

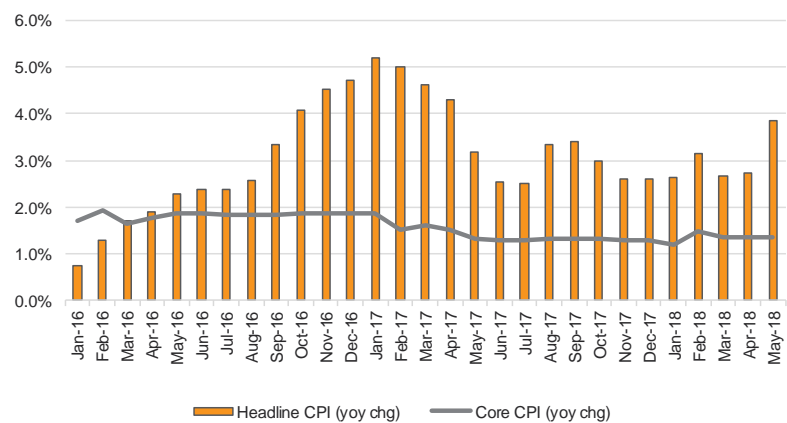
THE CREDIT CYCLE IN VIETNAM IS BOUND TO MATURE SOON

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At the beginning of January this year when we put out our annual **Vietnam Navigator** year-end strategy report, we pointed to the risks of a return in inflation in the second half of the year based on what we saw as early signs of an overheating economy, heady levels of credit growth (3x real GDP growth) seen in 2017 and a projected recovery in oil prices, per global consensus. Come mid-year and inflation seems to be just about rearing its ugly head. Credit growth has slowed but remains high.

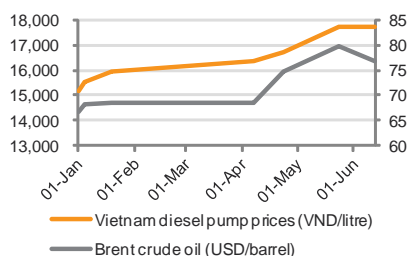
Inflation remains under control but is accelerating... While overall CPI growth remains under control, May CPI growth came in at 3.86% yoy, closing in on what we believe marks the upper bound of the SBV's comfort level. As the chart below shows, there was a marked uptick in inflation last month.

Figure 1: Inflation movement



Source: VNDIRECT, GSO

Figure 2: Global crude price and Vietnam diesel pump prices from the beginning of 2018



Source: VNDIRECT

...driven by rising oil prices... Oil prices have seen a strong rise year-to-date. Although the crude oil rally seems to have run out of steam on news of a possible relaxation of OPEC supply cuts, an increase in Russian production and the re-entry of shale producers, Brent crude is currently hovering around USD 75/barrel with the YTD daily averaged price up 58.8% versus the same period last year. Vietnam has raised pump prices 5 times already this year with current pump prices up 16.6% versus the 2017 year-end level.

...and continued strong GDP growth. Economic growth remains robust with 1Q18 GDP up 7.2% versus the same period last year. Industrial production has been the main engine of growth with 5M YTD production up 9.7% yoy and consumption (ex-inflation) has also grown by a robust 8.3% yoy over the same period. 5 month YTD credit growth came in at 6.2% which is just a tad lower than the 6.5% level seen in the same period last year but substantially above the levels seen in the 2 years prior to 2017. Against this backdrop of loose credit conditions and subdued inflation, it is easy to see why consumer demand has stayed robust.

We foresee credit growth decelerating in the second half of 2018... While 5 month YTD credit growth remains elevated, we believe that full year 2018 credit growth will come in below 2017 levels. This would seem like a “no-brainer” but is not so apparent

when you consider credit growth seasonality patterns seen in 2015 and 2016. If you extrapolate YTD 2018 credit growth to full year credit growth using the 5M-to-full year credit growth ratio seen in those 2 years, 2018 full year credit growth is projected to exceed 20%, a marked acceleration from 2017 levels.

Figure 3: Credit growth scenarios

	Credit growth		Notes
	5 Months	Full year* 5 months growth as a % of full year growth	
	4.5%	17.3%	26.0%
	5.5%	18.7%	29.4%
	6.5%	18.2%	35.7%
Scenario 1	6.2%	21.1%	Assumes that 2017 was an anomaly year due to deceleration of credit growth in 2H; 2016 is a representative year
Scenario 2	6.2%	20.4%	Assumes that credit growth seasonality varies across years with no one year being representative; uses average seasonality pattern of all 3 historical years
Scenario 3	6.2%	17.4%	Uses 2017 as a representative year, assuming that this year will see a similar pattern of Q-o-Q credit growth deceleration in the second half as govt. tries to keep inflation under control

*Note: Full year credit growth for 2018 scenarios is forecasted based on assumed ratio of YTD 5 month growth to full year credit growth

Source: VNDIRECT

...driven by more hawkish talk by the SBV and the fact that 2018 GDP growth targets are achievable. We believe that the 5 month credit growth-to-full year credit growth ratio seen in 2017 is more representative of the seasonality expected in 2018 for 2 reasons:

1. **Full year GDP growth targets look achievable:** Unlike in 2015 and 2016 when the government used credit growth to make up for sluggish first half GDP growth and stimulate second half growth to meet growth targets for the full year, 2017 first half growth was strong enough for the government to not have to resort to pushing credit in the second half in order to meet full year economic growth targets for the year. First quarter GDP growth in 2018 hit a first quarter record high of 7.2% and, hence, we also see no need for credit-stimulus in 2H 2018 as the full year government GDP growth target of 6.7% looks achievable with the status quo being maintained.
2. **Policy rates should rise to contain the twin pressures in inflation and capital outflows:** Inflation is accelerating as pointed out earlier and this should continue given the lag between a rise in global crude prices and local energy prices as well as between the recent hikes in local pump prices and the impact of this on the broader economy. Combine this with the fact that global gas prices are on a sharp uptrend, triggering recent trucker strikers in China, and it is easy to see that logistics and transportation costs are bound to rise in Vietnam through the rest of the year. Furthermore, the continued rate hikes by the US Fed and the tightening of global liquidity driven by QE reversals is prompting a wave of policy rate hikes across emerging markets. Indonesia recently raised its benchmark rate by 125 bps while India hiked its benchmark lending rate by 25 bps recently, the first increase in 4 years. While FDI inflows into Vietnam remain robust, a narrowing trade surplus driven by decelerating export growth and a tempering of portfolio inflows are bound to shift the onus of maintaining currency stability to monetary policy. Vietnam government bond yields have also been creeping up after hitting historic lows earlier this year.

Keep a close watch on stocks that are sensitive to rising rates and slowing credit growth. Given a potential maturing of this credit

cycle, we advocate keeping a close eye on banking, brokerage and property stocks and, in general, avoiding highly leveraged companies. Following is a summary of our view on which sectors are most likely to be impacted and how.

Impacted sector	Impact	Explanation
Banks	Mixed	<p>A possible tightening of interbank liquidity from current high levels and intense competition for deposits could keep funding costs elevated while blended asset yields should continue to rise as many banks re-orient their lending mix to the retail segment. Banks that are unable to raise asset yields to offset higher funding costs will see NIM compression.</p> <p>Expect a system-wide deceleration in loan growth so pick banks which can offset this through NIM expansion and market share gains.</p>
Brokers	Negative	<p>Tighter liquidity could weigh on stock market liquidity which has already weakened in recent weeks. Higher margin lending rates will coincide with weaker stock market performance to reduce appetite for margin loans. Overall, brokers could be hit by a potent combination of lower interest income from margin lending as well as lower brokerage fees.</p>
Real Estate Developers	Mostly Negative	<p>With mortgages having gained in importance in the housing market, a rise in rates will surely weigh on home purchases. Couple this with repeated recent directives by the SBV to banks to contain their lending to property developers and it is clear that real estate developer margins will be under pressure. Pick select developers that have good pre-sales track records (no need for working capital funding) and that focus on property segments that are less dependent on mortgages and, yet, are not seeing a supply overhang (e.g. landed properties).</p>

Source: VNDIRECT

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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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