July 2019

VIETNAM MACRO ECONOMIC OUTLOOK REPORT 2H.2019

GDP growth: GDP growth in the first two quarters of 2019 was modest with the main force of processing – manufacturing sector. GDP in 2019 is forecast to have a positive growth of 6.6 – 6.8%.

Inflation: Inflation in the 1H.2019 hit its 3-year lows, but the inflation pressure is expected to come back due to the increase in the government administrated prices. The average inflation rate in 2019 is under control, stays around 3.5 – 4.0%.

Monetary policy: The SBV management of monetary policy was quite easing in 1H.2019, but in the last six months, it will be more prudent under the pressure of core inflation.

Exchange rate: The VND dipped 0.54% YTD and is expected to depreciate 2 – 2.5% in the whole year of 2019.

VIETNAM ECONOMIC OUTLOOK 2H.2019

RISKS AND OPPORTUNITIES

CONTENT

Table 1: Vietnam key macro indicators

	Unit	2016	2017	2018	Q1/2019	Q2/2019	2019F
GDP growth	%YoY	6.21	6.81	7.08	6.79	6.71	6.6 – 6.8
Average CPI	%YoY	2.67	3.52	3.54	2.63	2.64	3.5 - 4.0
Credit growth	%Ytd	18.3	18.2	13.3	3.13	6.22	14
M2 growth	%Ytd	18.4	16.9	11.34	2.89	6.05	13
10-year Government bond yield*	%	5.4	5.2	5.1	4.8	4.7	4.8
Export growth	%YoY	9	21.2	13.8	4.8	7.3	8
Import growth	%YoY	5.2	20.8	11.5	9.0	10.5	10
Average interbank exchange rate*	USDVND	22,761	22,698	23,240	23,189	23,301	23,600

Source: GSO, SBV, KBSV

* At the closing session of the last trading day of a quarter of a financial year

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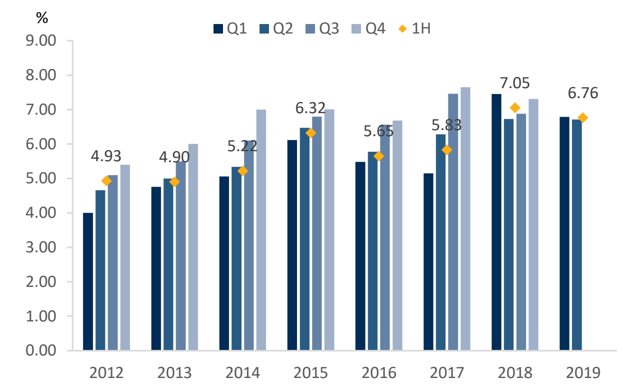
GDP GROWTH

❖ GDP growth of the first six months of 2019 was modest

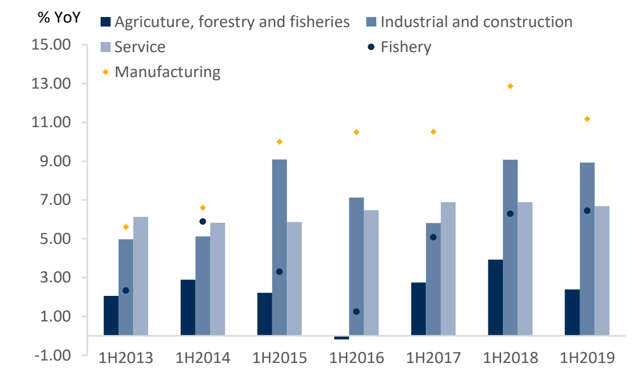
According to the data from the General Statistic Office of Vietnam (GSO), **GDP in the first six months was estimated to gain 6.76% YoY**, lower than the same-period increase in 2018, but much higher than that in the first half of 2011 – 2017 (Figure 1). GDP growth in Q1 and Q2 were 6.79% and 6.71% respectively.

Figure 1: GDP growth rate by quarters



Source: GSO, KBSV

Figure 2: GDP growth rate by sectors



Source: GSO, VN Customs, KBSV

➢ **Industrial and construction sector** climbed 8.93% YoY and added 51.8% to the overall economic growth in 1H2019.

Processing and manufacturing, with a positive growth, was still the main force for economic growth

Processing and manufacturing was a highlight with an increase of 11.8% YoY, and led the overall growth to reach a two-digit increase in 13 consecutive quarters. In the first two quarters, some secondary industries including *oil refinery 0*(+69.1%, Nghi Son Oil Refinery project); *metal manufacturing* (+40.1%, Formosa Factory); *wood processing* (+15.1%, thanks to benefits from the trade war and free trade agreements) achieved high IIP (Figure 3). On a quarterly basis, *electronics* and *optical products manufacturing* showed signs of improvements in May and June, which increased 20.33% YoY. The reason for this may be the promising sales of Samsung Galaxy S10 offered to public on March and April. To be more specific, more than 1 billion S10 5G phones have been sold on Korea market in only 80 days, Samsung revealed.

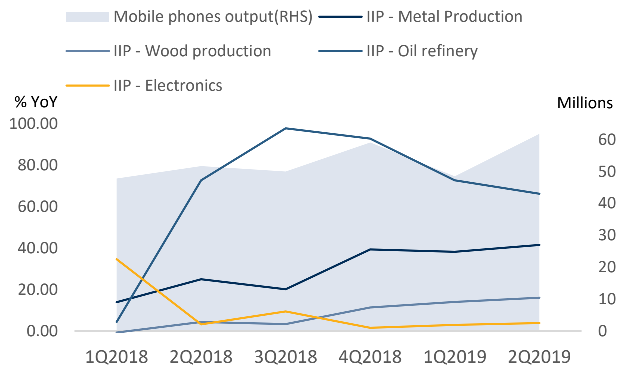
PMI stayed above 50 – bright outlook for manufacturing sector

PMI in the first six months was always above 50 points - much higher than the average PMI of Southeast Asia (Figure 4). Particularly in the surveys taken by IHS Markit in May and June, the production and number of new orders surged due to increasing demand from customers.

Mining sector slightly increased after many years of decline

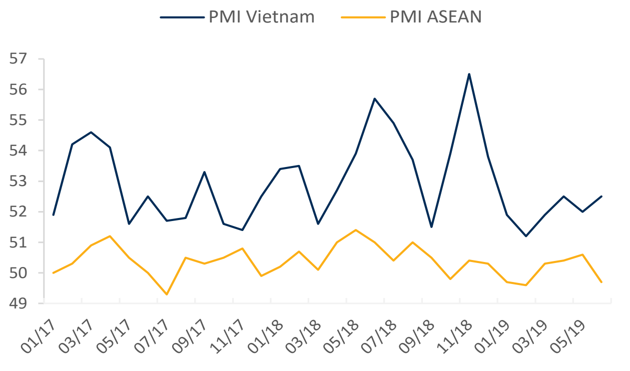
The *mining sector* inched up 1.78% YoY in the first six months after many consecutive years of decline because high coal mining output offset the drop in crude oil exploitation. Hot weather in the past two months has led to a high demand for electricity, so coal mining capacity was boosted to meet the demand for electricity production from thermal power plants, while the electricity production in hydroelectric plants was decreasing.

Figure 3: IIP and mobile phone output



Source: HSBC, Nikkei, KBSV

Figure 4: PMI of Vietnam



Source: GSO, KBSV

Service growth stayed positive

- **Services** in the 1H of the year climbed 6.69% YoY, lower than the growth in 2017 – 2018, but higher than that in 2012 – 2016, adding 42.2% to the overall growth.

Wholesale and retail activities held the highest component in service structure, +8.09%, while the revenue of retail sales and consumption services gained 11.5% YoY, which shows that the domestic consumption demand is still positive.

However, service growth slightly decreased over the same period in 2017 and 2018. We suppose that the reason for this was partly because the plunge in the number of tourists from China (-3.3% YoY).

Agricultural growth slowed down, while fishery growth still stayed high

- **Agriculture, forestry and fishery sector** increased by only 2.39% YoY in 1H2019 due to many difficulties in weather and epidemics.

Agricultural growth was significantly slowed down, only reached 1.3% YoY (lower than 3.07% in 2018), under the impact of epidemics and contracted export markets, especially for pork and rice products. Vietnam pig breeding market was volatile because of African swine flu (ASF). As of June 24, the ASF has appeared in 60 provinces and cities, and according to Ipsos, the supply of pork in June 2019 has decreased by 30% YoY. Meanwhile, rice exports are facing difficulties when major rice import markets such as China, Indonesia and Bangladesh all reduce imports in 1H of the year (rice exports fell by 17.8% in value). Rice prices, though slightly increased in April and May, were still generally in a downward trend (Figure 5).

The *fishery* sector, despite not having many favorable conditions as in 2017 – 2018, was still quite positive. Fishery growth hit 6.45%, the highest in the last nine years (Figure 2), and fishery production gained 5.8% YoY. However, by June 15, 2019, fishery exports reached USD3.5 billion, -1.2% YoY, according to the statistics by Vietnam Customs, due to the slowdown in the demand of import markets.

❖ GDP growth is expected to be positive in 2H2019

It is expected that Vietnam GDP will have a positive growth in the next two quarters of 2019, with a forecast increase of **6.6 – 6.8%,** which is 0.4% lower than that in 2018 under the impact of slowing global economic growth, but still higher that the relevant figures in countries of the same region.

❖ GDP boosters in the last six months of 2019

Processing and manufacturing will still be the main force of economic growth with a strong support from FDI businesses

In the last six months, *processing and manufacturing* will still be the main force of economic growth. FDI holds a large component in the sector, with large companies such as Samsung, LG, Formosa, Nghi Son Oil Refinery, which help to maintain a big contribution to processing and manufacturing. Industrial manufacturing in the last six months of the year is likely to accelerate compared to the first six months due to some main reasons: (1) New phone products of Samsung and Apple expected to be launched in the Q3, 2019 will support the production of mobile phones and components; (2) LG and Sharp are projected to move the production line of mobile phones and computers to Vietnam (about to come into operation in the Q4); (3) Under the pressure of escalating trade tensions (especially since May 2019), textile and footwear manufacturers in China and Vietnam plan to expand manufacturing system in Vietnam (Brooks Running,..); (4) Seasonal factor - at the end of the year, businesses will focus on boosting production to achieve targets.

Samsung Vietnam is still considered to be positive

Figure 6 shows a plunge in the revenue of the parent corporation and Samsung Vietnam since Q2, 2018, and significant influence of the Sino-US trade war on FDI businesses. However, as Samsung Vietnam only focuses on mobile phone, component, and household appliance manufacturing, so it will be slightly influenced (The decrease in revenue of the parent company was mainly caused by the decline of electronic chip trading). According to our assessment in the last six months of 2019, Samsung's revenue and profit will continue to be positive and serve as a major contributor to economic growth. Production of mobile phones and components will still positive due to: (1) Samsung is expected to launch Galaxy Note 10 product in Q3; (2) Samsung and LG are two major OLED display suppliers for Apple; (3) Samsung may benefit from phone lines amid US sanctions against Huawei in May.

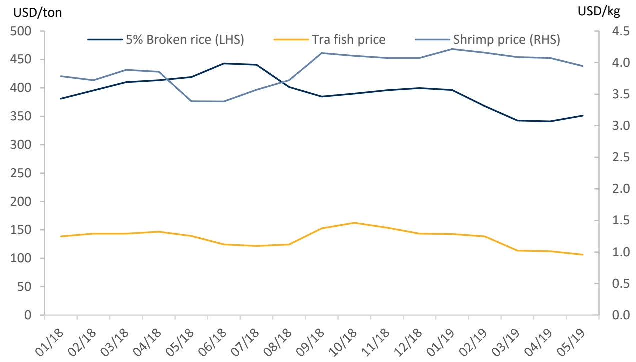
Seafood exports will have positive progress as China eases import policy

China has approved 33 Vietnamese seafood products, including lobster, common and giant tiger prawn, frozen tra fish, pangasius,... which are exempted from import taxes by the end of May. This will have a significant impact on exported seafood to China in the coming time. According to VASEP, the export target to China will reach over USD1.5 billion in 2019 and by the end of May 2019, the total seafood export turnover will reach USD381.8 million.

Trade agreements, including the new effective AHKFTA and newly signed EVFTA, will bring many advantages for Vietnam's exports.

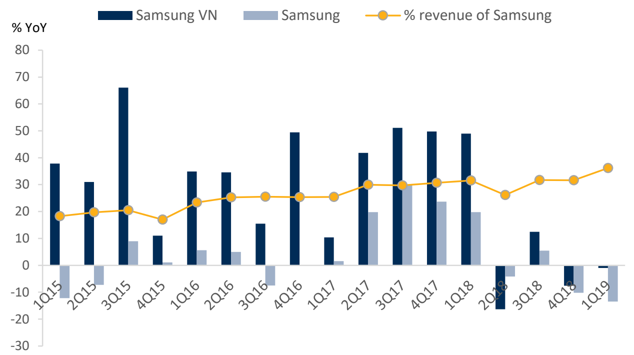
Trade agreements including CT-TPP (effective from January 2019); The AHKFTA (effective from June 2019) and EVFTA (signed on June 30, 2019) are factors that create competitive advantages between Vietnamese and other countries. Some key export products of Vietnam such as textiles, footwear, agricultural and seafood will benefit most directly.

Figure 5: Price movements of rice, tra fish and shrimp



Source: Bloomberg, tepbac.com, KBSV

Figure 6: Revenue growth of Samsung VN and Samsung



Source: GSO, Samsung, KBSV

❖ Potential risks to GDP growth

The US-China trade war is an unpredictable factor in evaluating Vietnam economic growth

The US-China trade war, despite being in a second truce after the leaders of the two leaders met at the G20 Trade Summit, still has a risk of further disruption in negotiations. In the case of prolonged trade tensions between major economies, aggregate demand for goods will decrease, competitive pressure on Chinese goods will increase on the domestic market (causing trade deficit from the early year), and on the third markets due to the depreciation of CNY, and Chinese goods seeking alternative export markets. In addition, the prolonged trade war has strongly affected the production activities of FDI enterprises in Vietnam. These businesses, which are the links in the global product value chain of enterprises from the US or China, will be directly affected by the impact of this war. Trade war scenarios are given as follows:

Table 2: Trade war scenarios

Trade war scenarios				
Scenarios	Tariffs for USD 200bn	Thuế với 300 tỷ hàng hóa TQ còn lại	Note	Probability
Positive	10%	Not applicable	US and China will reach new trade agreement this year	10%
Baseline	25%	Not applicable	US and China continue to negotiate till end-2020	50%
Negative	25%	25%	Trade agreement can be reached and full-blown trade war	40%

Source: KBSV

INFLATION

❖ **Inflation rate in the last six months of 2019 was the lowest during three years**

According to data from GSO, **the average CPI in the first six months increased 2.64% YoY** - the lowest level within three years. On a monthly basis, the CPI increased sharply in February and May due to the impact of the Lunar New Year and the surge in electricity/gasoline prices. Although the average inflation remained positive, the average core CPI was currently at 1.87% YoY, approaching the 2% target set by the National Assembly. On a monthly basis, core inflation increased from 1.7% in December 2018 to 1.96% in June 2019. This movement shows that money supply should be managed more prudently to keep the core inflation under the target.

Food and electricity prices contributed the most to CPI fluctuations in 1H2019

In the first two quarters of the year, the main factors affecting the overall CPI include:

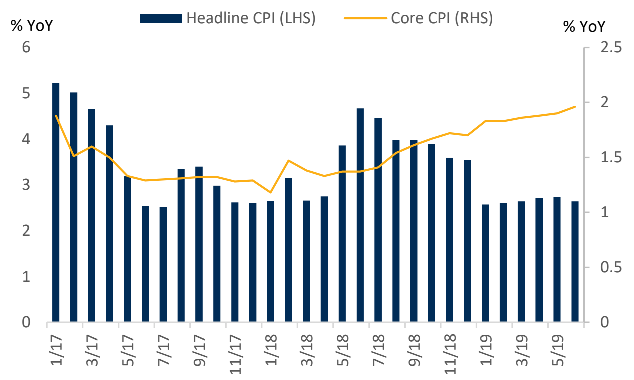
(1) Food prices increased by 5.4% YoY, mainly in February due to the effect of Lunar New Year (up to 5.5% YoY, the highest level since June 2012) and the impact of CPI overall increase of 1.22%.

(2) Housing and building material prices climbed 2.7% YoY from April due to the impact of electricity price adjustment and the overall CPI increase of 0.42%.

(3) Prices of education services increased 6.24% YoY because textbook prices increased from April 2019, making the overall CPI increase 0.37%.

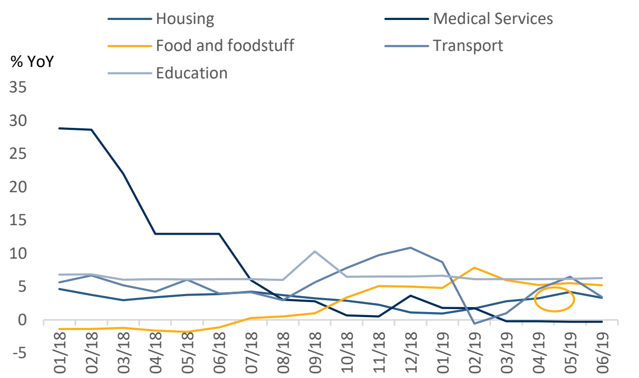
(4) Prices of transportation dropped by 1.21% due to gasoline price adjustments (gasoline prices decreased by 3.55%), causing overall CPI to fall by 0.11%.

Figure 7: CPI



Source: GSO, KBSV

Figure 8: CPI movements in goods and services



Source: GSO, KBSV

❖ **Forecast average inflation in 2019 - maintains at the target of the Government (approximately 3.8% - 4%)**

We see the pressure on general inflation in the remaining months of 2019 will depend largely on (1) the price increase of services managed by the State; (2) Fluctuations in world crude oil prices and; (3) Price fluctuations of pork. We estimate that the average inflation in 2019 will increase approximately 3.5 - 4.0%, still within the target set by the government.

State managed service prices including tuition and healthcare fees will increase

The roadmap to increase tuition fees under Decree No.86/2015/ND-CP will raise the education group's prices by 6.06% YoY annually (making the overall CPI increase 0.31%). Normally, this increase in tuition fees will affect CPI in August and September - beginning of the new school year. In addition, the Ministry of Health has announced that it will adjust an increase of about 1,900 health services at the base salary. The increase in health service prices is not as sudden as in previous years, but in the context of increasing tuition and base salary at the same time, there will be strong impacts on inflation in the coming time.

Crude oil prices started to rebound from early year to May, and will have unpredictable moves in the last two quarters

The average Brent crude oil price in the first six months reached USD65.85 per barrel, gaining 16.63% over December 2018, and decreasing 8% YoY. The average Brent oil price in 2019, according to EIA's forecast in May, is forecast to reach USD66.69 per barrel, USD3 lower than the forecast in April. However, the crude oil supply in the next period was threatened by US-Iran tensions and the production cut of OPEC + until March 2020. The US shale oil production is forecast to remain high, which will partly offset the decline in supply mentioned above. In general, crude oil prices will continue to fluctuate unpredictably in the coming Q3 and Q4.

Food prices tend to increase in the upcoming quarters

Pork prices plunged in the first six months of the year due to ASF, and are likely to decrease further in the near future due to the decline in pork supply and customer demand. However, in Q4, pork consumption demand will gradually rise, and according to Ipsos, Vietnam may lack of 500,000 tons of pork, equal to 20% of aggregate demand; pork prices this period will gain sharply. This is similar to the situation in China market these days, when pork prices on this market climbed 26.6% YoY on average due to the decrease in supply due to ASF since August 2018, said the Ministry of Agriculture and Rural Affairs of China.

Additionally, the prices of substitutes including beef, poultry meet, and seafood will continue to go up in the upcoming period, resulting from increasing demand for pork substitutes. FAO Food Index has been increasing for five consecutive months, and is forecast to maintain this gaining momentum until the end of the year.

MONETARY POLICY

❖ The management of monetary policy – more accomodative

The monetary policy in 1H 2019 was managed in a more loosening way compared to that in 2H 2018 because the pressure from exchange rate and inflation has been partly eased (shown in the positive gap between added M2 and credit in each quarter, Table 3). However, compared to the period from 2015 to 1H 2018, the SBV was much prudent in M2 control in the system and credit control. Credit growth ceiling in 2019 decreased to 14% instead of 18 - 20% as in previous years.

M2 growth increased slightly while credit growth was somewhat controlled

By June 18, **M2 increased 6.05%, credit increased 6.22%** compared to the end of 2018, according to the newly updated GSO report. M2 growth was stimulated, especially at the end of each quarter, while credit growth was allocated over the months.

On a monthly basis, M2 increased mainly in the first two months of the year. In March, April and May, the money supply increased slowly and credit increased more sharply with an increase of VND294 trillion and VND346 trillion, respectively, compared to the end of February. In June, money supply increased strongly again by nearly VND 100 trillion in 18 days.

The SBV bought foreign currencies to supplement foreign exchange reserves and increase money supply in the system in the first four months

M2 gained at the beginning of the year as a result of injecting VND into the system through buying USD to supplement foreign exchange reserves. The purchase of foreign currency concentrated in the first four months of the year, the total value USD bought by the SBV was estimated at over USD8.35 billion, equivalent to injecting about VND194 trillion.

Table 3: Money demand and supply in the economy

(VNDbn)	31/03/2018	30/06/2018	30/09/2018	31/12/2018	31/3/2018	18/6/2019
M2	8,521,098	8,879,582	8,933,154	9,211,848	9,478,157	9,769,165
Growth rate YTD (%)	4.01	8.39	9.04	12.44	2.89	6.05
Growth rate QoQ (%)	4.01	3.80	1.00	3.12	2.89	3.07
Increase in M2 amount by quarters	328,550	358,484	53,572	278,694	266,309	291,008
Credit outstanding balance	6,741,609	7,021,533	7,129,596	7,414,077	7,646,138	7,875,233
Growth rate YTD (%)	3.56	7.86	9.52	13.89	3.13	6.22
Growth rate QoQ (%)	3.56	4.03	1.54	3.99	3.13	3.00
Increase in lending amount by quarters	231,751	279,924	108,064	284,481	232,061	229,095
Difference between M2 and lending growth annually	96,799	175,359	120,868	115,081	34,248	96,161
Difference between M2 and lending growth by quarters	96,799	78,560	-54,491	-5,787	34,248	61,913

Source: GSO, SBV, KBSV

Liquidity is relatively abundant in 1H 2019

Liquidity in the credit institution system is most clearly expressed through the fluctuation of interbank interest rates and net position of SBV through open market operations (OMOs) (Figure 9). In general, in the first six months of 2019, liquidity was relatively abundant except at the end of March - early April as the State Treasury suddenly withdrew its deposit from the system, causing a temporary shortage of liquidity. VND interbank interest rates were relatively low and stable (but still maintain a certain distance of at least 0.5% with USD interest rates). The total volume of net withdrawal of the SBV was about VND 98 trillion in the first six months.

Government bond yields plunged due to excess liquidity

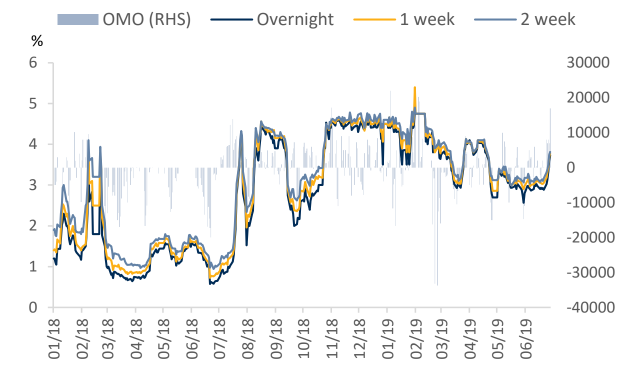
Vietnam Government bond market in the first six months experienced a decrease compared to the end of 2018 in terms of yields due to excess liquidity in the banking system, resulting in favorable absorption of bond auctions. Government bond yields on the secondary market moved in the same direction with the primary market, with a decline of about 30-80 bps compared to that in December 2018, in which 1 year term yield witnessed the sharpest fall.

Long-term deposit rates tend to increase while short-term interest rates are quite stable

Deposit rates dipped for terms of less than 12 months, ranging from 4.1-5.5% per year for terms of less than 6 months, and 5.5% - 7.45% for terms of less than 12 months since short-term funds in banks were quite abundant. However, for 12-month and longer terms, there is a contrasting adjustment due to dependence on capital balance to meet the requirements for short-term capital ratio for medium and long-term loans. The average deposit rate for 12, 13 month terms is 6.4% - 8% per year.

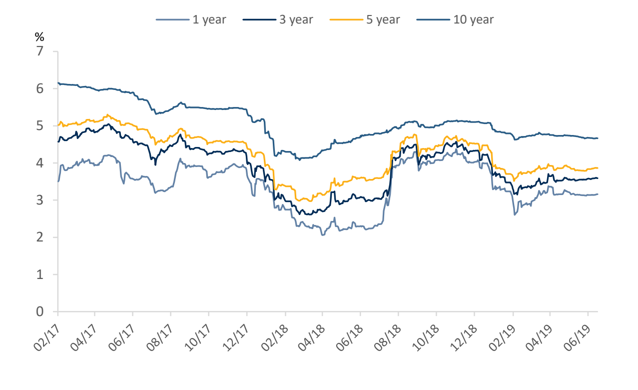
Lending interest rates remained stable amid rising deposit rates. Lending rates were even corrected down by 0.5% at state-owned commercial banks in some priority areas. Currently, short-term lending interest rate is popular at 6-9% per year, and 9-11% per year for medium and long term.

Figure 9: Interbank interest rates and net injection/withdrawal in the OMOs



Source: Bloomberg, SBV, KBSV

Figure 10: Fluctuations of Government bond yield on the secondary market



Source: Bloomberg, SBV, KBSV

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

M2 and credit growth in 2019 will reach 13% and 14% respectively

For the rest of 2019, we assess the pressure of exchange rates will not be very large in the base case, while inflation is still under control. However, core inflation tends to escalate quickly (See more at *Exchange rate and Inflation*), so it is likely that SBV will maintain its prudent monetary policy as at present, and M2 growth will slightly increase compared to that in 2018, while credit growth will be equivalent to the level last year.

In contrast to the tightened monetary policy as in 2018, big central banks in the world have changed to a more dovish policy. In particular, after re-accessing the risks to the US and global economic growth, the Fed signaled a

Large central banks in the world have changed their monetary policy to a more dovish one

rate cut in the future if necessary. According to our base case, the Fed will have at least one interest rate cut in 2019 due to the main reasons: the increasing risk from trade tensions, and Fed's forecast inflation in 2019 dropping to 1.5% - much lower than the expected rate of 2%.

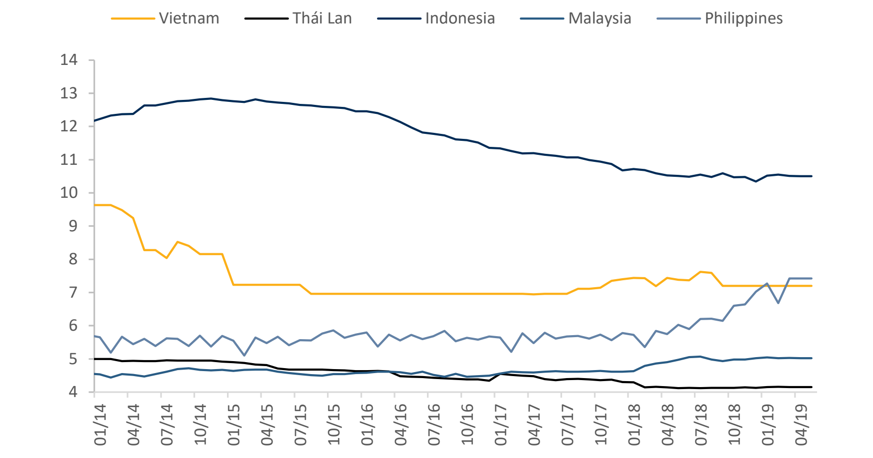
The ECB also signaled the possibility of further interest rate cuts and other measures to boost the growth and inflation of the Eurozone. In addition, regional banks such as Indonesia and the Philippines have also raised interest rates and India has even cut interest rates twice in the past 6 months. Reverse Banks of Australia and New Zealand also cut 25bps in June to stimulate growth. In this context, we assess there will be very small possibility that the SBV will increase its policy rate in 2019. However, as analyzed above, the continuous increase in core inflation from now on will limit the possibility of loosening monetary policy of SBV.

Mobilization interest rates tend to go up, while lending interest rates will not have many changes

In the coming time, short-term deposit interest rates will not be much changed, maybe even reduced because the short-term capital source in the system is quite abundant under the impact of Circular 36/2014/TT-SBV. For longer terms of more than 12 months, interest rates will continue to increase slightly because banks are having to restructure their capital sources, especially in the case that a draft on continuing to reduce the ratio of short-term capital for medium and long-term loans to only 35% at the beginning of next year of the SBV is approved and comes into effect.

Lending interest rates, in the coming time, will be subjected to two opposing and neutral pressures: (1) Long term deposit rates are expected to inch up, creating pressure on lending rates; (2) Loosening trend of central banks in the world and in the region, leading to widening lending interest rates between Vietnam and the world, creating pressure to reduce lending rates. Currently, Vietnam's lending rates are lower than those of Indonesia and the Philippines, and higher than the rates of Thailand and Malaysia (Figure 11). The reduction in interest rates of Indonesia and the Philippines in the near future will make Vietnam more disadvantaged in exchange rates and supporting export enterprises.

Figure 11: Average lending interest rates in countries of the same region



Source: IMF, KBSV

TRADE BALANCE

❖ Trade deficit in 1H 2019

According to GSO, it is estimated that ***the trade balance of goods in 1H 2019 had a deficit of USD34 million*** due to decreasing exports in line with the world' trend and surging imports. In general, in 1H 2019, electronics and agricultural exports weakened, textile, footwear and wood groups grew well while imports of raw materials and machinery skyrocketed.

Table 4: Im-export growth of regional countries in 1H 2019

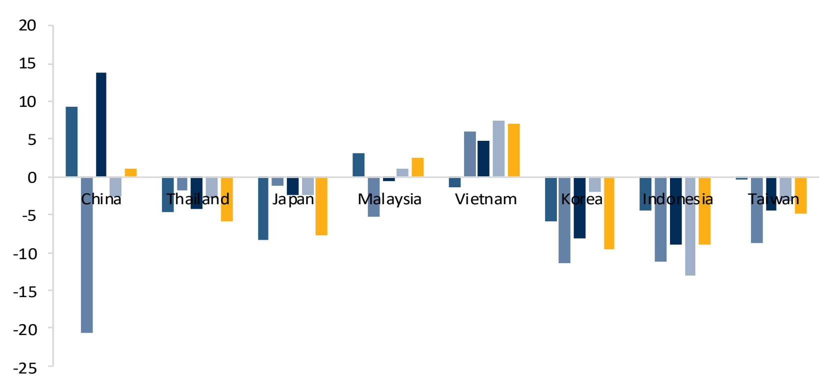
	Exports from Vietnam			Imports to Vietnam		
(%)	1H2019	1H2018	1H2017	1H2019	1H2018	1H2017
US	27.4	9.2	9.5	17.1	16.3	27.2
EU	-0.4	12.3	12.6	9.1	9.2	16.3
China	1	28	42.5	21.8	15.6	16.8
ASEAN	6.7	17.4	26.7	6.4	11.8	17.6
Korea	6	31.8	29.1	1	-0.8	51.2
Japan	9.1	12.5	19.5	-0.7	12.2	10.7

Source: GSO, KBSV

Exports show signs of a slowdown in line with the general downward trend in the region

Export growth in 1H 2019 was at its lowest level in the last three years. Export turnover is estimated at USD122.79 billion, +7.3% YoY. However, if compared with other major exporting countries in the region (Figure 12), Vietnam is a bright spot. Export turnovers of Japan, South Korea and major exporting countries in ASEAN all show signs of decline in the first five months of the year while Vietnam's exports always maintain a stable growth.

Figure 12: Export growth of countries in the same region



Source: Bloomberg, KBSV

The export growth of FDI sector has slowed down

Export of FDI sector reached USD85.9 billion, +5.9% YoY, the lowest level since 2011. This figure dropped sharply compared to 14.5% and 21% in 2018 and 2017, showing the impact of deceleration in the growth of the global electronics sector has been more demonstrated in Vietnam's export growth. However, on quarterly basis, FDI sector export in the second quarter of this year has recovered slightly. Export growth of phones and components - the main contributor in the FDI sector, reached 13.6% YoY in the Q2, much higher than in 2018 (Figure 14).

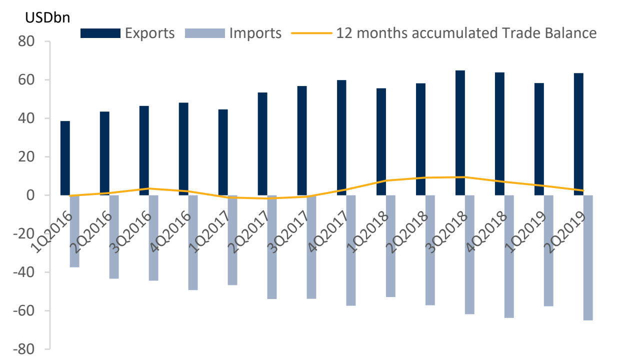
Domestic economic sector has achieved some improvements

Meanwhile, domestic economic sector has achieved some improvements with an export turnover of USD36.8 billion, +10.8% YoY. It showed that wood product, textile, bags and footwear gained 17.7%, 9.9%, 12% and 14.2% YoY respectively in 1H 2019 (Figure 14).

The US-China trade war is the reason why Vietnam's traditional exporting products surged

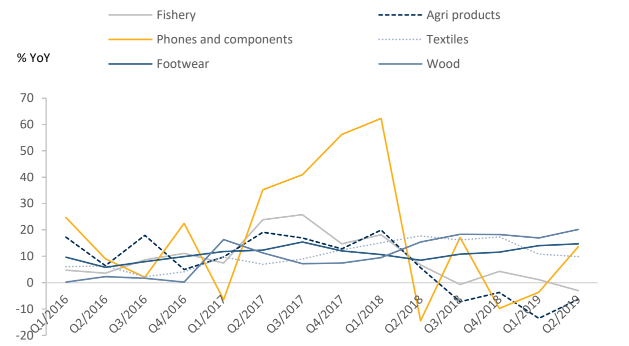
Table 4 said that Vietnam are benefiting from the Sino-US trade war. The exports from Vietnam to the US have tripled in 1H 2019 compared to that in 2018, estimated to hit USD21.5 billion, +27.4% YoY. The products that Vietnam exported the most to the US were textiles (about 25%), phones and components (16.6%), footwear (11.5%) and wood products (8.1%). The value of export of these products in the first five months of the year, according to data from the Vietnam Customs, were 11.1% YoY, 91.7% YoY, 13.3% YoY, 35%, respectively.

Figure 13: Im-export turnovers and the trade balance



Source: GSO, VN Customs, KBSV

Figure 14: Export movements in the key sectors



Source: GSO, KBSV

The importation of machinery and equipment rebounded sharply in 1H2019

It is estimated that the import turnover in 1H2019 posted at USD122.76 billion, +10.5% YoY. Imports are mainly raw materials for export processing such as machinery and equipment, spare parts, electronics and components, textile and garment materials, footwear production...

In particular, the importation of equipment, machinery continued to rebound strongly since 2H2018. The import value of these two in 1H2019 was USD17.88 billion, 14.8% YoY. This is a positive signal showing that investment is still rising amid unpredictable trade war.

❖ The trade balance – is forecast to have a surplus in 2019

In 2019, we forecast that the trade balance will maintain a surplus of about USD1-3 billion. The export value in 2H2019 will grow more positively than in the 1H2019 as electronics (accounting for about 32% of total export turnover) shows sign of growth again. Traditional industries such as textiles, footwear and furniture will still maintain positive growth. However, in the context of slowing global economy with increasing risks, we lowered our forecast for export growth in 2019 to **+8% YoY** (compared to 13.1% in 2018). Import growth will be **10% YoY** (compared to 11.5% in 2018). Factors affecting trade balance in the last six months include:

Export growth of electronics group is forecast to stay positive

- The last six months of the year is the climax when enterprises will focus on manufacturing, especially consumer electronics products (phones, televisions, etc.) when consumer demand increases. The new phone lines from Samsung and Apple expected to be launched in the Q3 of 2019 will strongly support the industry of manufacturing phones and components while the Thanksgiving and Christmas period (Q4) is the peak for consumer shopping.

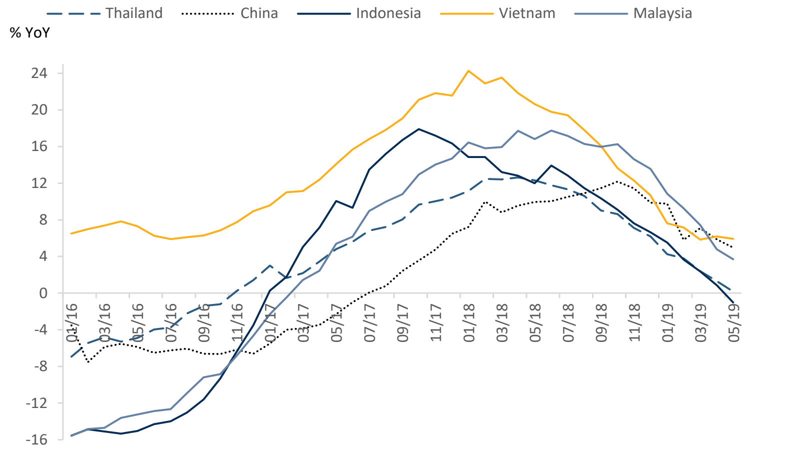
The sharp increase in imports of goods from China threatens Vietnam's trade balance

- There are two main reasons for the increase in imports from China: (1) CNY depreciates significantly compared to VND and; (2) the trade war. According to Vietnam Customs, as of May 31, 2019, trade deficit from this market reached USD16.3 billion, equal to 68.2% of the 2018 trade deficit (USD23.9 billion). This suggests that RMB (CNY) devaluation is a factor that increases the amount of goods flowing from this country to Vietnam when Chinese goods become cheaper. In addition, many manufacturers have imported Chinese goods - mainly textiles, seafood and agricultural products, labeled Made in Vietnam illegally to avoid taxes from the United States. Recently, the US President Donald Trump has criticized Vietnam for taking advantage of US-China trade war and with the signs of a strong increase in trade deficit from China, we think that the Vietnam Government will have a stricter move to manage import contracts from China in the near future.

The slope of Vietnam export growth is larger than in regional countries

- Figure 15 shows export growth rate in some major countries in the region. It can be seen that Vietnam's export has a higher growth rate than other countries (between 2016 - January 2018), however, when sudden factor (global economy decelerated, trade war becomes tense between the US and China), Vietnam's exports will be subject to greater pressure when the speed of deceleration is quite fast (the slope of the growth line is large during the period of 01/2018-01/2019).

Figure 15: Export growth in the region



Source: Bloomberg, KBSV

EXCHANGE RATES

❖ **The VND depreciated 0.54% YTD in 1H2019, and have different moves compared to the previous period**

Exchange rates sharply rose in May

From the beginning of the year to the end of April, VND trading was stable with the increase of the central exchange rate higher than the increase of the interbank and unofficial average rates. However, only in a short time (1H of May), the interbank and unofficial market rates surged (Figure 16). In June, exchange rates was stable again. Specifically, as of June 28, **the central exchange rate increased the most, 1.06% YTD while interbank exchange rate rose 0.54% YTD. Unofficial market exchange rates climbed only 0.17% YTD.**

NEER and REER approached and soon surpassed the level of 106 - previously considered a signal for SBV to devalue the VND

According to our calculation model, NEER (multilateral nominal exchange rate), measuring the value of VND against a basket of eight reference currencies according to the central exchange rate mechanism and REER (multilateral real exchange rate), an inflation-adjusted index compared to NEER), can be used as an important signal to determine when the SBV should devalue the Dong. Especially in the period of 2015 - 2016 and 2018, when REER road approached the level of 106, SBV had to adjust the VND price to stabilize market expectations and avoid adverse impacts on exports. However, at present, even though REER has crossed the 106 threshold (Figure 17), market movements are quite stable and SBV has not yet intervened.

The gap between the interbank/ unofficial exchange rates and the ceiling rate is still quite safe

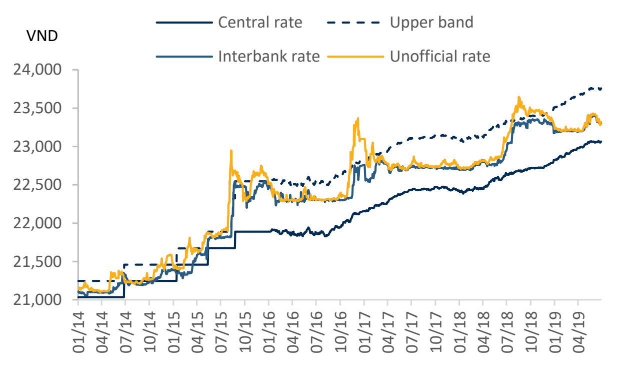
In the past, when there were external factors that put pressure on the exchange rate, the gap between the interbank exchange rate, the unofficial exchange rate and the ceiling rate was often widened, which once was considered another signal for SBV to decide whether to devalue VND. In recent years, despite unfavorable external factors, the interbank and unofficial rates still fluctuate with each other and have not created a big gap as in the previous periods, indicating that market sentiment is relatively stable. In addition, the gap between the interbank exchange rate and the ceiling rate is still quite safe (about 1.5% lower than the ceiling rate) (Figure 16).

External factors triggered strong fluctuations in exchange rates in May

The US-China trade tension suddenly escalated in May, causing CNY strong fluctuations while the Dollar has stayed high since the beginning of this year. Specifically, the average depreciation of CNY in May was 2.06% compared to April, and is now moving around 6.9 CNY/USD - very close to the psychological threshold of 7.0 - only established in the crisis period finance in 2008. DXY index – measuring the strength of the dollar against the basket of six other currencies, always maintained around 97 - 98 in the first five months of the year, and only showed a slight decrease when the Fed gave a dovish signal about its monetary policy.

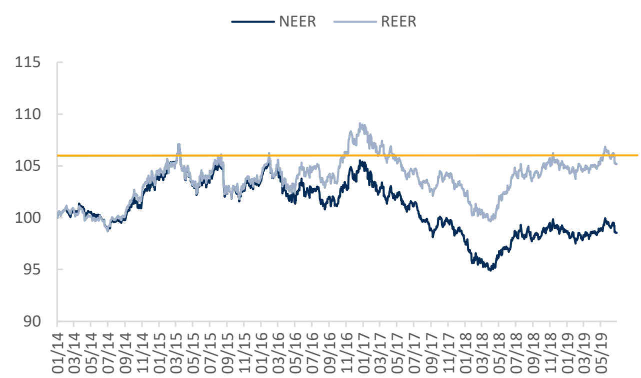
We believe that there are some reasons to help stabilize the domestic foreign exchange market despite unfavorable movements of the world currency market, even when REER has surpassed the threshold of 106: (1) SBV has actively adjusted the central exchange rate since the beginning of the year to narrow the gap with the general market; (2) Abundance of foreign currency supply in the last period, especially from disbursed FDI inflows; (3) SBV has proven its ability to stabilize exchange rates in recent years, building trust on the market, which helps to reduce speculation and hoarding of USD.

Figure 16: USD/VND exchange rate movements



Source: Bloomberg, FinnPro, KBSV

Figure 17: NEER and REER

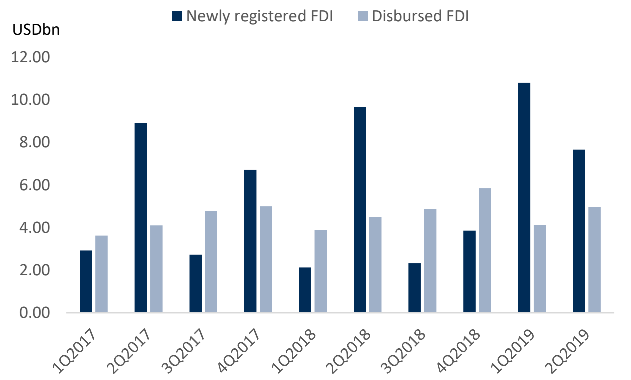


Source: Bloomberg, KBSV

❖ **The VND is expected to depreciate 2.0% – 2.5% in 2019**

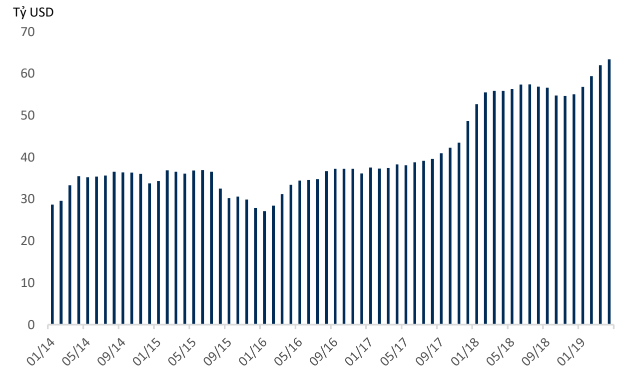
For the rest of the year, exchange rate fluctuations will be dominated by three main factors. First, the downward trend of USD, according to our base case, will have a favorable effect on VND because even if the USD/VND exchange rate does not change much, VND will still tend to depreciate against most currencies in the basket (except CNY). Second, the trend of CNY depreciation, according to our base case, will have an adverse effect on VND since the trade deficit from China will tend to increase. Third, the stability of foreign currency supply, which we forecast remains positive, will support the exchange rate.

Figure 18: Disbursed and newly distributed FDI



Source: FIA, KBSV

Figure 19: FX reserves



Source: Bloomberg, IMF, KBSV

Trade war is the biggest risk in the short term

We are currently positive about the case in which the US-China trade war will hardly achieve significant progress, at least in this year. The current tariff, including 25% taxes imposed on USD250 billion Chinese goods, will remain. In this case, the USD will not fluctuate too strongly at the current 96-97 level and CNY still shows signs of decline.

The USD is expected to weaken due to Fed's dovish monetary policy

The trend of DXY this year will be going down with the main reason coming from the change in Fed's view of the monetary policy. With the expectation that FED will have at least one interest rate cut in 2019, the interest rate gap between the US and G20 countries will be narrowed and the dollar will therefore be slightly reduced. However, unpredictable movements of US-China trade war tensions will make it difficult for DXY to fall deeply.

USD/CNY exchange rate is expected to fluctuate around 7.0 if the negotiation process does not bring about many changes

We believe that CNY will fluctuate around 7.0 in the base case due to strong pressure of CNY depreciation, but the depreciation can be curbed by PBoC. Macro data, especially financial data, are signaling that China economy has slowed significantly, putting pressure on the CNY.

Comparing the impact level of the first factor (USD depreciation) and the second factor (CNY depreciation), technically, we observe that the USD depreciation in general will have a more powerful impact as it also indirectly affects via the gaining trend of other currencies in the basket. This is quite evident in recent weeks when the USD decreased and CNY also went down, the NEER still reversed to go down.

According to our quantitative model (the dependent variable is the nominal exchange rate (NEER), and the independent variables are DXY and USD/CNY) with the base case, if the Dollar Index moves around **95 - 96**. and USD/CNY exchange rate is traded at around **6.9 - 7.0** at the end of Q4, the nominal exchange rate will increase by 0.51%, and the USD/VND exchange rate will depreciate by about 2%. However, in fact, because the trade deficit with China is increasing rapidly, SBV may still have to consider adjusting the VND price to a reasonable level to protect exports and avoid trade deficit. We provide forecasting cases for the year-end exchange rate as follows:

Scenarios for USD/VND exchange rates in 2019

Table 5: Scenarios for exchange rates

	Negative			Baseline			Positive		
	DXY	USD/CNY	USD/VND*	DXY	USD/CNY	USD/VND*	DXY	USD/CNY	USD/VND*
Q4/2019	> 100	> 7.0	3 - 4%	95 - 96	6.90 – 7.0	2 – 2.5%	< 94	< 6.7	1 - 2%

* VND price compared to that at the end of 2018

Source: KBSV

DISCLAIMER

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