KBSV RESEARCH

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IN-DEPTH REPORT

VIETNAM - "CURRENCY MANIPULATOR?"

It is likely that Vietnam will still be in the watchlist for currency manipulation by the US in the upcoming period as two criteria for this tag of Vietnam will hardly change significantly.

There is still a possibility that the US will raise tariffs imposed on some certain commodities from Vietnam, especially in areas where Chinese goods circumventing penalties of US by being shipped through Vietnam.

RISK OF BEING PLACED ON THE WATCHLIST FOR CURRENCY MANIPULATION

In the report of the United States Department of the Treasury for the 1H of the year summited to the National Assembly, for the first time, Vietnam has been added to the Currency watchlist. In particular, the Department of the Treasury of the US tightened evaluation criteria, which made 9 countries be added to this list (including Vietnam):

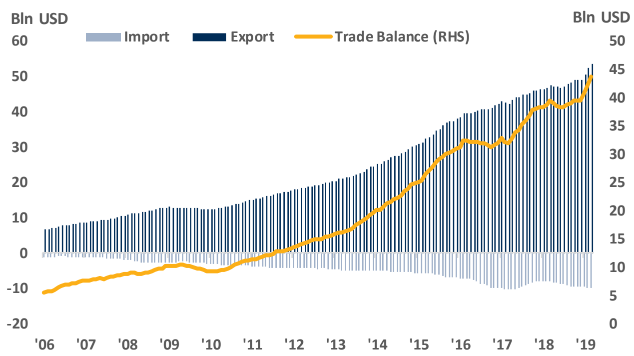
Table 1: Criteria to assess a currency manipulator

Criteria	Old limit	New limit
Total bilateral trade (Import + export)	12 countries with largest bilateral trade surplus	> USD40 billion
Total goods surplus with the US	> USD20 billion	> USD20 billion
Current account	> 3% of GDP	> 2% of GDP
Net foreign currency purchase and time period of consecutive purchases (months)	> 2% of GDP and net purchase consecutively in 8 out of 12 months	> 2% of GDP net purchase consecutively in 6 out of 12 months

Source: The US Department of Treasury

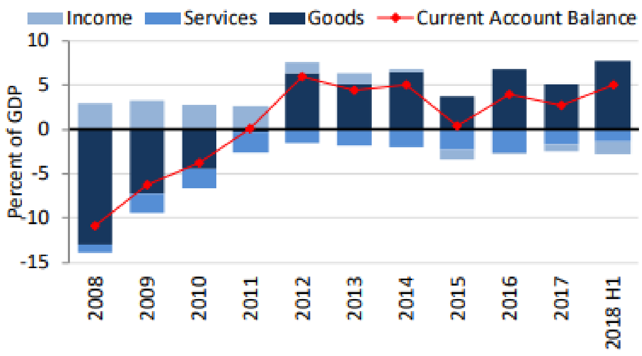
Vietnam violated the first three criteria including total bilateral trade with the US > USD40 billion, goods surplus with the US > USD20 billion, and current account > 20% of GDP. In particular, in 2018, Vietnam has become the 6th largest trading partner of the US, and the trade surplus officially hit USD40 billion. In addition, accumulated in the 4 quarters to June 2018 (IMF data referenced by the US), Vietnam current account surplus has been 5% more than GDP.

Figure 1: Trade surplus with the US



Source: Bloomberg, KBSV

Figure 2: Vietnam current account balance



Source: IMF

Vietnam has not violated the criteria of (one-side and persistent) intervention in the FX market. To be more specific, the volume of net purchased USD (from January – December 2018) hit 1.7% of GDP and under the limit of 2% allowed by the US. The period of net purchase of Vietnam was also not consecutive in 6 months. Furthermore, Vietnam also had a convincing reason to buy USD to enhance FX reserves while FX reserves of Vietnam in 2018 was only enough for 2.9 months of import, under the minimum level recommended by IMF. The US side accepted this reason, but still urged Vietnam to undertake monetary policy reforms – and raise REER to decrease trade surplus with the US.

Below is the reference table of the countries in the Currency watchlist. Vietnam, Italy, Ireland, and Malaysia all surpass the limit of trade surplus with the US, and have large current acounts.

Table 2: The US Department of Treasury's evaluation for 9 countries in the watchlist

	Trade surplus with the US (Trailing 4Q)	Current account balance (% GDP, trailing 4Q)	FX intervention	
			Net purchases (% GDP, trailing 4Q)	Net purchases 6 of 12 months+
Vietnam	40	5.4	1.7	No
Malaysia	27	2.1	-3.1	No
Singapore	-6	17.9	4.6	Yes
China	419	0.4	-0.2	Yes
Korea	18	4.7	-0.2	No
Japan	68	3.5	0.0	No

Germany	68	7.4	N/A	N/A
Italy	32	2.5	N/A	N/A
Ireland	47	9.2	N/A	N/A

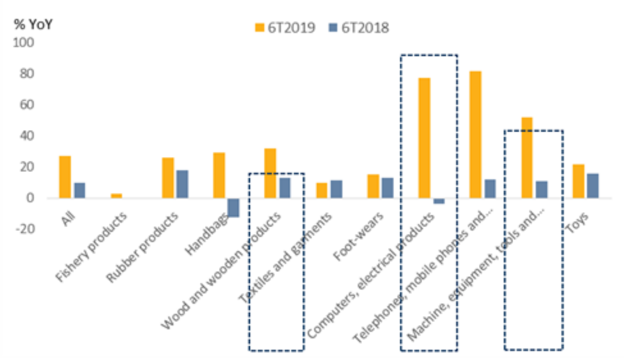
Source: Haver Analytics, U.S Census Bureau; The US Department of Treasury

RISK ASSESSMENT FOR THE NEXT REVIEWS

We believe that Vietnam will still be included in the Currency watchlist in the next reviews, but the risk of being labeled as a currency manipulator is low:

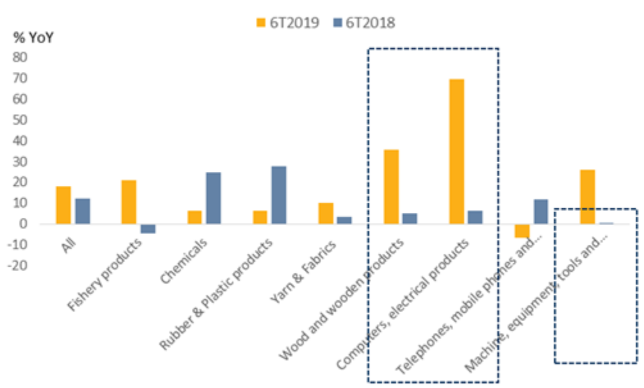
In terms of trade surplus with the US, it is difficult for Vietnam to lower the trade surplus with US in the short term. The rising trend of trade shift from China to Vietnam, and the volume of Vietnamese goods replacing Chinese goods on the US market may keep trade surplus with the US rising in the coming time. In addition, we notice that the recent surge in trade surplus with the US was partly resulted from the increase in Chinese goods illegally labeled "Made in Vietnam" to avoid taxes when exported to the US. Specifically, it can be seen that except for mobile phones and components, a lot of commodity groups with strong growth rates to the US coincide with the rising commodity groups imported from China like computers, electronics, spare parts, wood and wood products. As a result, if Vietnam can keep this phenomenon well under control, Vietnam's trade surplus with US, despite increasing, will probably be slowed down compared to the surplus in the 1H.2019.

Figure 3: Movements of some exported sectors to the US



Source: VIETNAM CUSTOMS, KBSV

Figure 4: Movements of some imported sectors from the China



Source: VIETNAM CUSTOMS, KBSV

In terms of current account balance, Vietnam will still violate this criteria as the current trade account balance is estimated to reach 2.7% of GDP in the coming review in October (data collected from July 2018 – June 2019). For the review in April 2020, we do not think there will be a huge change in the current account balance, although export conditions are not as favorable as before. According to our estimation, the account surplus in 2019 will can go down to 2.4% of GDP, but still higher than the criterion of 2%.

In terms of FX intervention, Vietnam will tend to meet this criterion because the net purchase volume (from July 2018 – June 2019) will be under 1% GDP as the SBV had sold USD in the 2H.2018 to prevent a strong depreciation in the VND. For the review in April 2019, (data collected from January – December 2019), if estimated GDP of Vietnam in 2019 reaches USD270 billion, the volume of foreign currencies that SBV is allowed to buy to meet the criterion of 2% GDP will be around USD5.4 billion. Based on the official data from IMF (by April 30, 2019) and our collected data, SBV has over-bought compared to this limit, reaching USD 8.5 billion from the beginning of this year. In the context of unpredictable moves from the intentional market, it is reasonable for the central bank to accumulate FX reserves, which helps SBV to deliberately control exchange rates in case of an adverse condition. Considering risk of a sharp VND depreciation in the 2H of the year (triggered by CNY depreciation), we believe that SBV will choose a right time to sell foreign currencies, which will not only help to keep exchange rates under the target of 3% in early year, but also help Vietnam to meet the target of keeping net purchases under 2% of the US. In addition, if the SBV does not sell to reduce FX reserves, Vietnam will still not violate the target of under 2% because SBV's net purchase period does not exceed 6 months in a row.

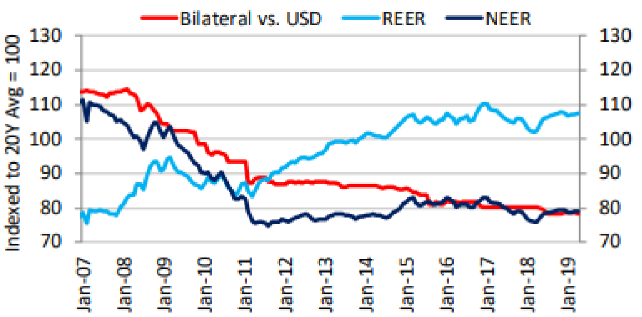
ASSESSMENT

Firstly, the watchlist for "currency manipulation" of the US can be seen as a threat from the US, which aims at creating an advantage of leverage in bilateral trade negotiation, especially over a small country like Vietnam. One of the concerns of the US is that Vietnam's tariff and non-tariff barriers currently hinder American businesses from accessing the Vietnamese market in some areas such as automobiles, agriculture and electronic payment…

Secondly, Vietnam needs to closely follow and regulate the trade surplus rate to the US when the trade surplus with the US will likely continue to increase rapidly. Vietnam Government may continue to encourage and support enterprises to increase the import of aviation machinery and airplanes as it does recently to reduce the trade deficit in the coming time, although this is only is a temporary solution. In particular, in the effort to punish China, the US gets very tough on the Chinese goods "labeled" as originated from Vietnam to be exported to the US. Therefore, in order to avoid the risk of Vietnamese goods being adversely affected, the Vietnam Government should urgently prepare a draft on the regulation of labeling "Made in Vietnam" and should strengthen measures to monitor and punish any violation.

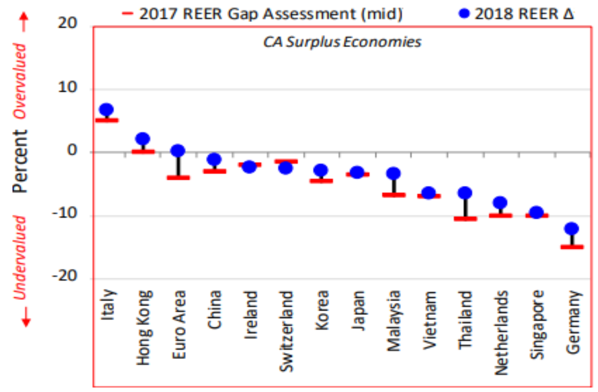
Thirdly, the State Bank of Vietnam is under a great pressure to change the exchange rate operating mechanism as well as the exchange rate target. The SBV may reduce the level and intensity of the impact, so that exchange rates will be more flexible in the future. Additionally, the target of devaluation will need to be adjusted carefully to avoid the depreciation of the currency. The US uses REER to evaluate the value of the currency. Although in 2018, REER of Vietnam increased by 2.3% but according to IMF's report, Vietnam's REER was still undervalued. Vietnam is recommended to gradually increase REER to reduce trade deficit with the US.

Figure 5: Exchange rate movements in Vietnam



Source: Vietcombank, JP Morgan

Figure 6: Estimated REER



Source: IMF, BIS REER, JP Morgan và FRB

Fourthly, the evaluation criteria in the report are only relative, and the decision to label a country as a currency manipulator seems to be a subjective judgement from the US. This can be seen clearly when the United States recently claimed that China is a "currency manipulator" even though China does not violate all three criteria. Vietnam has recently been in the watchlist of the US after the US President Donald Trump announced that Vietnam was "almost the single worst abuser of everybody."

CONCLUSION

In the medium term, we cautiously assess that the risk of Vietnam being tagged as a monetary manipulator is medium. The practical need for an increase in FX reserves to improve the health of the monetary system makes it easier for Vietnam to fall into a sensitive position, violating the level of intervention in the FX market in the evaluation report of The US Department of Treasury.

However, we think that Vietnam currently has a special relationship with the US. Specifically, Vietnam has an important political position with the US and the US needs Vietnam to reduce China's influence in the region. In addition, Vietnam has always deliberately contacted and showed the willingness to cooperate with the US to avoid being accused of currency manipulation. Therefore, we believe that the US will impose strong tariff barriers, or comprehensive sanctions on Vietnam. However, there is still a possibility that the US will increase tariffs on certain goods of Vietnam, especially on commodities showing signs of fake labels and exported in a large volume to the US.

DISCLAIMER

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