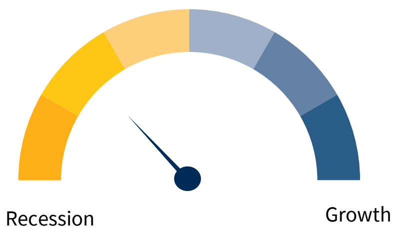
KBSV Research Division
April 2020

VIETNAM MACRO OUTLOOK IN 2Q20

General summary

GDP growth



+ Public investment acceleration

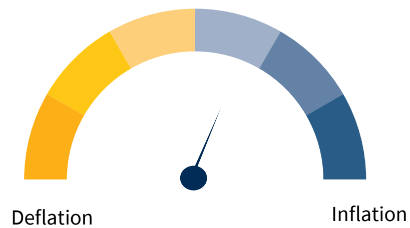
+ EVFTA effective from 2Q20

Risks:

+ Demand-supply shocks by COVID-19

+ Economic growth forces interrupted

Inflation



+ The Gov's administration price curb measures

+ Oil & gas prices at 11-year lows

+ Plunged consumption demand and lower discretionary goods prices

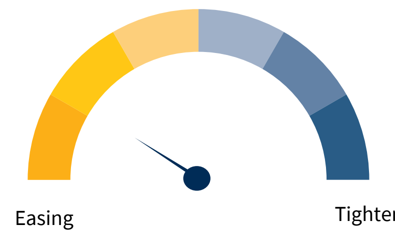
+ Lower input materials prices leading to lower production cost

Risks:

+ Rising essential goods prices

+ Easing monetary policy

Monetary policy



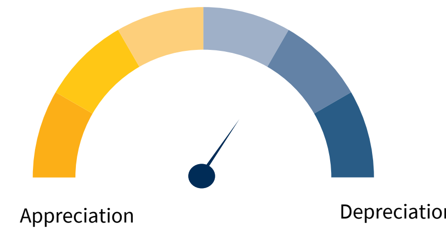
+ Room available for further rate cut

Risks:

+ Existing pressure from inflation and exchange rates though not high

+ Low credit absorption due to COVID-19

Exchange rate



+ Capital inflows are not "hot money"

+ SBV may interfere in the market by selling FX reserves

+ **Risks:**

+ Unfavorable FX supply – demand

+ Depreciation in local currencies in emerging markets due to USD liquidity shortage

Key macro indicators in 2020E

			KBSV	
	Unit	1Q2020	Old	New
GDP growth	% YoY	3.82	6.73	4.50
Headline CPI	% YoY	5.56	3.70	3.50
Credit growth	% YTD	0.68*	14.00	13.00
M2 growth	% YTD	1.55*	13.00	13.00
Policy rate (refinancing rate)	%/year	5.00	5.75	4.50
USD/VND	VND	23,637	23,200	23,750

Source: General Statistics Office (GSO), KB Securities Services (KBSV)
* As at March 20, 2020

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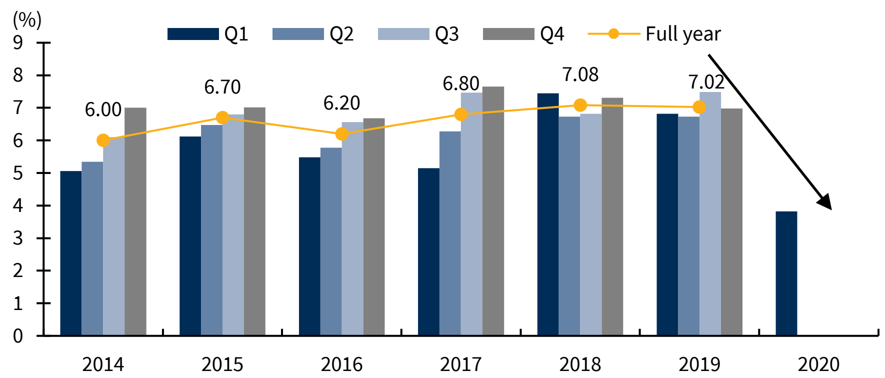
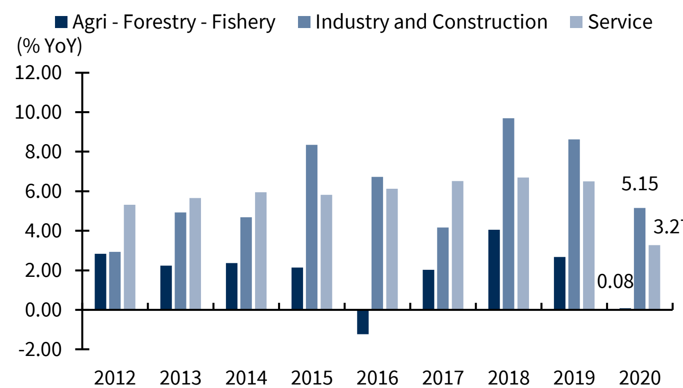
I. 1Q20 GDP growth plunged to 3.82% YoY

Vietnam GDP growth by quarters



Source: GSO, KBSV

1Q GDP by sectors



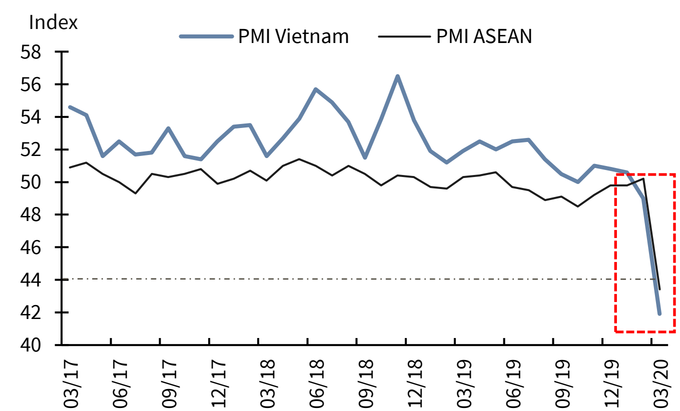
Source: GSO, KBSV

Vietnam 1Q GDP growth decelerated to only 3.82% YoY – its 10- year lows, and decreased by 3% compared to 2019's. All sectors witnessed a decrease due to Covid-19.

On the demand side, travel restrictions and pandemic fears hindered domestic consumption. Retail sales growth (+4.7% YoY), plummeted from 12.0% in 2019 with all components reducing significantly. For investment, the total registered FDI capital in 1Q20 (two major projects in 1Q20 and 1Q19 excluded) decreased by 34.5% YoY and disbursed FDI decreased by 6.5% while narrowing trade volume with China also slowed import and export growth.

On the supply side, manufacturing and processing (+7.12% YoY) continued to be the main growth driver, and was strongly supported by Samsung new products (before the Covid-19 outbreak), and Nghi Son Refinery's full capacity operation in 1Q. However, Vietnam's PMI fell faster than the region due the sharp drop in new orders from main export markets such as the US and EU from March (down 18% YoY). The service sector was hit the most by the outbreak. Travel services growth decreased by 18.6% YoY, and the international visitor traffic fell 18.1%.The agricultural sector decreased by 1.17% YoY as exports to China (accounting for 35% of the export market in 2019) almost froze in February due to salinity intrusion in the Mekong Delta.

PMIs of Vietnam and ASEAN



Source: IHS Markit, KBSV

COVID-19 impacts on economic growth

We update the GDP forecast with a dramatic cut amid the prolonged Covid-19 due to two main reasons: 1) larger impact to the economy as a second wave of COVID-19 cases forces the government to implement social distancing rules and order a nationwide lockdown; and 2) larger-than-expected impact to several driven sectors such as textiles, footwear and electronics arising from falling consumer demand in major trading partners like the US and EU.

We gauged the impacts of COVID-19 on Vietnam economy in three phases:

Phase 1 (happened): Covid-19 mainly occurred in China, and Vietnam has completely controlled over it. The impact of the first phase to Vietnam was reflected obviously in 1Q through (1) slowed tourism revenue (down 27.8% YoY), plummeted Asian tourist traffic (down 21.1% YoY); and (2) adversely affected imports of essential raw materials from China (down 18% YoY).

Stage 2 (ongoing): COVID-19 has rapidly spread to the world, and becomes more difficult to control in both Vietnam and Asian countries. This leads to: (1) lower domestic demand in 2Q; (2) falling world consumption demand, triggering a decline in export turnover; and (3) Sharp drops in tourism, aviation and transport revenue due to suspension from many Governments.

Stage 3 (may happen): The pandemic may last until 3Q or longer, causing an economic recession.

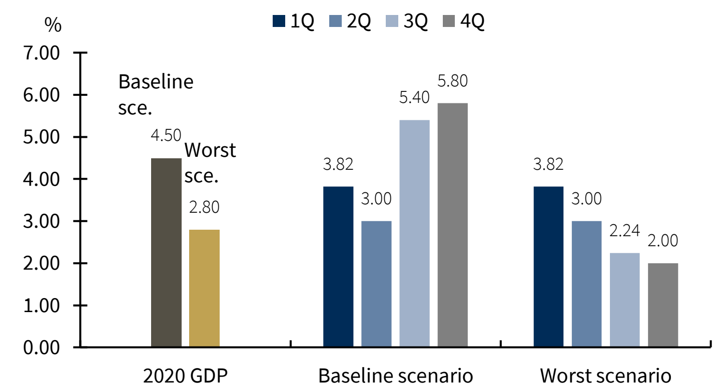
Our new base scenario of 4.5% GDP growth in 2020 assumes the negative impact from the pandemic begins to wane by the end of 2Q20. There also remains the possibility for a 0.4 percentage point increase to this forecast as the government accelerate public investment disbursements by about VND700 trillion according to our estimates.

Estimated impacts of Covid-19 on some sectors

Sector	Baseline scenario	Worst scenario
	Covid-19 fully controls in Q2	Covid-19 lasts till Q3 or longer
Tourism	Down by 15% YoY domestic visitors	Down by 40% YoY domestic visitors
	Down by 35% YoY foreign visitors	Down by 55% YoY foreign visitors
Exports	Down by 10% YoY	Down by 20% YoY
Imports	Down by 5% YoY	Down by 15% YoY

Source: KBSV

Two GDP scenarios for 2020



Source: KBSV

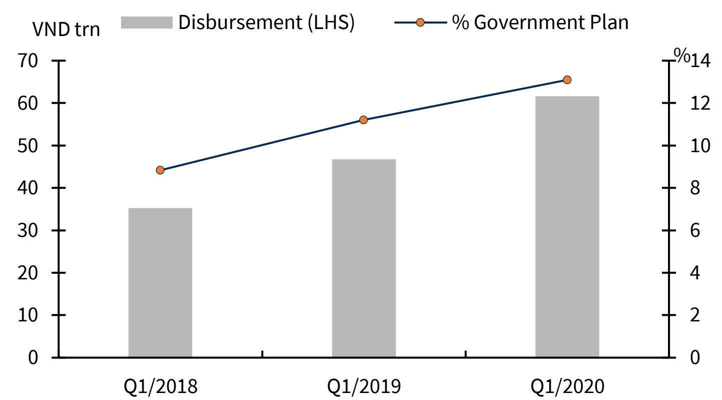
I. Forecast GDP growth in 2Q20 – waiting for more public investment signals

GDP growth in both quarter 2 and full year of 2020 will largely depend on the progress of Government's public disbursement as the COVID-19 showed profound impacts on Vietnam's economy in 1Q, reflected in the narrowing production scale of all economic sectors. Even if the pandemic ends soon, the economy may still bear the burden due to disrupted business operations in a long term.

The Ministry of Finance data showed the total public disbursement in 1Q20 at 13.09% of the National Assembly's plan (up 2% YoY), supported from strong disbursement of the Ministry of Transport (up 29.3% YoY). The Government has expedited some advocate measures, including accelerating approved public investment projects and transferring form public private partnership (PPP) projects to public investment for quick implementation, which bodes well for the public disbursement in the near future. The public investment will be focused on infrastructure, health care and education to minimize losses as seen in 2000 - 2007.

Total disbursed capital in 2020 should reach VND 700 trillion, including the disbursement of the remaining capital in 2019 and the target for 2020. The Ministry of Planning and Investment estimated a 1% increase in the public disbursement growth equals to a 0.06 percentage points plus in the GDP growth, so if the above guidance is successful (100%), the GDP growth will gain 0.42 percentage points.

Public disbursement



Source: Ministry of Finance, KBSV

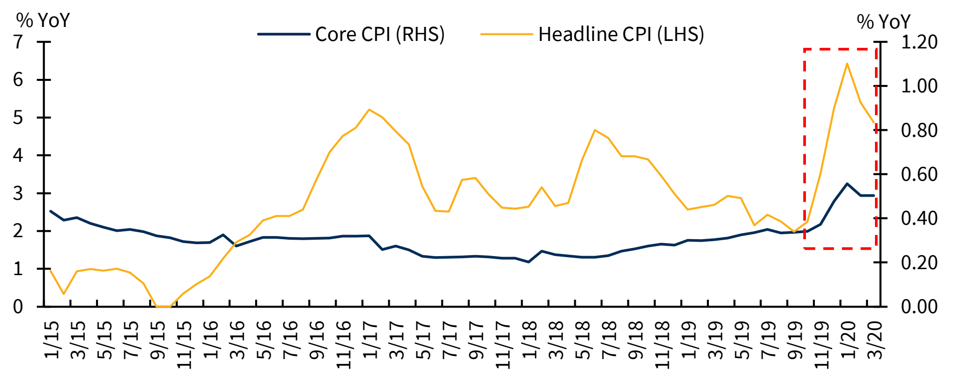
Some large public projects in 2020

Name	Investment capital (VNDtrillions)
3 sub-projects under North - South expressway	29.5
My Thuan - Can Tho Highway	4.8
Repairs of the runway in Tan Son Nhat and Noi Bai airports	4.2

Source: KBSV

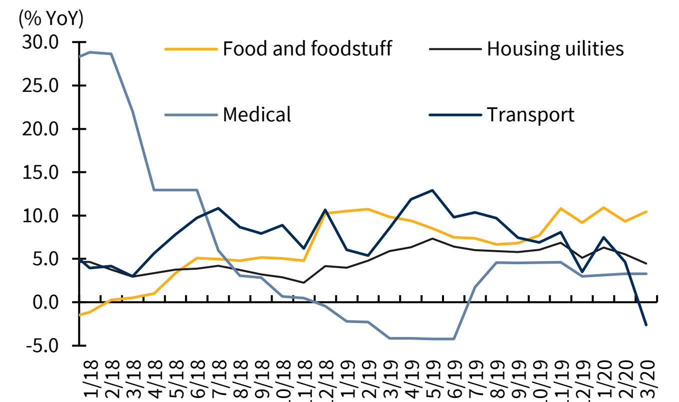
II. 1Q20 inflation stayed high at 5.56% YoY

Headline and core inflation



Source: GSO, KBSV

CPI movement in key groups



Source: GSO, KBSV

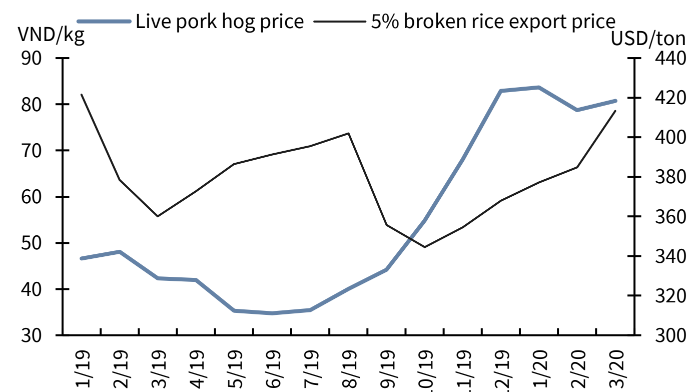
The average CPI in 1Q20 reached five-year highs at 5.56% YoY, and exceeded the Government's target of 4% due to low base in 1Q2019 inflation. However, positive signals arise as the MoM inflation rates tend to go down thanks to sharp drops in gasoline and raw materials prices, and lowered demand (for food, entertainment, etc.) during the pandemic.

Meanwhile, core inflation stayed high at 3.05% YoY.

The main factors affecting 1Q CPI included:

1. Food prices increased 13.21% YoY, mainly due to the 58.81% YoY surge in pork prices (+2.47 percentage points to the overall CPI);
2. Gasoline prices were adjusted down five times since early this year with Ron 95 prices down VND4,180/liter, E5 prices down VND3,830/liter, diesel prices down VND3,560/liter;

Live pork hog and export rice prices



Nguồn: KBSV tổng hợp

II. Forecast inflation in 2Q20 – would lower thanks to the Government's curb

Forecast inflation in 2Q20

No.	Groups	Weights (%)	+/- (%)	Contribution to overall CPI (%)
1	Food and foodstuff			
	Grains	4.46	3	0.13
	Foodstuff	22.60	12	2.71
	Outdoor eatings	9.06	7	0.63
2	Beverages and tobacco	3.59	1	0.04
3	Clothing and footwear	6.37	1	0.06
4	Housing, water, electricity, gas and other fuels	15.73	3	0.47
5	Furniture, household equipment and maintenance	7.31	1.5	0.11
6	Health	5.04	3.4	0.17
7	Transport	9.37	-2	-0.19
8	Communication	2.89	-0.6	-0.02
9	Education	5.99	4.5	0.27
10	Entertainment	4.29	-3.4	-0.15
11	Miscellanous goods and services	3.30	3.7	0.12
	Total			4.37

Source: KBSV

Inflation in 2Q20 is expected to go down thanks to the Government's price control measures

- **The risk of inflation in 2Q comes from the surge in grain prices**, especially the rice prices. Rice prices skyrocketed in this quarter as people increased food storage amid the pandemic, while the rice output saw a sharp fall following drought and saltwater intrusion in Mekong Delta. However, we expect domestic rice prices will remain stable thanks to the government's reassurances about national food security.
- **The transport group will be a factor to support CPI in 2Q**, thanks to: 1) Low international crude oil prices (one-third of the price in the same period); and 2) Abundant Petroleum stabilization fund of VND 5,000 billion, allowing further interference in the pump prices in case of a surge in world oil prices.
- **We expect pork prices, especially live pork hog in 2Q would sharply turn down to VND60,000 – 70,000/kg** thanks to more import supplies
- **Electricity prices could decrease 10% in 2Q** , which may help CPI decline 0.4 percentage points.
- **The prices of public services such as health care and education** are not in schedule to rise in 2Q, thus not worrisome to 2Q inflation. Furthermore, the Government may delay to raise the prices to maintain inflation rate lower than the target of 4%.

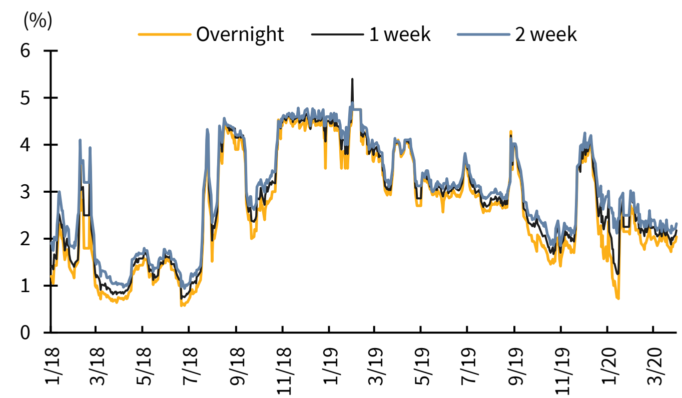
III. 1Q20 monetary policy – ample liquidity

Demand – supply on the money market

(VNDbn)	31/12/2018	31/3/2019	30/6/2019	30/9/2019	31/12/2019	20/3/2020
M2	9,211,848	9,478,157	9,866,810	10,083,289	10,573,725	10,737,618
Growth rate YTD (%)	12.44	2.89	7.11	9.46	14.78	1.55
Growth rate QoQ (%)	3.12	2.89	4.10	2.19	4.86	1.55
Increase in M2 amount by quarters	278,694	266,309	388,653	216,478	490,436	163,893
Credit outstanding balance	7,211,175	7,437,086	7,742,083	7,888,910	8,195,393	8,251,122
Growth rate YTD (%)	13.89	3.13	7.36	9.40	13.65	0.68
Growth rate QoQ (%)	3.23	3.13	4.10	1.90	3.88	0.68
Increase in lending amount by quarters	225,521	225,911	304,997	146,827	306,483	55,729
Difference between M2 and lending growth annually	115,081	40,398	124,054	193,706	377,659	108,164
Difference between M2 and lending growth by quarters	53,173	40,398	83,656	69,651	183,953	108,164

Source: SBV, KBSV

Interbank interest rates



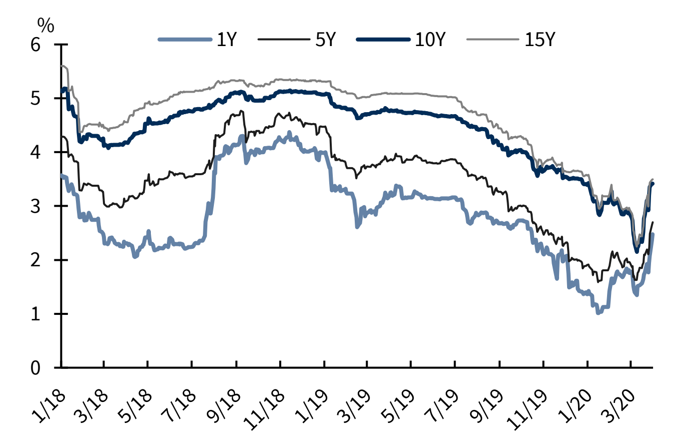
Source: Bloomberg, KBSV

Liquidity in the banking system in 1Q20 was abundant, with the gap between M2 and credit growth reaching three-year highs. This was largely due to: 1) the SBV's raising FX reserves by USD3.6 billion, or VND 84 trillion before Lunar New Year to support liquidity; and 2) weaker demand for credit as businesses were facing many difficulties due to COVID-19.

Excessive liquidity pushed government bond yields down to the lowest level ever. In addition, the open market operation and the interbank market were subdued as the SBV only using treasury bills to withdraw a large amount of money in the system (VND147 trillion).

However, the abundance of liquidity in the interbank market cannot translate into lower deposit and lending rates due to their weak transmission. In fact, the SBV had to use administrative measures, including lowering the policy rate, lowering the deposit rate cap for terms of less than 6 months in mid-March. As a result, the deposit interest rates for more than 6-month terms were reduced by 30-50bps. Lending interest rates of existing loans and new loans from April 01, 2020 at commercial banks also decreased from 0.5 to 2% per year for customers who are exposed to the Coronavirus (according to Directive 02/CT -NHNN).

Vietnam bond yields



Source: Bloomberg, KBSV

III. Forecast monetary policy in 2020 – change from prudent to easing after the COVID-19

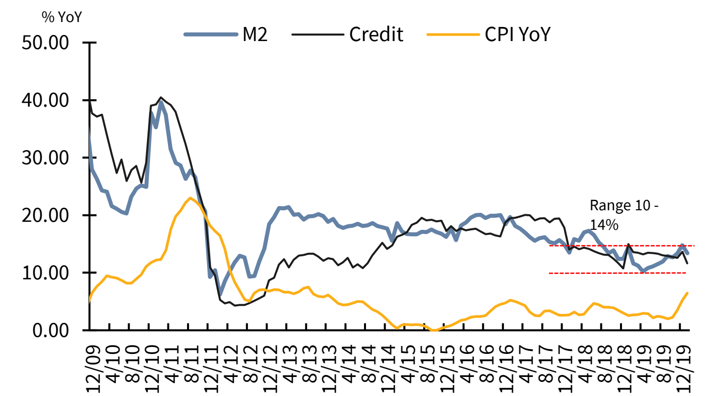
SBV should maintain the growth of money supply (M2) and credit between 10-14% YoY throughout the year to avoid bad debt and asset bubbles (such as real estate) as seen in 2009 - 2011. This goal is reasonable and has been maintained in the last two years to stabilize macroeconomy and boost growth, while Vietnam's credit/GDP ratio (about 110%) after GDP was adjusted is still high compared to other regional peers.

Short and medium term liquidity measures may need to be used flexibly. Albeit currently ample liquidity, we need to consider the liquidity risk arising from exchange rate movements. In the short term, open market operations (OMO) will be flexibly used as OMO interest rates fell to only 3.5%. In the medium and long term, SBV should plan to improve the refinancing and rediscounting tools, postponing the implementation of regulations on reducing the ratio of using short-term capital for medium and long-term loans (most likely effective from October 2020). In addition, the SBV cannot use the required reserve ratio to improve liquidity as this ratio is lower compared to other countries.

SBV will loosen the credit cap for banks, and prioritize ones achieving Basel II requirements, with an estimated of 2-3 percentage points increase from 3Q - the start of the peak lending season for banks. However, the absorption capacity of the economy is forecast to be quite weak and depend on the pandemic movements, and the resilience of the economy after the pandemic ends.

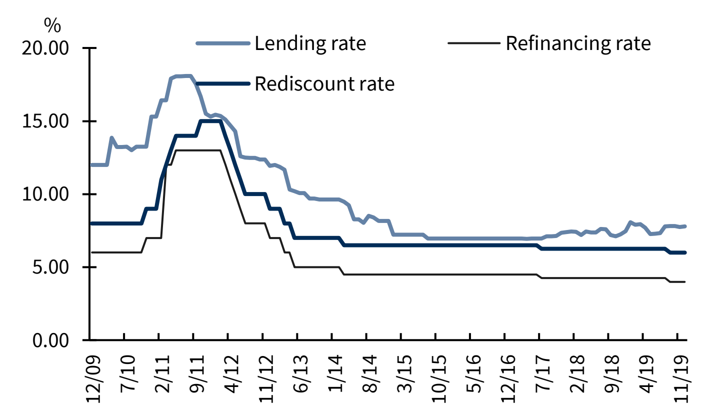
The downward trend in lending rates may be clearer in the near future. We noted a matching relationship between lending rates and policy rates, especially when system liquidity has any issues. However, they began to move in different directions in the past three years mainly due to the SBV's liquidity control regulations (reducing the ratio of short-term capital used for medium and long-term loans).

M2 & credit growth



Source: SBV, KBSV

Vietnam – policy and lending rates



Source: SBV, IMP, KBSV

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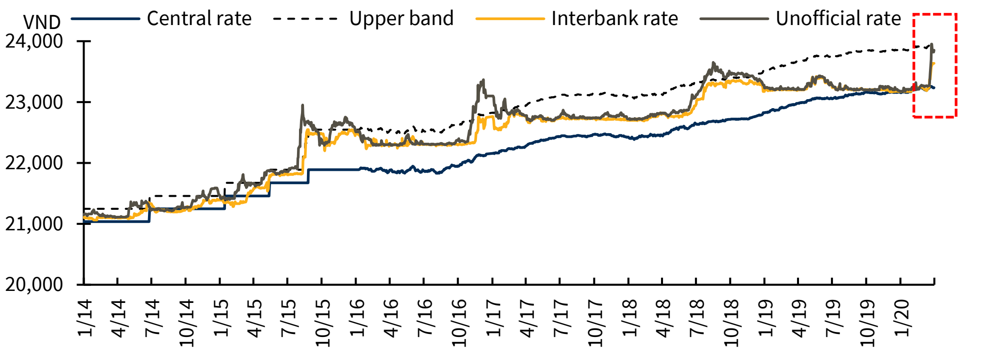
IV. Exchange rate in 1Q2020– surged in the last 2 weeks of March

USD/VND exchange rates



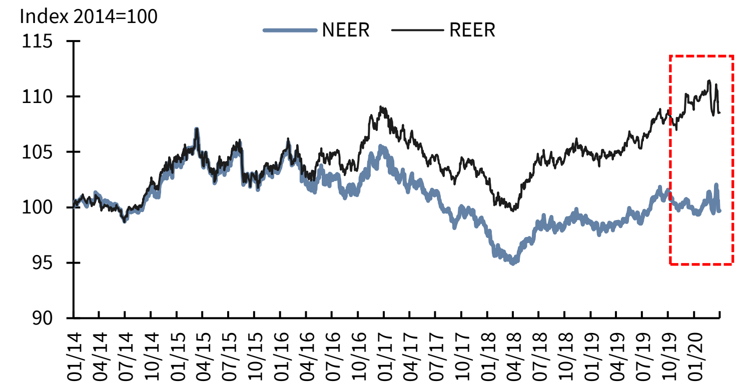
Source: Bloomberg, KBSV

USD/VND exchange rates surged in the last two weeks of March, contrary to the quiet situation in the previous two months. Just in two weeks, **interbank and unofficial exchange rates skyrocketed by 2% and 2.8% YTD respectively**, and approached the ceiling rate for the first time since mid-2018. However, compared to other regional countries, the VND depreciation was still relatively low.

We believe that the depreciation pressure on VND was higher as NEER and REER continued to surge over this period, and the gap between the unofficial and interbank exchange rates widened considerably. SBV immediately reassured the market sentiment by sharply lowering USD selling rate at the exchanges by 1%, which is cheaper than the market so that commercial banks can buy USD at low prices.

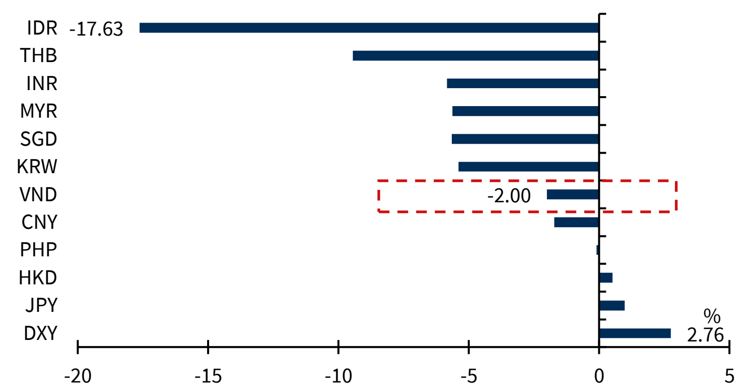
The direct cause of the strong depreciation of VND is the surge in USD prices in the global market. More importantly, the DXY bounced back from 94 to 103 points in only two weeks. The complicated movements of the COVID-19 pandemic may trigger a global economic recession, so investors are looking for USD as a safe haven currency. We can also notice this downtrend in financial assets such as stocks and bonds.

NEER &REER



Source: KBSV

Regional currencies movements (YTD)



Source: Bloomberg, KBSV

IV. Forecast exchange rates in 2020 – limited foreign currency supplies

We modify our view and believe that the VND should lose of about 2.5% of its value in 2020 - different from the sideways scenario mentioned in our 2020 Macro Outlook report, due to the USD shortage problem amid COVID-19. However, we expect the VND will not be devalued strongly thanks to the improved macro factors and the SBV's management.

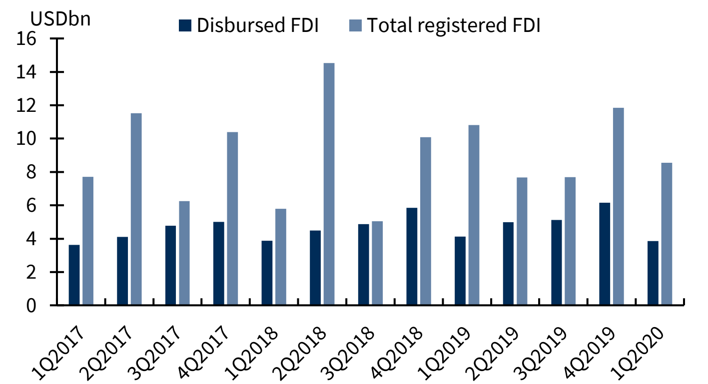
The FX supply in 2020 will be limited. In 2017-2019, the large supply of foreign currencies, including both current account surplus and financial balance, was a fundamental tool to curb USD/VND exchange rate. However, with ongoing Covid-19 pandemic in 2020 creating a supply-demand shock in Vietnam's import and export activities, we estimate that **the current balance will shift to a deficit of about 0.2% of GDP in 2020E**. The trade balance will have a slight surplus/deficit when exports to the two largest markets - the US and the EU drop sharply. Meanwhile, the world economic downturn will cause remittances and FDI inflows to grow slower than 2019.

The soaring demand for USD in 2020, especially in emerging countries amid concerns about a looming recession has led to strong capital withdrawal pressure. For the first time since GFC, FED had to signal readiness for swap lines to improve the liquidity of the global Dollar. This pressure of capital withdrawal can be easily noted from foreign trading activities on Vietnam's stock market.

However, we still expect the VND should not depreciate sharply because: 1) Foreign capital inflows into Vietnam are mainly FDI and long-term investments (private equity purchase or strategic shareholder in listed companies), and hardly run into Vietnam's bond market, so the risk of USD liquidity shortage due to its inability to repay debt is low compared to other countries in the region; and 2) Vietnam's FX reserves are up to USD83 billion , equivalent to about 3.8 months of imports and 30% of GDP - a relatively good level for the SBV to have enough room to intervene in the FX market.

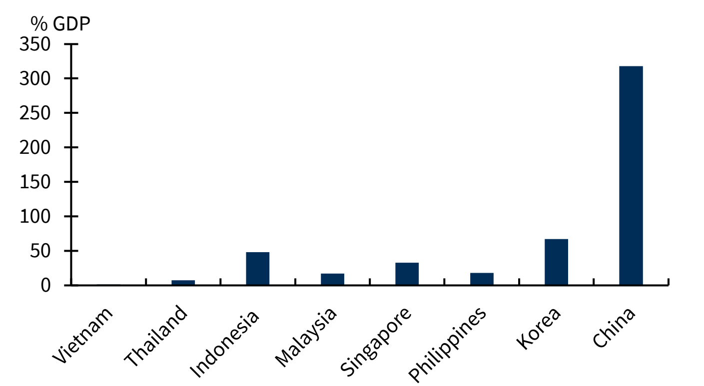
In addition, the Central Bank of Indonesia has completed a USD 60 billion repo with the Fed, which will open a new door for central banks of emerging countries, including Vietnam to cope with USD liquidity problem. With a holding of more than USD 30 billion in US Treasury bonds as collateral, the SBV is likely to have a chance to execute the repo.

Disbursed and registered FDI



Source: MPI, KBSV

Outstanding foreign currency bonds/GDP of Vietnam and the region (2018)



Source: ADB, KBSV

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