MACRO OVERVIEW 1Q.2019 – VIETNAM ECONOMIC OUTLOOK 2019

GDP growth: GDP growth in the 1Q.2019 was moderate with the main forces of processing and manufacturing sector. It is forecast that 2019 GDP will stay positive at 6.6 – 6.8%.

Inflation: Inflation in the first three months hit the three-year lows. However, inflation pressure may return in April. The average inflation rate in 2019 is expected to be under control, surrounding 3.8 – 4.0%.

Monetary policy: SBV monetary policy was further loosened in the 1Q, but in the rest of the year, it would be more prudent due to the inflation pressure.

Exchange rates: VND was quite stable in the 1Q and expected to depreciate by 1.5 -2% in the whole year of 2019.

VIETNAM ECONOMIC OUTLOOK Q1/2019

RISKS AND CHALLENGES

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Table 1: Vietnam key macro indicators

	Unit	2015	2016	2017	2018	1Q2019	2019F
GDP growth	%YoY	6.68	6.21	6.81	7.08	6.79	6.6 – 6.8
Average CPI	%YoY	0.62	2.67	3.52	3.54	2.63	3.8 - 4.0
Credit growth	%YoY	17.3	18.3	18.2	13.3	2.23	14
M2 growth	%YoY	16.2	18.4	16.9	11.34	2.67	13
10-year Government bond yield*	%	7.1	5.4	5.2	5.1	4.8	5.0
Export growth	%YoY	7.9	9	21.2	13.8	4.8	10 – 12
Import growth	%YoY	12	5.2	20.8	11.5	9.0	12
Average interbank exchange rate*	USDVND	22,485	22,761	22,698	23,240	23,189	23,600

Source: Stock market, SBV, KBSV

*In the closing session at the end of a quarter or financial year

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GDP GROWTH

❖ GDP growth in the 1Q. 2019 was moderate

GDP growth in the 1Q of 2019 was positive, mainly supported by processing - manufacturing sector. According to the data from Vietnam General Statistic Office – GSO (Stock market), GDP in the 1Q is estimated to expand at 6.79% YoY, lower than that in the same period of 2018 but much higher than the growth in 2011 – 2017 (Figure 1).

In the first quarter, industrial and construction sector contributed to 51.2% of overall GDP growth. Within this sector, the industrial sector climbed 8.95% YoY, construction industry gained 6.68%, while the mining industry lost 2.2%.

Processing – manufacturing is still the main force of economic growth with a relatively positive growth rate

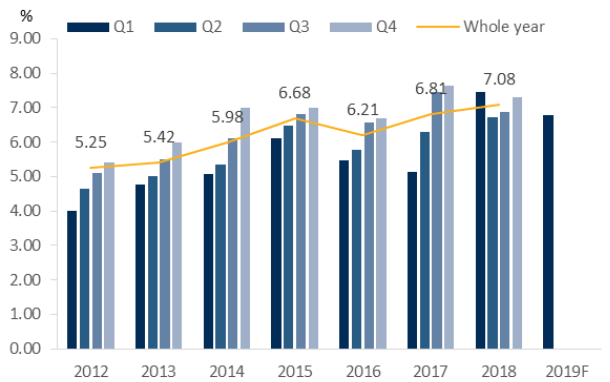
In the industrial sector, processing and manufacturing is the most outstanding industry, which leads the overall growth with an increase of 12.35% YoY. However, there are some signs of a slowdown in this sector since 3Q/2018, partly triggering from high growth base in the 3Q, 4Q.2017 and 1Q.2018. It is worth noting that the processing – manufacturing industry has maintained a two-digit growth in 12 consecutive quarters. In the 1Q, Samsung marked the industry with its launch of new products, and television manufacturing also saw a dramatic growth YoY. More specifically, the production volume of mobile phones in the first three months rose 2.1% YoY, while the TV production went up to 49.3% YoY.

The sectors seeing positive growth in 2018 such as coke manufacturing and refined oil, and iron and steel manufacturing still maintained an increase as the production of this industry gained 73.2% and 64.8% respectively. Nghi Son refineries and Formosa significantly contributed to this growth.

The mining industry is still in a downward phase

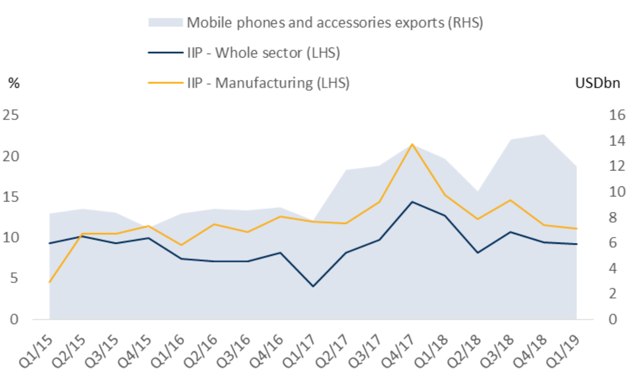
The mining industry witness a negative growth in the first quarter of this year, contrary to the increase of 0.40% YoY last year. Crude oil production fell by -10.3% to only 2.8 million tons in the 1Q, the lowest in recent years.

Figure 1: GDP growth speed by quaters



Source: GSO, KBSV

Figure 2: The IIP and the exportation of mobile phones and spare parts



Source: GSO, Customs Office, KBSV

PMI stayed above 50 – positive signs for the manufacturing industry

PMI stayed flat around 52 points in the first three months of 2019, after peaking at 56.5 points in November 2018. PMI has stayed above 50 points in the last 40 months, much higher than the average PMI for Southeast Asia region (Figure 3). Amid less tightening global trade tension, positive PMI and increasing indices such as production and new purchase order volume showed stable bright prospects of the manufacturing industry.

The service sector witnessed a stable growth

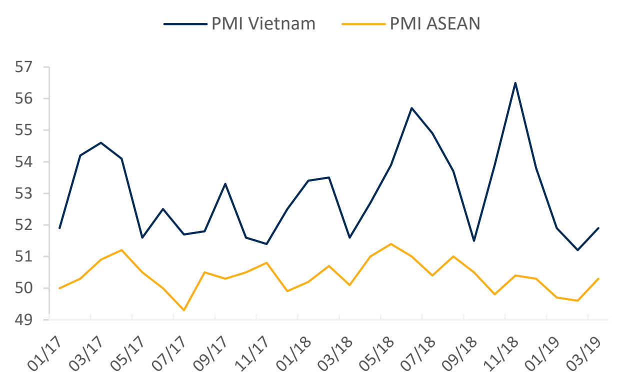
Trade and service activities in the first three months of 2019 saw a good growth when consumer purchasing increased. Specifically, the service sector rose 6.45%, and contributed 43.9% to the overall growth of the economy. In the service sector, the wholesale and retail industry gained 7.82% YoY (7.45% in 2018), indicating that domestic demand still showed positive signs.

Agricultural growth slowed, while the fishery growth stayed high

Agricultural growth slowed markedly as the growth rate was only 1.84% YoY (compared to 3.76% in 2018). The main reason is that export orders fell as well as increasing competition from Thailand and Cambodia. Rice exports fell by 11.5% in volume and 23.6% in price compared to the same period last year. Other crops such as fruits and vegetables, coffee also dropped 10-20% in value.

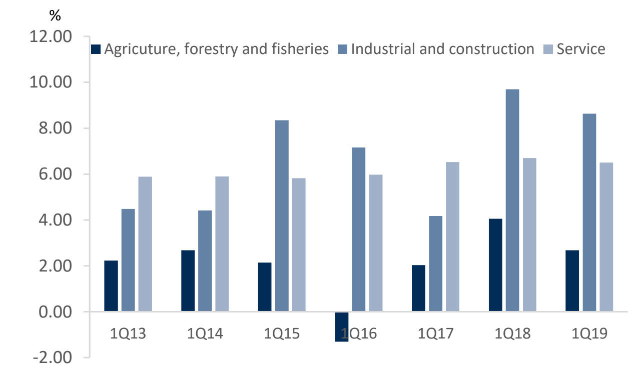
Contrary to the agricultural sector, favorable changes in the export market have helped promote the fisheries sector, particularly tra fish farming and processing. Fishery industry growth reached 5.1%, the highest increase in the first quarter of the past 9 years and seafood production in this quarter also gained 4.8% YoY. However, the prices of exported tra fish in March declined 15% against the first 2 months, the volume of tra fish exported to the US and China slowed down, so the value of export of fishery sector in the first 3 months of 2019 slightly decreased USD 1.7 billion, equivalent to 1.4%.

Figure 3: Vietnam PMI



Source: HSBC, Nikkei, KBSV

Figure 4: GDP growth rate by sectors



Source: GSO, KBSV

❖ Forecast GDP growth in 2019 – slower but still positive

GDP growth prospect in the rest of 2019 of Vietnam remained stable with expected annual growth rate of **6.6 - 6.8%,** about 0.4% lower than that of 2018 due to reduced export growth by the deceleration of China's economy and some of the world's major economies.

❖ **Potential boosters for GDP**

Manufacturing and processing is still the main driver with a large contribution from FDI enterprises

For the rest of the year, manufacturing industry will still be the main force of Vietnam economic growth. However, after peaking in 2017-2018, the growth of this sector may encounter a slowdown in 2019, stemming from the slowing global economy. This is the third time that manufacturing sector has slowed down since the 2008 recession. The reasons for this are involved in seasonal factors (from semiconductor materials and mobile phones production); automobile production declined in China and Europe and the impacts of US-China trade war. The FDI sector accounts for a large proportion in the industry, with companies such as Samsung, Formosa, Nghi Son Refinery still maintaining a large contribution to the processing and manufacturing industry.

The close relation between Vietnam GDP and Samsung revenue growth has been clearly demonstrated in Figure 5. Samsung has added a large proportion in Vietnam GDP since 2015, the total revenue from the four Samsung subsidiaries in 2018 was equal to 27.8% of total GDP. In 2019, it is expected that Samsung revenue will reach 5 – 8% GDP, going down as the global consumption market of mobile phones in 2019 seems to become saturated. The total number of Samsung mobile phones consumed in 2019 estimated by IDC is 284 billion units, down by 3% YoY, but the prices were higher so the revenue was ensured. In addition to the five high-end and key product lines launched in the first quarter of 2019, it is expected that in the second half of 2019 Samsung will continue to launch the M product (exclusively for the Indian market) and A (mid high-end). Demand for mobile OLED screen in mobile phones is estimated to increase significantly in the last 6 months, so Samsung Vietnam revenue is projected to remain positive in 2019.

In 2019, Formosa steel manfufacturing is expected to gain USD3.4 billion in revenue (+30% YoY) with liquid iron production in 2019 reaching 6.5 million tons; hot rolled steel 4.4 million tons. Meanwhile Nghi Son Refinery has a capacity of 10 million tons of crude oil/year, estimated to meet about 40% of domestic petroleum demand; this will certainly contribute to offset the slowdown of Samsung revenue proportion in GDP growth in 2019.

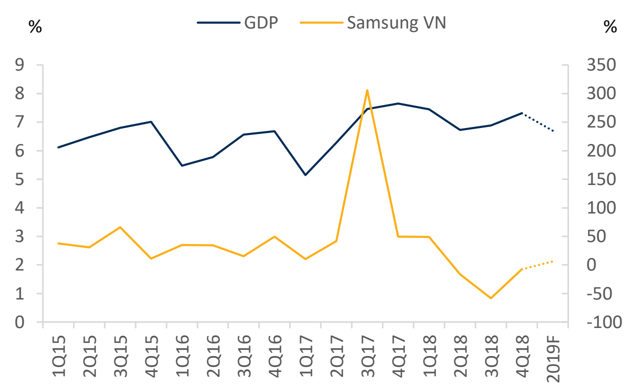
EVFTA is expected to be approved in July and bring many benefits to Vietnam exports

EVFTA, if approved and valid, will initially liberalize about 70% of goods and services in Vietnam. Therefore, EVFTA is an important factor aimed at strengthening trading between Vietnam and the EU. Some key export commodities of Vietnam such as textiles, footwear, agricultural and fisheries products will benefit the most because the current import taxes are quite high (5-20%), which will be reduced to 0% when EVFTA becomes effective.

Monetary policy tends to be more loosened and prudent

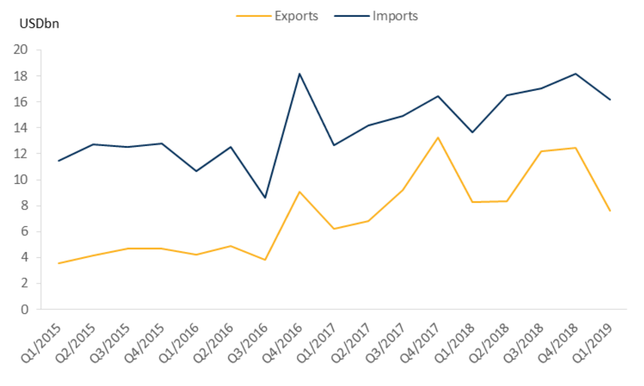
In the coming quarters, inflation pressure will increase when the prices of electricity and petroleum were adjusted up at the end of March, causing SBV to have more prudent policy management. Nevertheless, we believe that the inflation rates this year are still under the government control, the pressure from exchange rates will lessen, and SBV policies will be more flexible. If there are no sudden changes (crude oil prices soared to over 30%), the monetary policy throughout the year tends to be loosened.

Figure 5: GDP growth and Samsung VN revenue



Source: GSO, Samsung, KBSV

Figure 6: Im-export turnovers from Vietnam to China



Source: Customs Office, KBSV

❖ **Risks that may affect GDP growth**

The slowdown of China economy

The slowing China economy, to a neighbor country like Vietnam, is one of the remarkable issues in 2019. It can easily be seen that the export turnover from Vietnam to China has significantly reduced in the 1Q this year (Figure 6). The export turnover to China in 2018 hit USD41 billion, accounting for 17% total GDP. So if China GDP sheds 1%, the estimated GDP of Vietnam will lose 0.35%.

The US – China trade war is an unpredictable factor in Vietnam economic growth assessment

The US-China trade war, though cooling down somewhat in the past three months, has not yet been officially ended with a specific deal, and there is still a potential risk of failure in the trade talks. It is still too early to confirm whether Vietnam can benefit from trade war. In fact, Vietnam has recently benefited from two angles: trade diversion through export growth to the US and shifting production networks and supply chains (especially in processed goods) to Vietnam. However, these effects are slowing down and along with the positive changes in the recent US-China negotiation progress, many businesses have decided to wait for negotiation results instead of moving production plants from China.

In addition, if trade tensions between major economies continue to last, aggregate demand for goods will decrease and commodity competition will rise in the third markets for Vietnamese exports as Chinese goods have to look for alternative export markets.

INFLATION

❖ **Inflation rates in the 1Q/2019 are the lowest in three years**

According to data from GSO, the average CPI in Q1 gained 2.63% YoY. On a monthly basis, the CPI surged in February due to the impact of the Lunar New Year and cooling in March. The average core CPI remained at 1.83% YoY, lower than the 2% target of the National Assembly, showing that the monetary policy is managed reasonably by the SBV.

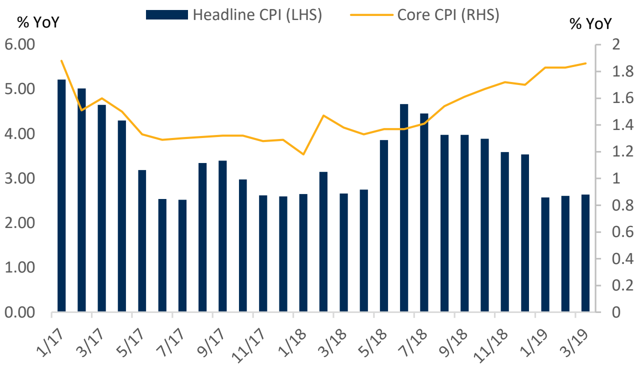
Food prices and gasoline prices contributed the most to CPI fluctuations in 1Q

In the 1Q, the main factors affecting the general CPI include:

(1) Crop prices gained 1.15% YoY and food prices climbed 6.6%, mainly in February (increasing 5.5% YoY, the highest since June 2012), which raised the overall CPI by 1.54%.

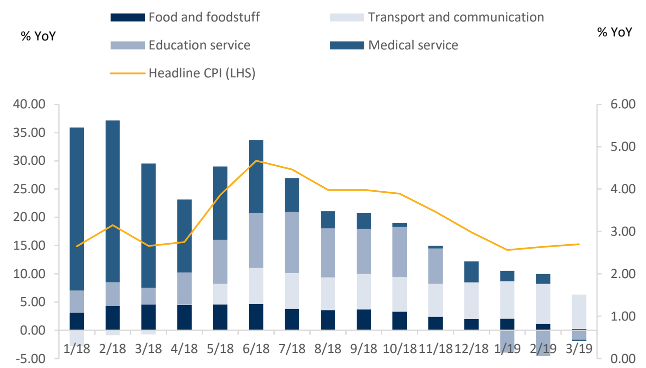
(2) Petrol prices corrected once and gained once in 1Q. Petrol prices index decreased by 8.22% YoY in the 1Q, causing CPI to fall 0.34%.

Figure 7: CPI



Source: GSO, KBSV

Figure 8: CPI movements in commodities and services



Source: GSO, KBSV

❖ **Forecast average inflation rates in 2019 – stay around the target of 3.8% - 4% by the Government**

We assess that the inflation pressure on the rest of 2019 will heavily depend on the world crude oil prices and affected by the electricity price hike last 1Q. Most of service prices managed by the Government were raised in the 1Q (except for tuition fees to be adjusted up in August – September), and are expected to be less volatile in the rest of the year. We estimated the average inflation rate in 2019 to go up by around **3.8** - **4.0%**, which is still under the Government target.

Electricity prices hit 8-year highs

Electricity prices climbed 8.36% by March 20, which will directly impact April CPI as it has not been calculated with March CPI. Electricity accounts for 3% in the basket of goods, we estimate the overall CPI will increase by 0.3%. However, electricity is an essential commodity, so an increase in electricity prices will influence the chain, causing many commodity prices to rise. In our opinion, the indirect impact of electricity price on CPI is about 0.4 - 0.6% and will mainly reflect within the next 3 - 6 months.

Crude oil prices started to recover in February, but hardly surge

The average Brent crude oil price in March reached USD63.13 per barrel, gaining 11.8% compared to that in December 2018, and down 6% compared to the same period last year. Expected Brent oil prices in 2019, according to EIA forecast in February, will be USD63 per barrel, climbing USD2 over the forecast in January. Although many analysts suppose oil prices will not fluctuate strongly in 2019, the decrease of Vietnam Petroleum Stabilization Fund in the last 3 months will undermine the price control in the future. As of March 18, Petrolimex Stabilization Fund has shed 66% compared to the end of 2018, and the room for using the fund will not be much.

Food prices tend to go down in the next months

Prices of pork and rice and some other crops have declined considerably in the 1Q/2019 and it is estimated that this trend will remain in the second quarter. Specifically, for pork, under the impact of two epidemics including African swine flu and Taeniasis, the demand for pork has dropped by 30-50%, according to surveys in traditional markets. Pork prices will continue to fall if the diseases keep spreading at the current speed. However, the prices of substitute goods, including poultry and seafood, may increase in the coming time due to increasing demand for pork substitutes. The prices of live chicken has now increased by more than 40%, duck meat prices gained by 8.8% against last year.

SBV will have a more prudent monetary policy in the coming time

Monetary policy has been loosened in the 1Q due to decreasing pressure from exchange rates and inflation. In the next quarters, with electricity and oil prices adjusted, the SBV will have a more prudent monetary policy to avoid creating many risks of inflation as in the electricity price hikes in 2011 – 2013.

MONETARY POLICY

❖ The monetary policy – loosened in the 1Q

Monetary policy in the first quarter of 2019 is generally more relaxed than in the last 6 months of 2018, due to pressure from exchange rates and inflation eased. However, compared to the period of 2015 - the first half of 2018, the SBV had a more prudent view in coordinating money supply into the system as well as controlling credit.

M2 growth outsped credit growth in the 1Q

As of March 25, total payment means increased by 2.67%, credit gained 2.28% against of 2018, based on the latest data from the SBV. As inflation and exchange rate pressures were no longer apparent in the first three months of the year, M2 growth has increased faster than credit growth, but the difference was not too large as in the same period in 2018.

On a monthly basis (January and February), M2 increased significantly VND 192.5 trillion compared to the end of 2018, while credit growth in the economy only was only up by VND56.8 trillion. In March, the money supply in the system increased slowly and credit skyrocketed over VND110 trillion within a month.

Table 2: Money demand and supply in the economy

(VNDbn)	31/03/2018	30/06/2018	30/09/2018	20/12/2018	25/3/2019
M2	8,521,098	8,879,582	8,933,154	9,121,583	9,365,129
Growth rate YTD (%)	4.01	8.39	9.04	11.34	2.67
Growth rate QoQ (%)	4.01	3.80	1.00	2.11	2.67
Increase in M2 amount by quarters	328,550	358,484	53,572	188,429	243,546
Credit outstanding balance	6,741,609	7,021,533	7,129,596	7,375,669	7,543,834
Growth rate YTD (%)	3.56	7.86	9.52	13.30	2.28
Growth rate QoQ (%)	3.56	4.03	1.54	3.45	2.28
Increase in lending amount by quarters	231,751	279,924	108,064	246,073	168,165
Difference between M2 and lending growth annually	96,799	175,359	120,868	63,224	75,381
Difference between M2 and lending growth by quarters	96,799	78,560	-54,491	-57,644	75,381

Source: GSO, SBV, KBSV

SBV bought foreign currencies to supplement foreign exchange reserves, raising money supply in the system

According to our assessment, M2 growth outsped credit growth because of the VND injection into the system by buying USD to supplement foreign exchange reserves. The purchase of foreign currencies mainly focused on the first two months of the year, the total value of USD bought by the SBV in the 1Q was estimated at over USD7 billion, equivalent to pumping out about VND162 trillion.

Liquidity in credit institutions is quite abundant in the 1Q

Liquidity in the system of credit institutions is most clearly demonstrated via fluctuations of interbank interest rates and net injection/withdrawal of the SBV through OMOs. The movement of interbank interest rates tended to decrease slightly in 1Q (Figure 7). However, interbank interest rates were maintained around 3.5% in order to create a safe distance of about 1 - 1.5% between interbank USD interest rates, limiting commercial banks to accumulate the USD, reducing pressure on foreign currency supply. SBV also net withdrew about VND 61.5 trillion in 1Q, mainly after the Lunar New Year, to absorb a large amount of excess money in the system.

Government bond yields plunged

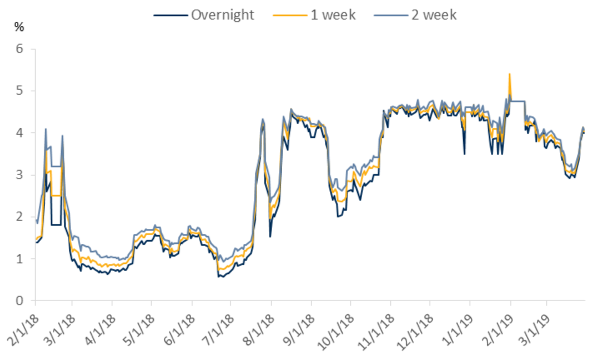
Vietnam Government bond market in the first three months experienced a slight decline in yields due to excess liquidity in the banking system, which resulted in the absorption of favorable bond auctions. As of March 29, 5-year and 10-year bond yields were 3.9% and 4.78%, and the 10-year yield gap of the US and Vietnam increased to 232 bsp from the record low in April 2018.

Deposit rates were volatile due to seasonal factors while lending interest rates slightly decreased in priority fields

Deposit rates increased slightly after January and February (before the Lunar New Year), short-term rates were adjusted down slightly in many banks, currently maintaining at 4.3-5.5% per year for the terms of less than 6 months. For terms of 6 months or more, there is a contradictory adjustment depending on the capital balance of each bank to meet the requirements of short-term capital ratio for medium and long-term loans. Terms from 6 to 12 month interest rates were 5.5-7.5% per year and 12, 13 month rates were 6.4% - 8% per year.

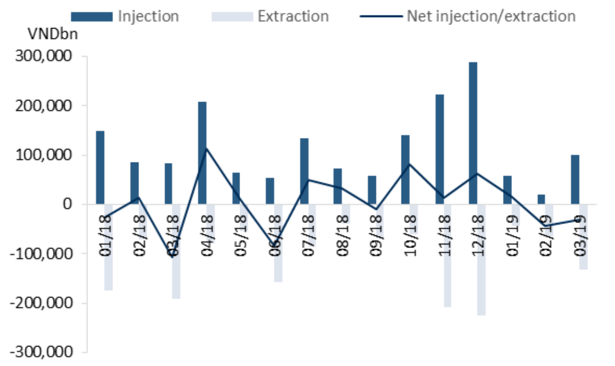
Lending rates remained stable in the first three months and interest rates in some priority areas were adjusted down by 0.5% at state-owned commercial banks. Currently, short-term lending interest rates are often at 6-9% per year, 9-11% per year for medium and long term.

Figure 9: Interbank interest rates



Source: Bloomberg, KBSV

Figure 10: Net-injection and net-withdrawal in OMOs



Source: SBV, KBSV

❖ **Monetary policy is forecast – to be prudent and based on market movements**

M2 and credit growth in 2019 hit 13% and 14% respectively

For the rest of 2019, we assess that exchange rate pressure will be not large while inflation rates are still under control (See more in *Exchange rates and Inflation*). Therefore, M2 growth will marginally rise against 2018, while credit growth will not change much compared to that in the previous year. This assessment is also in line with the SBV's credit determination for the whole year of 2019 after credit/GDP increased in the last years (122% in 2016; 130% in 2017; and 133% in 2018.)

Monetary policies of many commercial banks in the world become more neutral

Unlike the tightened monetary trend in 2018, large commercial banks in the world have changed polices to be more neutral. In particular, the Fed has announced to temporarily pause their interest rate hikes and stop cutting the balance sheet in 2019 after considering the risks to the US and global economic growth. Additionally, regional commercial banks in Indonesia, Malaysia or Thailand also showed that they will stop raising interest rates until the end of 2019 and India even cut 25bps policy interest rates in February. In that context, we believe that SBV will not likely to raise policy rates in 2019, and in a positive scenario, SBV may lower interest rates to boost the economy.

In a basic scenario, if there is no internal and external shocks, monetary policy in the rest of 2019 will be loosened in a more prudent way, depending on the market signals.

The current monetary policy management of SBV is suitable to the moves in international markets and Vietnam macro-economic data. Currencies of emerging countries tended to appreciate after Fed decided to stop rate hikes, which reduced the pressure on the USD/VND exchange rates. In general, inflation is still under control and SBV will not likely tighten monetary policy to protect the exchange rates or control inflation amid current currency stability. On the other hand, economic growth is also forecast to decrease 2019 due to slowing global economic growth, so it is reasonable that SBV will increase money supply in this year. Nevertheless, SBV had a more prudent view on its monetary policy management so that unstable situation from international market will not put pressure on exchange rates and inflation in Vietnam.

TRADE BALANCE

❖ The trade balance experienced a surplus in the 1Q

According to the data by GSO, the trade balance of goods in the 1Q of 2019 was estimated at a surplus of USD536 million, much lower than the level of USD2.7billion of the same period in 2018 due to declining export growth.

Exports in the domestic economy have seen improvements

Estimated export value in FDI sector in the1Q hit USD41.5 billion, +2.7% YoY. This number plunged compared to the increase of 23.2% in 2018, which showed that the slowdown in the processing and manufacturing growth has become more apparent in the export growth of Vietnam in the 1Q.

Despite slowing export growth in FDI sector, domestic economy experienced positive moves with the export turnover of USD17.1 billion, up by 9.2% YoY. This was achieved thanks to the increse in export growth of textiles, bags, footwear and wooden products. Breakdown from the data, textiles and bags saw a growth of 13.3% YoY while wooden products lifted 17% in the 1Q. This is higher than the growth in the same period last year because the number of outsource contracts gained in textiles, footwear,… (contracts are mostly from China, under the pressure of trade war.)

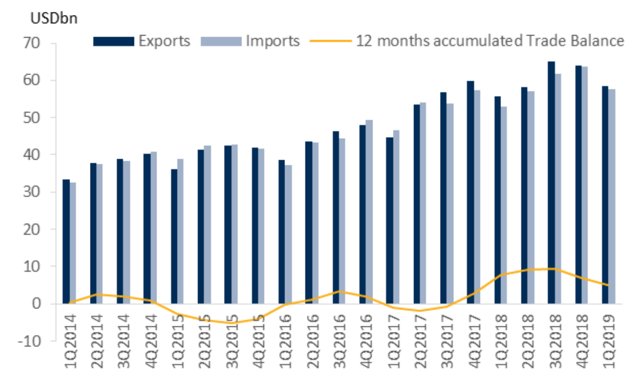
Machinery and equipment imports strongly recovered in the 1Q

Import turnover in the 1Q is estimated at USD58 billion, gaining 8.9% over 2018. Imports are mainly raw materials for export processing such as machinery and equipment, phones, electronics and components, fabrics, etc. In particular, growth in imported equipment and machinery has rebounded strongly since the 3Q of 2018, + 15.1% YoY (6.5% and 9.35 respectively in 3Q and 4Q, 2018) after staying negative or 10 consecutive months. This is a positive sign that investment will keep climbing amid unpredictable trade war.

Vietnam export growth has fallen quite rapidly compared to other countries in the region

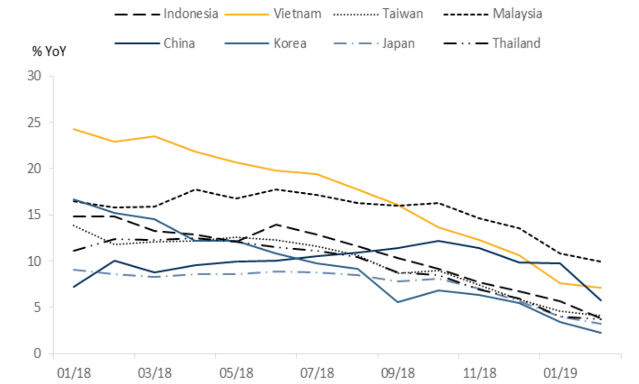
Figure 12 demonstrates the export growth rates in some large contries in the region. Eportation in Vietnam saw a much higher growth rate compared to other countries, but the unpredictable factor (mainly from Samsung) cooled down and the trade war became tense between the US and China, Vietnam's exports suffered greater pressure when the speed of decline was quite fast (growth line with high slope).

Figure 11: Im-export turnover and the trade balance



Source: Bloomberg, WB, KBSV

Figure 12: Export growth in the region



Source: GSO, KBSV

❖ **The trade balance – will have a surplus in 2019**

In 2019, we forecast the trade suplus will stil be around USD2-3 billion, lower than USD7.03 billion in 2018 due to slowing economic growth.

The trade balance had a surplus thanks to FDI operations

We preserve our forecast of a two-digit export growth (+ 10% YoY) in 2019 compared to 13.1% in 2018). Import growth will be at 12% YoY (compared to 11.5% in 2018) due to the expectation that investment will remain stable.

Although the prospect of global trade remains uncertain, we expect that the progress of trade talks between the US and China has made breakthroughs. Therefore, we do not see trade war as a major risk to Vietnam's trade balance. Instead, the deceleration of both the Chinese economy and global growth will have a greater impact on Vietnam's export performance.

EXCHANGE RATE

❖ **The VND was relatively stable in the 1Q of 2019**

Exchange market was stable in the 1Q

In 1Q, the trading of VND was relatively stable with the higher increase of the central exchange rate than the interbank average exchange rate. As of March 29, the central exchange rates increased by 0.68% while the interbank exchange rates climbed 0.06% compared to that at the end of 2018. Unofficial exchange rates also recorded a balance when decreasing about 0.03% YTD in 1Q.

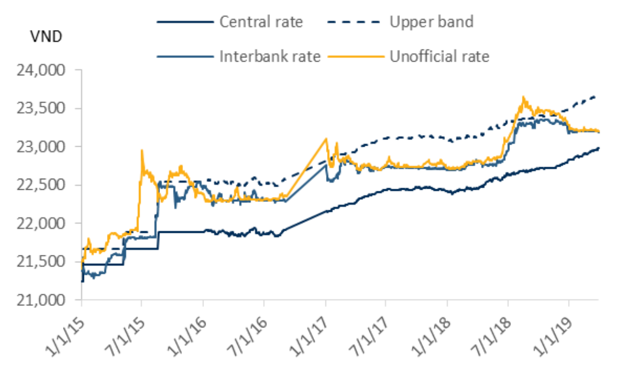
Quick interest rate hikes in the 1Q are the effort of SBV to be more suitable to the market

The central rate increased continuously in a short period and not strongly pressured by the external factors, which was a marked sign showing that SBV's policies on exchange rates were trying to follow the market closely. According to our assessment, when the market was tightening, the central rate kept stable by the SBV partly undermined the market fluctuations. VND is therefore highly valued compared to many currencies in the region (NEER and REER lines increased strongly, Figure 15), thus adversely affecting export activities. When the market has cooled down, SBV gradually raised the central exchange rate to narrow the gap with the interbank exchange rates and create a development room for the next period.

External factors were still the main reason for exchange rate uncertainty recently

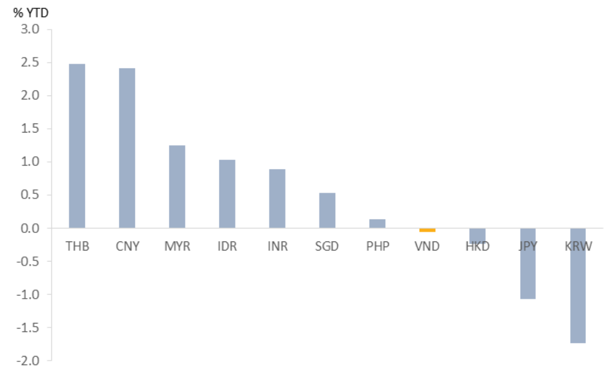
The USD and CNY are relatively stable in 1Q and are the main factors affecting the VND in the past time. Specifically, the DXY index tended to decrease slightly since December 2018 after the Fed's announcements were more neutral. Meanwhile, the CNY had relatively positive quarter as it appreciated 2.42% YTD by March 29 in the context of more positive US-China trade prospects. The value of the regional currencies has recovered strongly since the beginning of the year (Figure 12). As of March 29, the average regional currencies gained 0.76% YTD with the Thai Baht (+2.48% YTD); Renminbi (+ 2.42% YTD) and Indonesian Rupiah (+ 2.24%).

Figure 13: USD/VND exchange rate fluctuation



Source: Bloomberg, FinnPro, KBSV

Figure 14: Regional currencies' movements



Source: Bloomberg, KBSV

❖ **Positive signals in foreign exchange market in the 1Q**

NEER and REER go down slightly

In the 1Q, NEER moved sideways around 98 points as currencies in a basket tend to appreciate against the VND, while REER dipped due to low inflation in the first three months (Figure 15). This showed that the pressure on the USD/VND rate was not too much, considering the strength of the VND in the currency basket.

The gap between the interbank exchange rate, the free exchange rate and the ceiling exchange rate appeared again

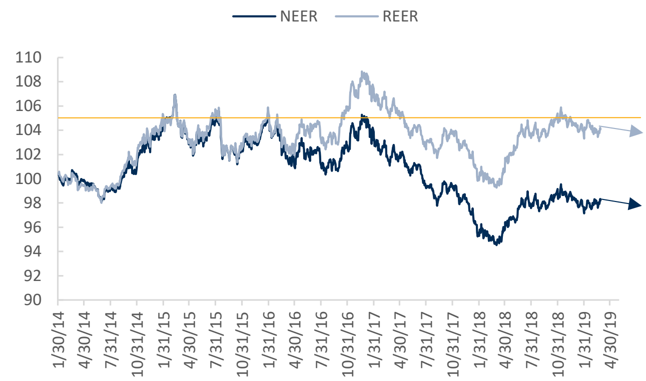
The gap between the interbank exchange rate, the free exchange rate and the ceiling exchange rate is considered a measure of expectation of VND devaluation in the market. In the 1Q, the above-mentioned gap returned to a reasonable level of + 1.5% of the central rate, similar to that in 2017 (Figure 13).

SBV bought foreign currencies to support foreign exchange reserves

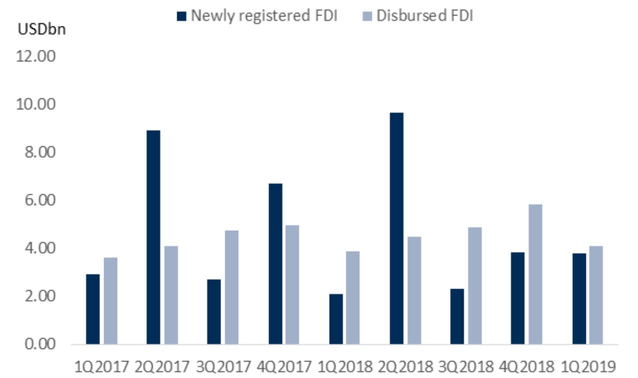
Given the above positive signals, SBV has started to raise the prices of buying foreign currencies to the average in the market, so it kept buying a large amount of foreign currencies, especially in the first two months. According to unofficial statistics, we estimate the total value of USD purchased is about USD7 billion, raising the level of foreign exchange reserves to the highest ever.

Figure 15: NEER and REER

Figure 16: Newly added and disbursed FDI



Source: Bloomberg, FinnPro, KBSV



Source: FIA, KBSV

❖ **It is estimated that the VND will depreciate about 1.5 - 2% in 2019**

Table 3: Key factors in the foreign exchange market

	Foreign currency supply - demand				Signals				
	Trade balance	Disbursed FDI	Capital flow into stock market	FX reserve changes	VNIBOR/LIBOR gap	Unofficial rate/Interbank rate	REER	DXY	USD/CNY
Unit	USD bil	USD bil	USD bil	USD bil	%	VND			% YTD
2018	7.03	19.1	2.75	3.5	0.53	96.6	102.7	93.58	6.62
1Q2019	0.66	4.12	0.4	7	1.59	18.8	104.1	96.39	6.75
2019F	3	20	na	na	1.0 - 1.5	20	100 - 103	93	6.72
Effect	(+)	(+)	(+)	(-)	(+)	(+)	(-)	(-)	(+)
Note	Estimated	Estimated		Estimated	Overnight	The gap narrowed in 1Q	REER is still at dangerous zone	DXY in a sideways drift recently	CNY appreciated recently

(+) Positive effect on VND stability

(-) Negative effect on VND stability

Source: GSO, SBV, KBSV

Table 3 shows the main indexes we used to analyze the fluctuation of the USD/VND rate. The drivers of the VND has become more positive, but we supposed in a short term, the prospects of VND will depend on the result of the US-China trade talks.

We believe that the pressure on the VND declined in the short term because 1) The US-China trade talks show many promising progresses; 2) The Fed's policy was expected to be more neutral in 2019, and the Greenback will likely depreciate in 2019; 3) PBOC will take measures to ease the pressure of CNY depreciation; 4) The overall trade balance is healthy thanks to the surplus and positive FDI capital flow.

Trade war is the biggest risk in the short term

If the United States and China reach an agreement to end the trade war, investors will reduce the perception that the Greenback is a safe haven currency and that capital will continue to flow into China market, leading to the CNY appreciation. On the contrary, the yuan will lose its value if both countries cannot reach an agreement and the US will escalate trade tensions by imposing a 25% tariff on China's USD200 billion exports in addition to the old tariff rates. However, we do not appreciate the probability of the bad scenario at present as the prolonged trade war will cause damage to both countries.

The DXY is expected to decline in 2019

In the forecasts of major financial institutions (Morgan Stanley, Citigroup,...), DXY index at the end of 2019 is expected to be 93 points. The FOMC meeting in March signaled that pause of the Fed rate hikes in 2019 and lowering US growth prospects would be supportive factors for the DXY to drop this year.

CNY is projected to inch up

The USD/CNY exchange rate will be traded at **6.72** at the end of the 4Q.2019, according to the average estimation from major world organizations (MUFG, Citigroup,...). The supportive factor is PBoC commission to ensure stable exchange rates in the context of the Government increased the use of monetary instruments to promote economic growth, creating devaluation pressure on CNY. In addition, the MSCI claimed they will quadruple the proportion of the MSCI China A Inclusion Index in the Global Standard Indexes basket from May 31, 2019, which will help to increase the capital inflows into China.

Foreign supply stays positive

The foreign currency supply in the Vietnam market is considered to be quite abundant, strongly supported by the current trade surplus and the financial balance.

The current trade balance in 2019 is expected to have a surplus about 2% GDP as Vietnamese key exports still see stable growth, not strongly affected by external factors.

The financial balance was supported by disbursed FDI and FII, which tend to flow into Vietnam (Figure 15). In particular in 2019, there are still new potential foreign currency supplies from SOE divestment to foreign strategic partners.

Vietnam's foreign exchange reserves after the first quarter are currently at USD65 billion, equivalent to three months of importation.

Forecast scenario of USD/VND exchange rate in 2019

	Positive	Basic	Negative
DXY	<90	92-95	>97
USD/CNY	<6.5	6.6 – 7.0	>7.0
USD/VND*	0.5% – 1.5%	1.5% - 2%	2% - 3.0%

* VND depreciation rate in the whole year of 2019 over 2018

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