US, some Vietnamese agricultural companies could capture the market space previously occupied by US exporters to China.

Possible beneficiaries: IDI (BUY), VHC (Non-rated)

- **Industrial park developers:** FDI flows into Vietnam should, over time, accelerate as Chinese companies try to use Vietnam as a backdoor to export to the US and, also, as Korean, Japanese and other investors drop plans to expand manufacturing capacity in China, in favour of Southeast Asia. If this happens, Vietnam could see a surge in demand for industrial park space. These names could also benefit from VND devaluation versus the US dollar as IP leasing rates are US dollar-denominated while the cost base for most industrial park operators is almost entirely VND-denominated.

Possible beneficiaries: KBC, LHG, IDC

- **Logistics, Transportation & Port Operations:** With a possible increase in FDI, we can expect an increase in freight flows throughout Vietnam. If more international companies relocate their factories to Vietnam to avoid the fall-out from the trade war, more goods will be imported and/or exported. This will result in more demand for port services, logistic services and transportation. But this is a longer-term trend as near-term trade flows could be disrupted by continued trade tensions and uncertainty.

Possible beneficiaries: GMD, SCS, NCT

The effects of the US-China trade war are multi-faceted and yet to be fully understood and quantified, so our suggestions may be off-mark. Even though a continued US-China trade spat could make Vietnam more attractive as an offshore manufacturing base in the long-run, the near-term uncertainty created by trade tensions is leading companies to delay their capital investments. This could actually lead to a slowdown in FDI flows into Vietnam. We should also not discount the possibility of an extension of US tariffs to include Vietnam, particularly if Vietnam is used as a back-door by Chinese companies to circumvent US trade barriers. With Vietnam already being one of the top 10 trading partners with which the US runs a trade deficit, it could well come into the cross-hairs of the Trump administration. Prepare for a rocky ride.

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The survey result is as of the date appearing in the Corporate Governance Report of Thai Listed Companies. As a result, the survey result may be changed after that date. CIMBT does not confirm nor certify the accuracy of such survey result.

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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RECOMMENDATION FRAMEWORK

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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