Vietnam

Economics Focus

Strong fundamentals can absorb rising external risks

- Investors have become more bearish on risk assets.
- Nevertheless, we think Vietnam will be able to absorb external shocks.
- We expect the SBV to raise the policy rate over the next 12-18 months.
- We expect Vietnam's GDP growth to decelerate in 2Q18F.

Investors turning their backs on emerging and frontier markets

In the past month, emerging markets have broadly suffered the worst outflows since Nov 2016 due to both global factors and country-specific issues. Vietnam saw a record high of net outflows of around US$258.0m from the equity market, excluding VHM's (Vinhomes) listing. In addition, the Vietnam equity market was hit the hardest compared to other Asian peers in May 2018 due to stretched valuations. However, the dong has been notably more resilient than Asian emerging currencies, having fallen 0.4% year to date.

Vietnam defied emerging market trend of weakening currency

Currency pressure has been particularly acute for countries with weak current account balances. Vietnam's current account has been in surplus for the past 12 months (2.9% of GDP in 2017). The dong was also supported in the first half of 2018 by continued FDI flows and interest from both foreign strategic and portfolio investors in the equitisations of state-owned enterprises (SOEs) and fresh listings.

Vietnam equipped to absorb external shocks…

Vietnam's bond market has a negative beta to US rates with a low correlation. The country has also shifted to domestic funding to finance public spending in recent years. Therefore, we believe Vietnam bond markets can withstand the pressure of rising US rates. However, as investor sentiment on emerging markets continues to sour, we think Vietnam equity and FX markets will not be insulated from external shocks but can nonetheless contain the impact.

… due to sound macroeconomic fundamentals

1) The country's external position is stronger now than before. Its current account is in surplus, with export growth outpacing import growth and sustained FDI inflows. 2) Policy makers have improved their ability to control inflation. 3) Fiscal deficit has also been reined in as the government is committed to fiscal prudence. 4) Vietnam is one of the more politically-stable countries in Asia, making it a magnet for long-term, sticky foreign capital.

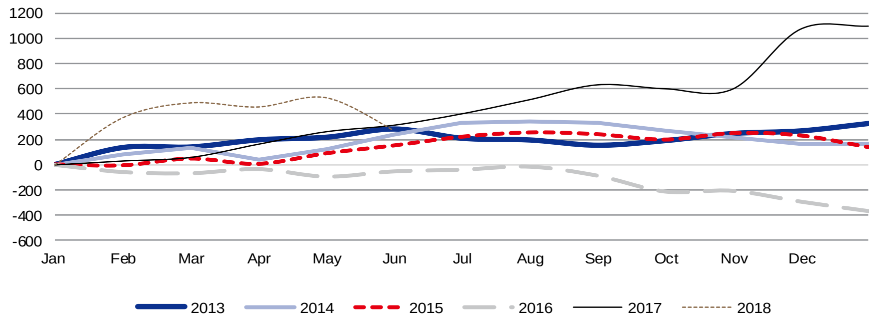
We expect the SBV to raise policy rates over the next 12-18 months

Vietnam's headline inflation is inching closer to the State Bank of Vietnam's (SBV) target rate of 4%. The real policy rate is now lower than other Asia emerging countries, such as Indonesia, India, Malaysia and China, where central banks have already raised policy rates during the first five months of this year. We expect the SBV to start hiking rates over the next 12-18 months; this could weigh on credit growth and equity market valuations.

We expect Vietnam's GDP growth to decelerate in 2Q18F

We believe Formosa's expansion in Vietnam will continue to make a large contribution to GDP growth and offset the slowdown in Samsung's activities. Besides, Nghi Son oil refinery (slated to be fully operational by early-Aug), is likely to have an outsized impact on economic growth in 2H18F. As we expect the positive momentum of electronics & electrical (E&E) output which has underpinned growth in the manufacturing sector in 1Q to weaken in 2Q, we project GDP growth to decelerate to 6.8% from 7.4% in 1Q.

Figure 1: YTD net foreign investment in equities (US$ m)



SOURCES: VND RESEARCH, FIINPRO
Excluding VHM's transaction in 2018's data

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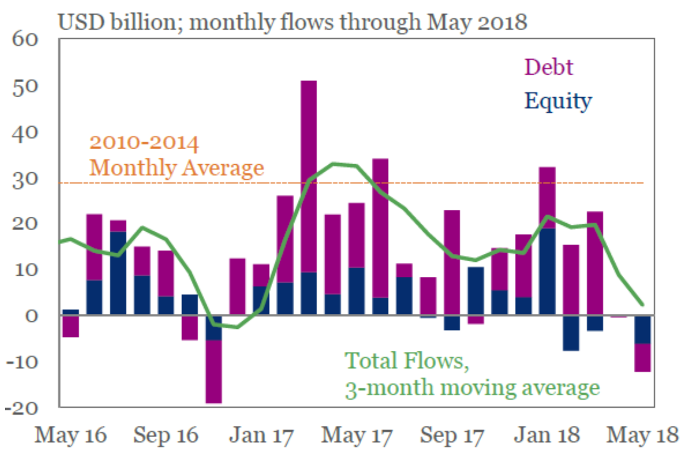
Sentiment has turned negative

Investors have become more bearish on emerging markets ›

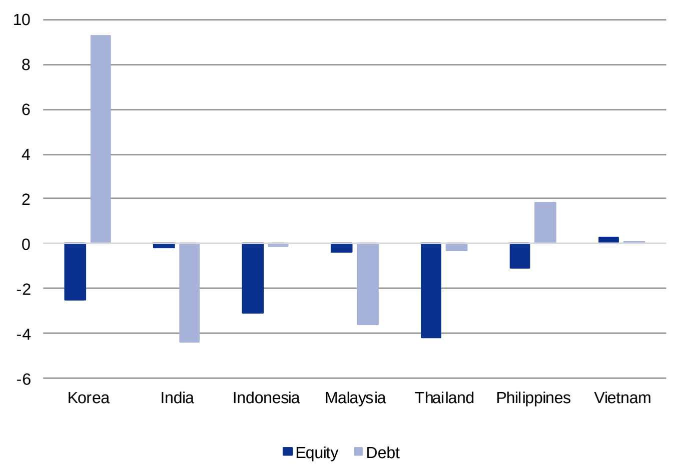
In the past month, emerging markets have broadly suffered the worst outflows since November 2016 due to both global factors and country-specific issues. According to the Institute of International Finance (IIF), non-resident portfolio outflows from emerging markets accelerated to US$12.3bn in May from US$0.3bn in April. This sharp drop cuts net portfolio inflows into emerging markets in the first five months to US$46bn (-65.7% yoy). Notably, outflows in May were concentrated in EM Asia (US$8.0bn), where Malaysia saw the highest outflows, followed by India. Vietnam also saw a record high in net outflows of around US$258.0m from the equity market in a single month, if the listing of VHM (Vinhomes) is excluded. So far in 2018, net inflows by foreign portfolio investors from stock and bonds amounted to US$365.3m (-55.7% yoy), excluding the VHM's (Vinhomes) transaction.

Figure 2: Net non-resident portfolio inflows to EM



SOURCES: VND RESEARCH, IIF

Figure 3: Portfolio flows into some Asian emerging markets and Vietnam in the first 5 months of 2018 (US$ bn)

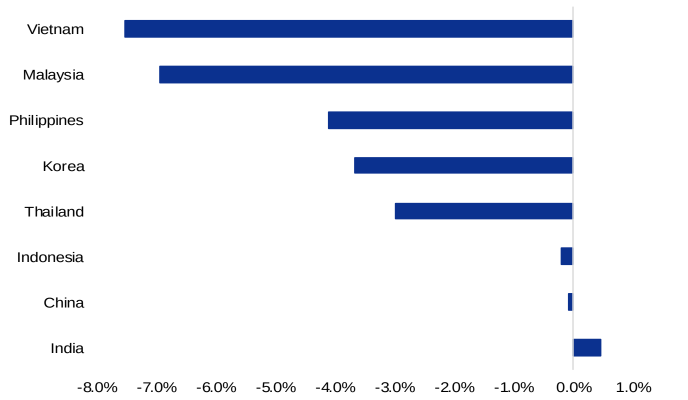


SOURCES: VND RESEARCH, ANZ RESEARCH
NOTE: Korea, Thailand and Philippines debt data for May are estimated
VHM's transaction is excluded from Vietnam equity data

The Vietnam equity market was hit the hardest compared to Asian EM countries in May 2018 due to stretched valuations. There was a sharp decline in the Malaysian equity market due to question marks over the change in government after its 14th general elections. Meanwhile, a weakening currency and rising inflation made the Philippine equity market one of the worst performers in May. The South Korean and Thai equity markets also saw a huge drop due to sharp withdrawals of foreign capital.

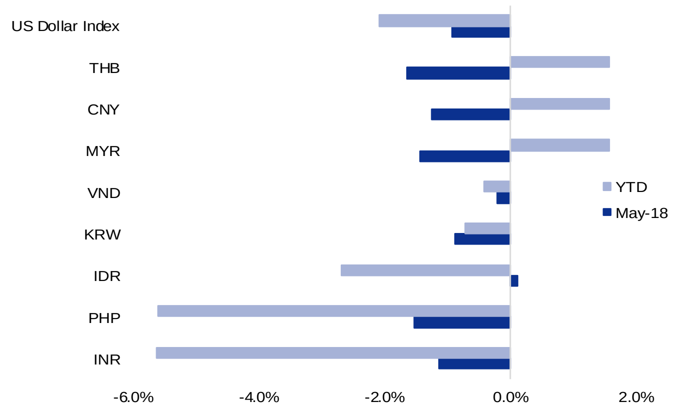
We note that currency pressure has been particularly high for countries with weak current account balances. India and Indonesia both stand out with current account deficits equivalent to 1.9% and 2.2% of GDP, respectively. It is therefore unsurprising that the INR and IDR were among the top three worst-performing regional currencies during the first five months. Although the Philippines has a moderate current account deficit (0.8%), its central bank expects the current account deficit to widen in 2018 due to widening trade deficit. The peso was the second-worst performer among emerging market currencies during the first five months of 2018. The dong has been notably more resilient than regional peers, having lost only 0.4% of its value against the USD so far this year. Vietnam's current account has stayed in surplus for the past 12 months (2.9% of GDP in 2017). The dong was also supported in the first half of 2018 by continued FDI flows and interest from foreign players in IPOs and newly-listed companies.

Figure 4: Vietnam's equity market was hit the most in May 2018



SOURCES: VND RESEARCH, BLOOMBERG

Figure 5: Most emerging currencies (excluding IDR) depreciated against the US$ in May 2018



SOURCES: VND RESEARCH, BLOOMBERG

Figure 6: Key macro health indicators of some Asia emerging countries and Vietnam (2017)

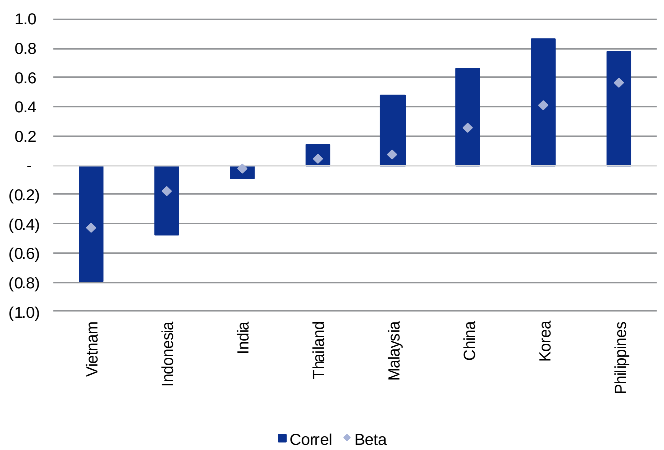
	China	India	Malaysia	Korea	Thailand	Vietnam	Philippines	Indonesia
Current account/GDP	1.4	-1.9	2.4	5.6	10.6	2.9	-0.8	-2.2
Government debt/GDP	20.3	45.5	50.8	41.1	32.5	61.4	42.1	29.0
External debt/GDP	14.0	20.1	65.3	27.3	35.3	49.0	23.3	34.7
Household debt/GDP	49.0	10.2	84.3	97.5	77.5	17.0	9.4	10.2
Fiscal balance/GDP	-2.9	-3.5	-3.0	1.4	0.7	-3.5	-2.2	-2.5
Import cover (months)	18.2	9.3	5.8	8.9	9.8	3.4	9.1	8.3

SOURCES: VND RESEARCH, COMPANY REPORTS

Vietnam equity and FX markets equipped to absorb external shocks ›

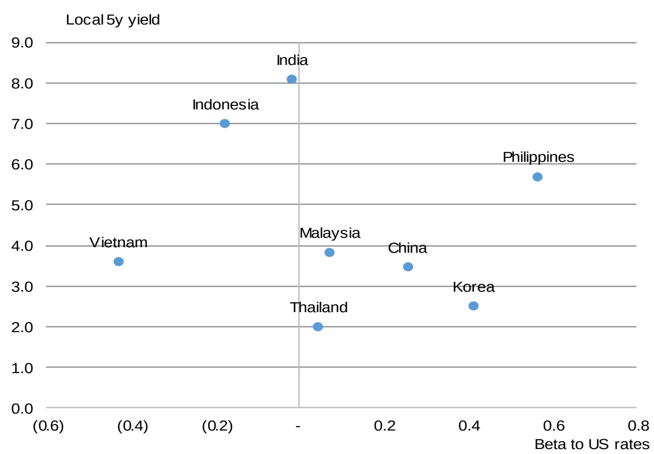
The US Federal Reserve delivered another 25bp rate hike in its Jun Federal Open Market Committee (FOMC) meeting, bringing the benchmark federal funds rate to the range of 1.75-2.0%. We think the Fed policy makers are likely to maintain a gradual rate hike trajectory and we project another two rate hikes in the second half of the year. The European Central Bank (ECB) also confirmed that asset purchases will end in December, causing markets to believe it will bring forward its rate hike to next year. Vietnamese bond yields appear to have a negative beta to US rates (see Figure 7). The country also has shifted to domestic funding sources to finance public spending in recent years. Therefore, we believe Vietnam's bond markets can withstand the pressure of rising US rates. However, as investor sentiment is turning more bearish on emerging markets, we think Vietnam's equity and FX markets are not immune to growing external risks.

Figure 7: Vietnam bond yields have a negative correlation with US rates



SOURCES: VND RESEARCH, BLOOMBERG

Figure 8: Asia EM bond yields vs. US rate sensitivity

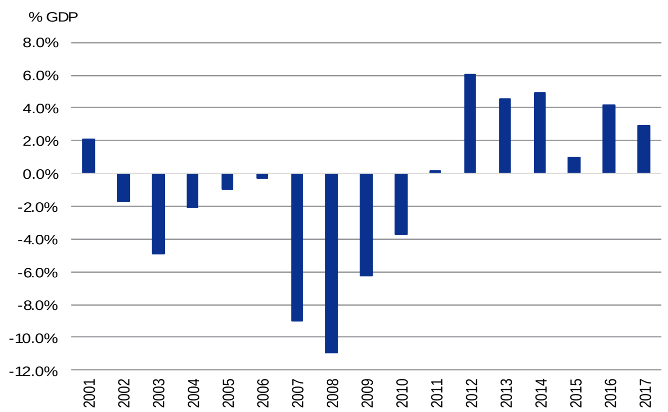


SOURCES: VND RESEARCH, BLOOMBERG

Beta and correlation of local rates to US rates is calculated based on data since 2015

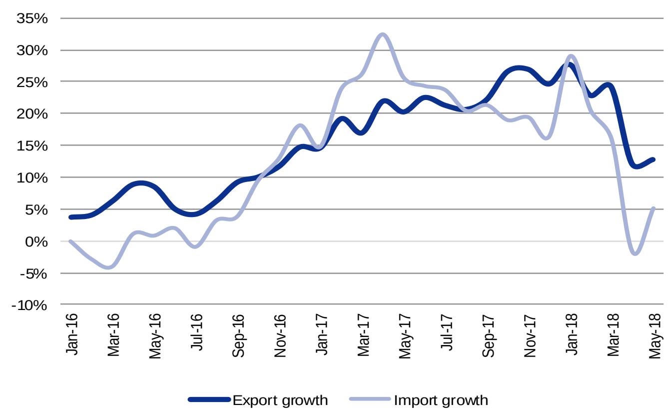
There are solid reasons why Vietnam has become better at absorbing emerging market shocks than before. First, the country's external position is stronger, with its current account in surplus and growth in exports outpacing import growth. Foreign exchange reserves are also much larger, giving the country a better buffer than before; forex reserves have now risen to over US$63bn, equivalent to 3.5 months of import cover, up from under 3.0 months less than three years ago. Moreover, foreign direct investment (FDI) continues to rise, with FDI disbursement up 9.8% yoy in the first five months of 2018. Second, policy makers have improved their ability to control inflation. Most recently, the government has used non-monetary policy tools to keep inflation at manageable levels by: 1) not raising electricity prices, 2) using the stabiliser fund to keep fuel prices stable, and 3) reducing the prices of healthcare services. Third, the fiscal deficit has also been reined in as the government remains committed to fiscal prudence. In the first five months of 2018, total budget revenue reached VND549,000bn (+13.6% yoy) while budget expenditure was VND526,600bn (+9.2% yoy). The state budget surplus is at an estimated VND22,400bn as at end-May vs. a deficit of VND6,400bn in the same period last year. Finally, Vietnam is one of the more politically-stable countries in Asia, making it a preferred destination for long-term capital, in our view.

Figure 9: Vietnam is improving its current account balance



SOURCES: VND RESEARCH, COMPANY REPORTS

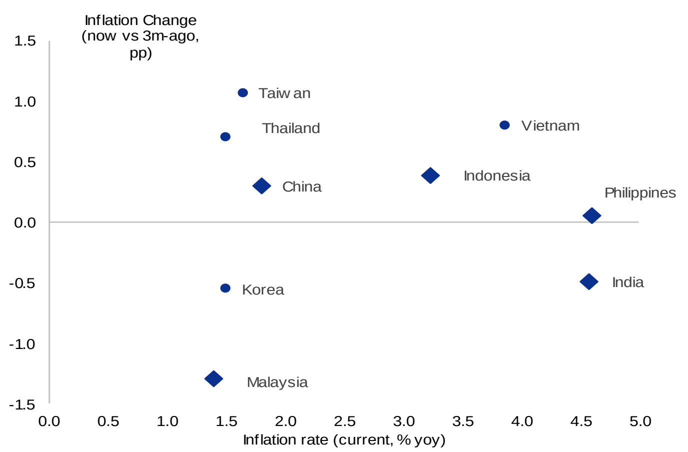
Figure 10: Export growth is still outpacing import growth



SOURCES: VND RESEARCH, VIETNAM CUSTOMS

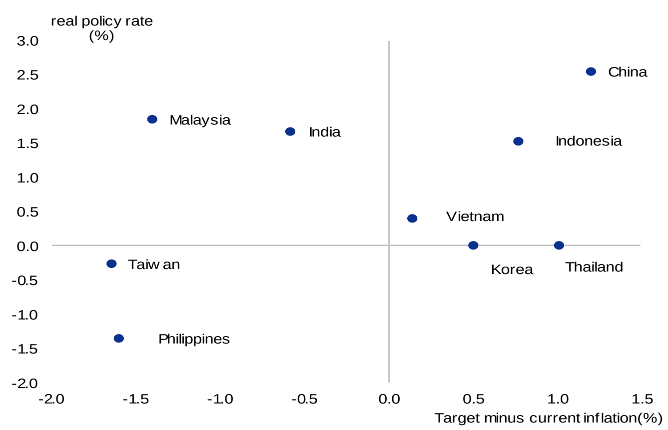
Going forward, we think the SBV can handle the heightened external pressures by intervening in the forex market to anchor the dong's stability (less than 2% depreciation this year). In addition, inflation is a key indicator for any policy interest rate hikes in the near term. Vietnam's headline inflation has inched closer to but remains under the SBV's target rate of 4%. The real policy rate is also lower than other Asia emerging countries, such as Indonesia, India, Malaysia and China, where central banks already raised policy rates during the first five months of this year. We expect the SBV to start hiking rates over the next 12-18 months, bringing government bond yields back to 5% by end-2019F.

Figure 11: Inflation dynamics: Vietnam and Asian peers



SOURCES: VND RESEARCH, BLOOMBERG

Figure 12: Inflation headroom vs. policy rate: VN vs. Asian peers



SOURCES: VND RESEARCH, BLOOMBERG

Diamond shape: country raised its policy rate during the first 5 months of 2018

We expect Vietnam's GDP growth to decelerate in 2Q18F

Vietnam's industrial production expanded 7.1% yoy in May vs. 9.4% yoy in April. The growth momentum was maintained in manufacturing and electricity production while the mining segment remained subdued in the first five months of? 2018, contracting 7.6% yoy in May (-5.0% yoy in Apr). Performance in export-oriented industries (E&E) has shown rapid deceleration in the past two months, growing 2.2% yoy in May vs. 14.9% yoy in Apr, and 29.3% yoy in 1Q18. Meanwhile, production growth of basic metals accelerated in 2Q to 23.4% yoy in April and 23.4% yoy in May compared to an expansion of 14.0% yoy in 1Q18. The output of consumer goods remained resilient in May, including food (+9.7% yoy), beverages (+10.7% yoy) and apparel (+17.0% yoy). We believe Formosa will continue to make a large contribution to economic growth and offset a slowdown in Samsung's activities. Besides, Nghi Son oil refinery, which is scheduled to be fully operational by early-August, is likely to have an outsized impact on economic growth in the second half of this year.

Figure 13: Vietnam's industrial production index (%yoy)

Industrial production index	Q12018	Apr-18	May-18	5M18
Manufacturing	**13.9**	**12.3**	**9.1**	**11.8**
Food	6.9	12.3	9.7	7.1
Beverages	8.0	15.5	10.7	9.7
Textiles	13.7	13.0	12.6	12.1
Apparel	8.8	16.5	17.0	10.8
Leather	9.4	14.7	11.2	11.0
Paper	9.8	11.4	3.4	8.5
Chemical	3.0	9.6	9.7	5.5
Medicine	17.9	20.7	19.5	9.5
Rubber & plastic	2.0	4.1	1.2	2.3
Non-metalic products	8.9	6.7	14.3	9.9
Steel	14.0	23.4	22.2	17.4
Electronic products	29.3	14.9	2.2	18.7
Electric equipments	2.6	8.9	6.6	4.5
Transport equipment and other manufactures	7.0	4.5	13.8	6.4
Furniture	12.8	21.0	13.5	11.2
Mining	**0.4**	**-5.0**	**-7.6**	**-2.2**
Electricity	**10.5**	**9.6**	**11.2**	**10.6**

SOURCES: VND RESEARCH, GSO

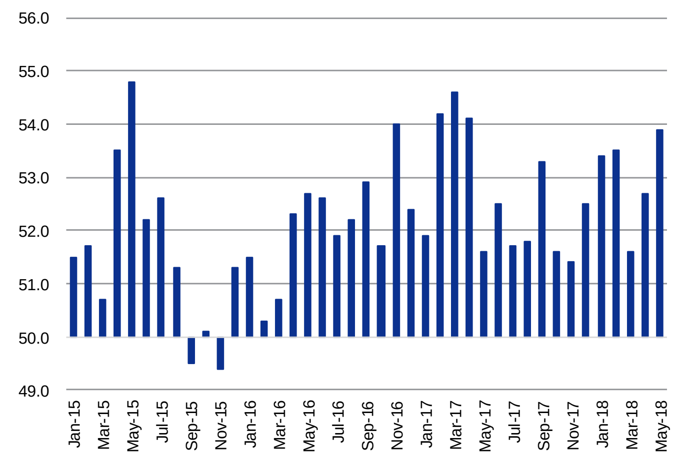
As we expect the positive momentum of E&E manufacturing that has underpinned growth in the manufacturing sector in 1Q18 to weaken in the second quarter, we project a slower GDP growth in 2Q18 (6.8% vs. 7.4% in 1Q18).

Macro indicators in May 2018

Figure 14: Vietnam's industrial production growth (mom % chg, 3-month moving average) from Jan 2015 to May 2018

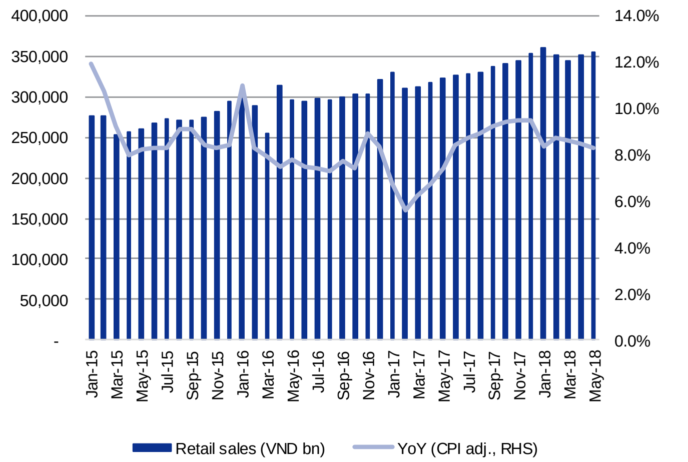
SOURCE: VND RESEARCH, GSO

Figure 15: Vietnam PMI from Jan 2015 to May 2018



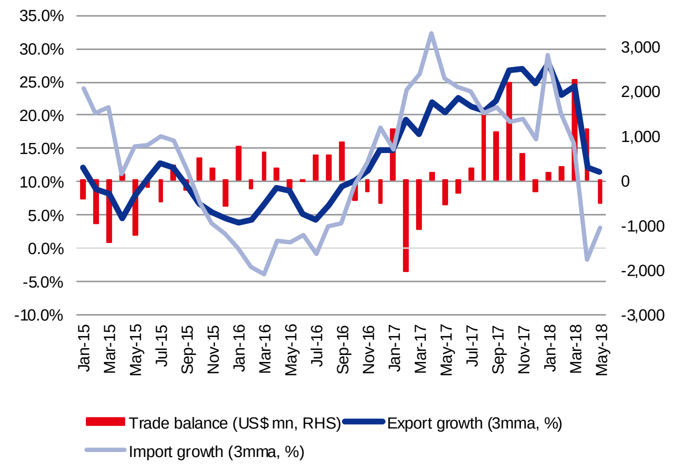
SOURCE: VND RESEARCH, NIKKEI

Figure 16: Retail sales from Jan 2015 to May 2018



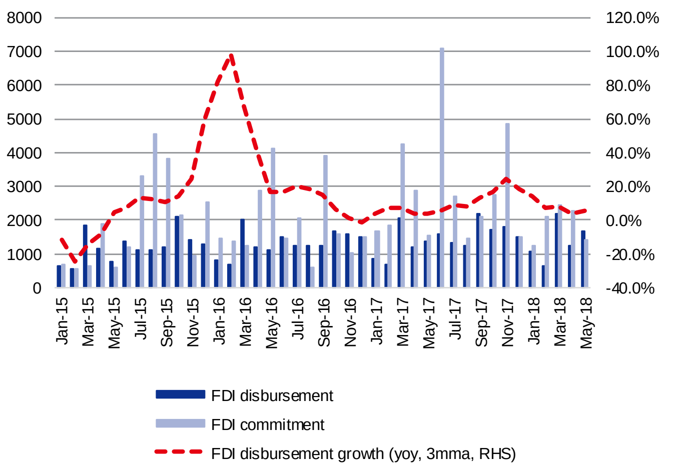
SOURCE: VND RESEARCH, GSO

Figure 17: Vietnam's trade balance, import and export growth from Jan 2015 to May 2018



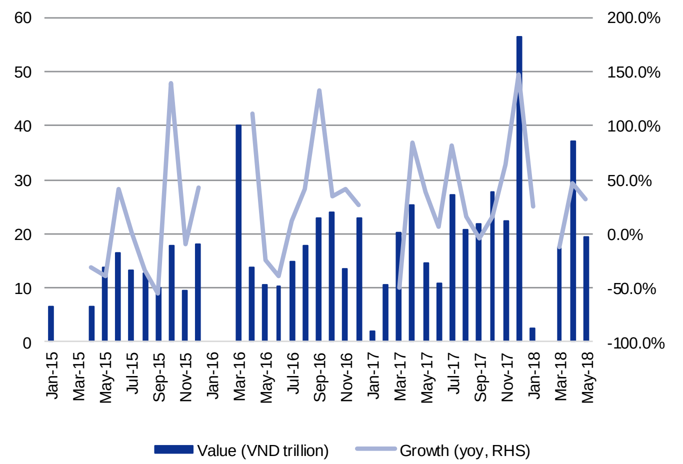
SOURCE: vND RESEARCH, GSO, CUSTOMS

Figure 18: FDI disbursement & commitment (US$ m) from Jan 2015 to May 2018



SOURCE: VND RESEARCH, GSO

Figure 19: Public investment from Jan 2015 to May 2018



SOURCE: VND RESEARCH, GSO

Figure 20: Commodities prices by industry (May 2018)

	Unit	Current	+/- YTD (%)	May 2018 average	+/- YoY (%)	+/- MoM (%)
Oil&Gas						
Brent	US$/barrel	73.4	10.3%	77.1	49.6%	7.3%
WTI	US$/barrel	65.1	7.8%	69.9	43.7%	5.4%
Transportation						
Baltic Dry Index		1,445.0	-22.5%	1,292.0	33.0%	14.5%
Baltic Clean Tanker		515.0	-21.4%	544.5	-0.2%	0.9%
Baltic Dirty Tanker		746.0	6.6%	703.3	-9.4%	9.5%
Steel inputs						
HRC	US$/tonne	617.0	9.2%	608.2	37.6%	0.9%
Scrap	US$/tonne	385.0	2.1%	395.2	94.2%	1.1%
Iron ore	US$/tonne	75.6	3.9%	63.7	7.3%	1.7%
Hard coal	US$/tonne	197.3	3.2%	182.6	11.4%	-3.3%
Graphite	US$/tonne	15,834.8	42.3%	12,471.1	404.4%	-17.6%
Agriculture						
Rice	US$/tonne	415.0	7.5%	432.1	8.8%	0.5%
Corn	US$/tonne	130.3	2.2%	145.9	7.7%	5.0%
Wheat	US$/tonne	183.5	15.2%	189.4	20.2%	8.4%
Chemical						
Urea	US$/tonne	335.0	-3.5%	336.4	32.5%	2.8%
Natural Rubber	US$/tonne	1,505.6	-17.7%	1,645.9	-33.7%	0.7%
Textile						
Cotton	US$/tonne	900.0	18.4%	821.3	8.4%	3.3%
Metal						
Lead	US$/tonne	2,405.0	-6.4%	2,373.5	11.1%	0.8%
Steel	US$/tonne	700.6	6.1%	635.4	20.2%	6.7%
Zinc	US$/tonne	3,080.0	-8.0%	3,071.4	18.0%	-3.9%
Copper	US$/tonne	7,020.0	-2.6%	6,847.4	21.7%	-0.5%
Gold	US$/oz	1,279.6	-1.8%	1,303.6	4.6%	-2.3%

SOURCE: VND RESEARCH, BLOOMBERG, PRICE AS OF 15 JUN 2018

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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.

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Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
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