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Head of Macro & Strategy
Tran Duc Anh
anhhd@kbsec.com.vn

Fed cuts rate to near zero

Impact on Vietnam's stock market

The Federal Reserve unexpectedly (Fed) cut its rates from 1% on March 15

— On March 15, the Fed cut its benchmark interest rates from 1% to 0–0.25% for the second time in March and promised to raise its bond holdings by at least USD700 billion, lengthened loan terms to 90 days and lowered the bank reserve requirement to 0%. The Fed noted it would maintain easing until it felt comfortable that the US economy could recover from recent wobbles.

Contrary to market expectations, Fed's dramatic rates cuts are usually followed by a plunge in the global stock markets.

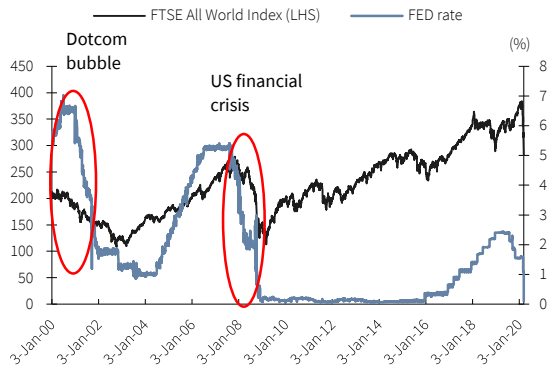
— Observing the Fed's interest rate management in the past 20 years, emergency cuts (1.5%–points or more within a month) are usually accompanied by sharp drops in global stock markets (Figure 1). This is in contrast with 'insurance' rate cuts from the Fed during healthy economic periods that often lead to rallies in global stock markets. Specifically, the Fed's aggressive rate cuts in the past were connected to the two latest crises: the dot-com bubble in 2000 and the global financial crisis in 2008. Both times rate cuts came before any signs of recession but negatively impacted stock markets for two main reasons: 1) investor concerns about the Fed's adverse assessment of the macro outlook; and 2) clearer signals of a looming crisis and concerns the Fed's move may not be effective enough to improve the economy in the short term.

Impact on Vietnam's stock market

- Due to limited data, we focused on foreign trading activity in Vietnam's stock market from 2012 to now (Figure 2). Between 2012 and 2014, the Fed had no rate cuts as the rates had already reached zero but quantitative easing programs did help Vietnam attract foreign capital inflows. From the end of 2015 to now, foreign trading volumes on Vietnam's stock market were highly correlated with Fed interest rates. Specifically, foreigners net-bought during rate hikes (2015–end to 2018–end) and net-sold when rates were cut (2019 to now). When the Fed raises rates the confidence level of foreign investors towards global economic growth usually improve and cash flows tend to head towards the emerging markets, and vice versa.
- There is a limitation to comparing the Fed's most recent aggressive cuts to the two periods of crisis in the past. Whether the COVID-19 pandemic can cause a deep and broad-based recession is highly controversial. However, given examples of previous shocks to the global financial system and the reaction of stock markets around the globe, we believe the Fed's rate cuts may have a limited impact on boosting Vietnam's stock market or reversing the net-selling activities of foreign investors.

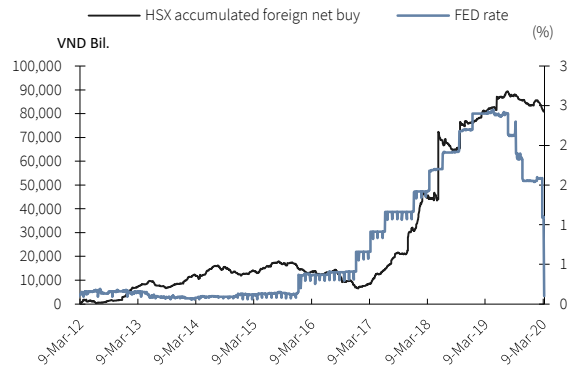


Fig 1. Federal Funds Target Rate – Correlation with global stock markets, Jan 00–Mar 20 (index points, %)



Source: Bloomberg, KB Securities Vietnam

Fig 2. Federal Funds Target Rate – Correlation with foreign portfolio investment into Vietnam, Mar 12–Mar 20 (VNDbn, %)



Source: Bloomberg, KB Securities Vietnam, & Fiinpro

KB SECURITIES VIETNAM RESEARCH

Head of Research – Nguyen Xuan Binh

binhnx@kbsec.com.vn

Macro/Strategy

Head of Macro & Strategy – Tran Duc Anh

anhtd@kbsec.com.vn

Macro Analyst – Thai Thi Viet Trinh

trinhtt@kbsec.com.vn

Market Strategist – Le Anh Tung

tungla@kbsec.com.vn

Equity (Hanoi)

Head of Equity Research (Hanoi) – Duong Duc Hieu

hieudd@kbsec.com.vn

Information Technology & Logistics Analyst – Nguyen Anh Tung

tungna@kbsec.com.vn

Property Analyst – Pham Hoang Bao Nga

ngaphb@kbsec.com.vn

Power & Construction Material Analyst – Le Thanh Cong

conglt@kbsec.com.vn

Financials Analyst – Nguyen Thi Thu Huyen

huyenntt@kbsec.com.vn

Equity (Ho Chi Minh)

Head of Equity Research (Ho Chi Minh) – Harrison Kim

harrison.kim@kbf.com

Consumer & Retailing Analyst – Dao Phuc Phuong Dung

dungdpp@kbsec.com.vn

Fisheries & Pharmaceuticals Analyst – Nguyen Thanh Danh

danhnt@kbsec.com.vn

Oil & Gas & Chemicals Analyst – Nguyen Vinh

vinhn@kbsec.com.vn

Research Marketing

Korea Marketing Analyst – Seon Yeong Shin

shin.sy@kbsec.com.vn

KB SECURITIES VIETNAM (KBSV)

Head Office:

Levels G, 2 & 7, Sky City Tower, 88 Lang Ha Street, Dong Da District, Hanoi, Vietnam
Tel: (+84) 24 7303 5333 – Fax: (+84) 24 3776 5928

Hanoi Branch:

Level 1, VP Building, 5 Dien Bien Phu, Ba Dinh District, Hanoi, Vietnam
Tel: (+84) 24 7305 3335 – Fax: (+84) 24 3822 3131

Ho Chi Minh Branch:

Level 2, TNR Tower Nguyen Cong Tru, 180-192 Nguyen Cong Tru Street, District 1, HCMC, Vietnam
Tel: (+84) 28 7303 5333 – Fax: (+84) 28 3914 1969

Saigon Branch:

Level 1, Saigon Trade Center, 37 Ton Duc Thang, Ben Nghe Ward, District 1, HCMC, Vietnam
Tel: (+84) 28 7306 3338 – Fax: (+84) 28 3910 1611

CONTACT INFORMATION

Institutional Client Center: (+84) 28 7303 5333 – Ext: 2656
Private Customer Care Center: (+84) 24 7303 5333 – Ext: 2276
Email: ccc@kbsec.com.vn
Website: www.kbsec.com.vn

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Investment Ratings for Stocks

(based on expectations for absolute price gains over the next 6 months)

Buy:	Hold:	Sell:
+15% or more	+15% to -15%	-15% or more

Investment Ratings for Sectors

(based on expectations for absolute price gains over the next 6 months)

Positive:	Neutral:	Negative:
Outperform the market	Perform in line with the market	Underperform the market

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