KB Securities

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VIETNAM'S MACRO ECONOMIC REPORT QUARTER 4/2018

GDP Growth: GDP growth strengthened in the first 9 months thanks to robust growth rate in Q1 and Q3, however, it is expected to slow down in Q4/2018.

Inflation: Q2 and Q3's CPI were on the rise, pressure on SBV's 2018 average inflation target of 4%.

Monetary policy: Monetary policy will be more prudent till year-end.

Exchange rate: Exchange rate will be under control if VND depreciation is within 3%. External factors will be the most influencers to VND in Q4.

VIETNAM MACROECONOMIC OUTLOOK FOR Q4/2018

RISKS AND OPPORTUNITIES

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EXECUTIVE SUMMARY

GDP Growth

GDP growth rate in the first 9 months displayed prospective with key driver from manufacturing sector. Agriculture – Forestry and Fishery sector was on the rebound. We forecast 2018 GDP growth at **6.9%.**

Inflation

Inflation was swift up in August and September due to an increase in education services and fuel prices. However, it is forecast to remain under control, as government priority objectives are to sustain macroeconomic stability. We predict that average inflation will be **3.9 – 4.0%** this year.

Monetary policy

State Bank of Vietnam (SBV) conducted the monetary policy in the first 9 months in a more prudent way to balance between inflation and exchange rate pressure and global economic conditions. Monetary policy was tightening in Q3 but remained easing in the first 9 months. M2 and credit growth rate are expected at **12 – 14%** and **14 – 16%**, respectively.

Balance of Trade

Surplus balance of trade of USD5.39bn was contributed mostly by FDI sector in the first 9 month. Vietnam's trade is expected to be slightly deficit in Q4 due to SAMSUNG's operating activities and 2018's balance of trade would reach a **USD4 – 5bn** surplus.

Exchange Rate

Exchange rate experienced a significant upward movement in Q3 and VND lost about 2.72% YTD of its value due to external factors. VND is expected to depreciate about **2.8 – 3.0%** for 2018.

Table 1. Vietnam macro indicators

	Unit	2015	2016	2017	2018			2018F	2018F
					Q1	Q2	Q3	Q4	
GDP Growth	%YoY	6.68	6.21	6.81	7.45	6.73	6.88	6.6	6.9
Inflation	%YoY	0.62	2.67	3.52	2.66	4.67	4.14	4.13	4.00
Credit growth	%	17.3	18.3	18.2	2.2	4.0	1.5	5.0	15.0
M2 growth	%	16.2	18.4	16.9	4.0	3.8	0.7	3.9	13.0
10 year government bond yield	%	7.1	5.4	5.2	4.3	4.8	5.1	5.2	5.2
Export growth	%YoY	7.9	9.0	21.2	24.6	9.2	13.2	9.0	14.0
Import growth	%YoY	12	5.2	20.8	13.4	5.8	15.3	11.0	11.5
Exchange rate	USDVND	22,485	22,761	22,698	22,794	22,938	23,315	23,350	23,350

Source: GSO, SBV, WB, IMF, KBSV

GDP GROWTH

❖ **GDP growth rate in the first 9 month displayed prospective**

According to GSO, within the first 9 months of 2018, GDP was estimated to grow by 6.98% YoY - its best performance since 2011. Within Q3, GDP increased by 6.88% YoY, lower than a rise of 7.46% in the same period of 2017, but still higher than the average in previous years. In addition, GDP growth in Q3 was higher than that of Q2 2018 (6.73%) – after slowing down compared to Q1 (Figure 1).

Industry and construction sector, in which manufacturing and processing continued to be a key driver for economic growth despite a slowdown in growth rate

In 9M2018, industry and construction sector had the largest contribution in GDP growth. Particularly, industry and construction sector expanded by 8.89% YoY, higher than those of 2017 (7.17%) and contributed 48.7% of GDP growth (Figure 4). However, growth rate in this sector has slowed down on a quarterly basis due to a decrease in exports, which translated into manufacturing output.

Manufacturing and processing remained a key driver for economic growth, with a YoY rise of 12.9% in the first 9 months (Q1: +15.7%, Q2: 9.6%, Q3: 13.2% YoY), with a significant rise of 15% YoY in mobile phones and accessories export output (Figure 2). On a quarterly basis, this sector experienced a hike of 13.2%, increasing considerably in comparison with a rise of 9.6% in Q2 (thanks to the launch of Samsung Galaxy Note 9), however, this figure was lower than an increase of 15.7% in Q1.

PMI decreased gradually in Q3, yet remained above 50 points

PMI in Quarter 3 gradually went down, after hitting a peak of 55.7 points at the end of June. Particularly, September PMI decreased to 51.5 points, the lowest level over the last 10 months according to a recent report released by IHS Market (Figure 3). This was also the 34th consecutive month that Vietnam PMI surpassed 50 points, indicating business condition improvement of manufacturing companies in the long-run. Nevertheless, as analysed above, the growth rate of manufacturing and processing sector has been slowing down as the number of product outputs and new orders increased marginally.

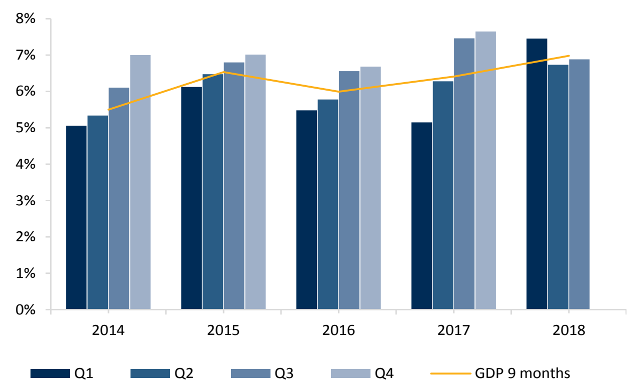
Growth rate within service sector remained relatively high

Service sector in the first 9 months expanded by 6.89% YoY, contributing 42.5% in GDP growth, lower than a hike of 7.21% in last year period yet still higher than the growth rate during 2012-2016 period. Wholesale and retail grew by 8.48% YoY, which was the fastest-growing segment in the service sector, and had the greatest contribution in the increase of total added value of the economy. Finance and banking, insurance and real estate improved, reaching 7.85% and 4.04% YoY growth rate, respectively.

Agriculture - forestry and fishery sector rebounded thanks to a surge in exports.

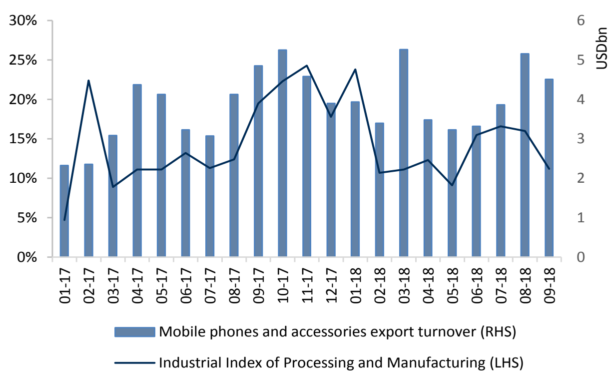
Agriculture, forestry and fishery growth rate had its best nine-month-performance since 2012, rising by 3.58% YoY thanks to the expansion of export market. Specifically, agriculture advanced by 2.78%, fishery expanded significantly by 6.37% and forestry rose by 5.9%.

Figure 1: GDP Growth Rate by Quarters



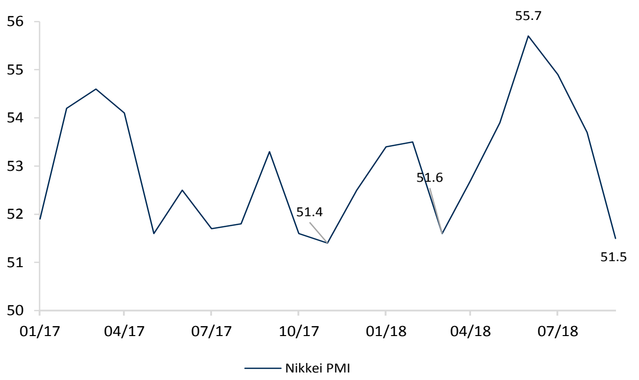
Source: GSO, KBSV

Figure 2: IIP and mobile phones and components exports



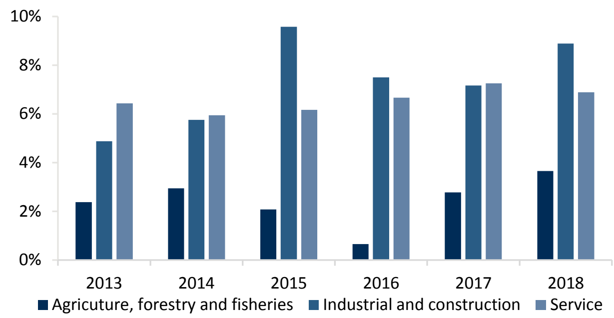
Source: GSO, Customs Office, KBSV

Figure 3: Vietnam PMI



Source: HSBC, Nikkei, KBSV

Figure 4: GDP Growth Rate by Sectors



Source: GSO, KBSV

❖ **GDP in Q4 is expected to remain high, achieving the government annual target for 2018**

For Q4/2018, we do observe some risks but the GDP growth outlook for Vietnam remains relatively high, at **6.6%** in Q4 and **6.9%** in 2018.

FTA and public investment disbursement progress will be factors that boost GDP growth in Q4

Factors may boost GDP growth consist of (1) CP-TPP was signed early this year and EVFTA will be signed in the late 2018 will attract FDI inflows, boost exports and new orders of related sectors; (2) The progress of public investment disbursement will highly likely accelerate since the progress was quite slow in the first 9 months, completing only 50% of the annual plan.

Prudent monetary policy, trade tensions and SAMSUNG'S revenue are factors that constraint GDP growth

Factors might have negative impact on GDP including: (1) Escalating trade tensions, despite having adverse impact on each sector, however in general, will slow down the global aggregate demand, placing pressure on exchange rate and the Government's macroeconomic indicators; (2) Tightening monetary policy in large central banks could force SBV to be more prudent in managing money supply till year-end to stabilize the exchange rate, especially inflation has already shown signs of accelerating; (3) SAMSUNG's revenue in

Q4/2018 could hardly increase since the launch of its flagship products Galaxy Note 9 has been considerably reflected in Q3. Specifically, in a preliminary assessment of the monthly mobile phones and components export turnover, we found that during Q3 and Q4 of 2017, when the new Samsung Note 8 was launched (September), export output increased sharply in Q3 and remained high in Q4. However, in 2018, when Samsung launched the new models (Galaxy S9 in March and Galaxy Note 9 in August), mobile phones export rocketed only in those months and the rise did not continue in the following months.

INFLATION

❖ **CPI continued to rise in Q3 but still under control**

According to GSO, average CPI in the first 9 months rose by 3.59% YoY. Particularly, after slowing down in July, the Consumer Price Index (CPI) rebounded in August and September, by 0.45% and 0.59% MoM. However, CPI YoY growth rate are more stable in Q3 after rocketing in June. In particular, CPI in August and September only increased by 3.98% YoY, in comparison with a rise of 4.67% YoY at the end of June (Figure 5).

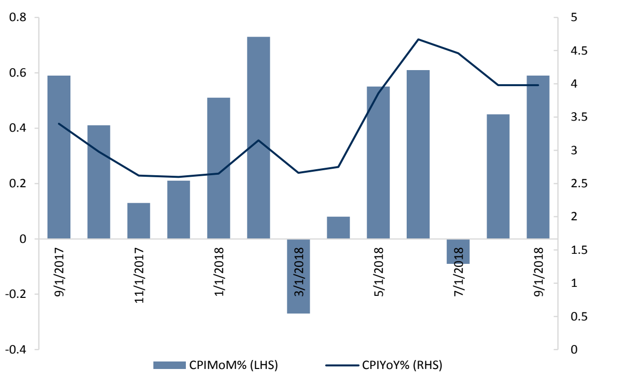
Transportation, education service and food & foodstuff contributed the most to CPI's hike in Q3

Breakdown from the data, within Q3, CPI in transportation group went up by 9.14% YoY, education service rose by 6.06% YoY and food and foodsfuff increased by 4.99% (Figure 6). In particular, petrol price was adjusted 4 times in August and September, pushing up the transportation price and contributing 0.82% in CPI's hike. Spending demand for new school semester increased along with the increase in tuition fees in accordance with Decree 86/2015/ND-CP in 49 provinces, raising education services price up by 6.06% YoY (CPI up by 0.31%). Pests and expanding rice export activities caused food prices to hike by 3.69% YoY (CPI up by 0.16%), food (mostly contributed by pork price) rose by 6.14% YoY (CPI up by 0.26%).

Core inflation is kept under control

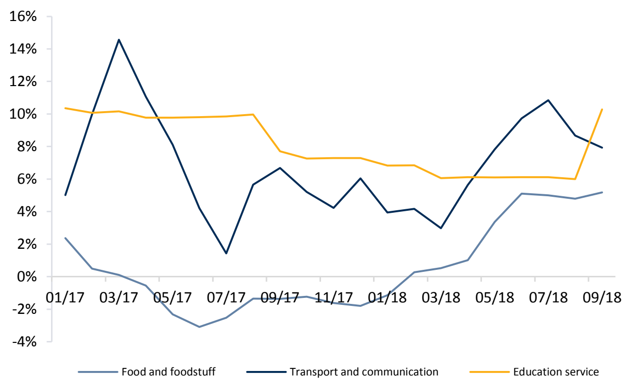
Core inflation in September, excluding food and fuel prices, climbed by 0.14% from the previous month, and rose by 1.61% from the previous year. Core CPI in the first 9 months maintained at 1.41% YoY, in line with the Government's target schedule of 1.5-1.7%.

Figure 5: Consumer Price Index (CPI)



Source: GSO, KBSV

Hình 6: Price movements of key sectors



Source: GSO, KBSV

❖ Inflation forecast – remained under Government's target of 4% in 2018

We do see some pressure on inflation in Q4/2018. However, they could be controlled and balanced by the government as government priorities are to sustain macroeconomic stability and to absorb any shocks in the economy. We forecast the average inflation of this year will be **3.8 - 4.0%** based on the following key catalysts:

Inflation pressure on the Government's target of 4%: food and fuel prices rose significantly

In addition to seasonal factors that will cause a rise in food and foodstuff prices in Q4, factors such as bad weather and diseases might arise to drive the prices of these commodities to increase sharply. Specifically, bad weather and diseases caused rice supply in the Mekong Delta to become scarce, while output in Southeast Asian countries such as Indonesia and the Philippines declined due to rainstorms. Since the rice demand in Q4 is forecast to significantly increase as export activities are expanding, and domestic rice market shows signs of acceleration and the uptrend likely continue in the coming months. In addition, pork price, due to concerns of Africa's cholera outbreak, will remain high over the same period. Fuel price, particularly crude oil price on the international market, is expected to keep rising in Q4 as (1) supply drops from Iran (US sanctions, effective from November 5); (2) OPEC and crude oil producers have no official plans to increase production; (3) Increasing demand for energy due to incoming winter. In some scenarios, Brent crude oil may reach USD100/barrel by the end of this year, according to a forecast from Merrill Lynch.

Government actions to prevent any shocks in CPI

Government has decided to suspend the price adjustment of commodities to prevent rising prices, especially the Ministry of Industry and Trade insisted to keep electricity prices unchanged in Q4/2018 and proposed to postpone imposing environmental protection tax for petroleum until to January 1, 2019 (instead of October as expected).

SBV also uses it discretion to set monetary policy in response to changing economic conditions by limiting credit growth and stabilizing money supply. Credit growth has been tightened in recent months and it is likely that the SBV will continue to maintain this policy unitl the rest of the year, as GDP growth remains positive.

INTEREST RATE/MONETARY POLICY

❖ **Monetary policy – tightening in Q3 but overall easing in the first 9 months**

Credit growth was higher than M2 and deposit growth

Up to 20/9, M2 grew by 8.74%, deposit growth was up by 9.15% and credit growth rate was 9.52% over the end of 2017. Its 2017 figure are 9.59%; 10.08% and 11.02%, respectively. Thus, credit growth was faster than M2 growth in Q3, as opposed to the end of June when M2 growth was at 8.39%, exceeding the 7.36% of credit growth. In general, monetary policy in the first 9 months was considered as easing.

On a quarterly basis, our estimates showed that M2 and credit growth in Q3 were at 0.72% and 1.54% QoQ, down sharply compared to same period last year of 3.43% and 2.94%, respectively (Table 2). Overall, SBV was actively tightened monetary policy to stabilize inflation and exchange rate. M2 growth was slower than credit growth.

Table 2: M2 and credit growth

(VNDbn)	30/09/2017	31/12/2017	30/03/2018	30/06/2018	20/09/2018
M2	7,877,753	8,192,548	8,521,098	8,844,675	8,908,577
Growth rate YTD	10.55%	14.97%	4.01%	8.39%	8.74%
Growth rate QoQ	3.43%	4.00%	4.01%	3.80%	0.72%
Increase in M2 amount by quarters	260,897	314,795	328,550	323,577	63,902
Credit outstanding balance	6,177,691	6,509,858	6,741,609	6,923,234	7,129,596
Growth rate YTD	12.21%	18.24%	3.56%	7.86%	9.52%
Growth rate QoQ	2.94%	5.38%	2.23%	4.03%	1.54%
Increase in lending amount by quarters	176,308	332,167	145,170	268,206	108,064
Difference between M2 and lending growth YTD	79,667	62,295	96,799	175,680	96,290
Difference between M2 and lending growth QoQ	84,589	-17,372	183,380	55,371	-44,162

Source: GSO, SBV, KBSV

Exchage rate pressure during June – August was the reason that SBV sold USD and drained VND

In the first 5 months of the year with favorable market conditions, SBV had purchased USD to accumulate FX reserves. Particularly, it is estimated that SBV had injected a large amount of Vietnamese Dong (around VND250tn) to net buy USD11bn while only extracting VND62.5tn via OMO. From June onwards, when USD/VND exchange rate began to rebound, SBV intervened by selling foreign currencies and extracting a large amount of the Dong. According to an unofficial figure, within 3 months (end of June-end of September), SBV sold about USD 4.5bn (equivalent to draining about VND 100tn).

Credit growth was slower in Q3

Within Q3, under the rebound of inflation in August and September, SBV took prudent views on credit supply to reduce inflationary pressure. In particular, credit growth annual target is established at 17% at the beginning of the year but credit growth limit granted to commercial banks is about 14% and Directive 04 issued on 02/08 confirmed SBV will not consider raising credit limit for most credit institutions, except for some commercial banks involved in the restructuring of banking system process. In addition, SBV also required commercial banks to avoid lending in high risk sectors such as real estates, securities,…

Interbank interest rate volatiled in Q3

As opposed to the relatively stable movements in the first 2 quarters, interbank interest rate was continuously fluctuated in Q3 (Figure 7). Rates in all terms were up from the end of July, with overnight rate reaching a peak at 4.53% on 16/08, twice times as the average of 1-2% in the first 6 months. In the last weeks of September, rate have adjusted down to 2.5 – 3%, however it is just a short – term equilibrium.

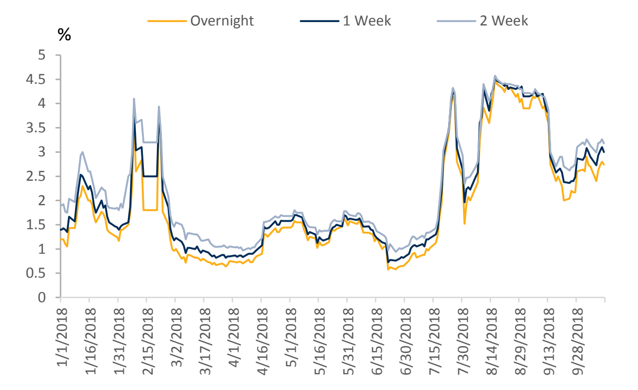
VND interbank interest rates were pushing up to create a safe VND – USD interest rate spread

Interbank interest rates remained high in July and August, as we believe it is SBV's policy to stabilize exchange rate in this period. SBV was actively pushed the VND interest rates up above 4% to create a 2% VND – USD spread to limit banks in accumalating USD and reducing foreign currency supply pressure.

Liquidity was tightened in Q3

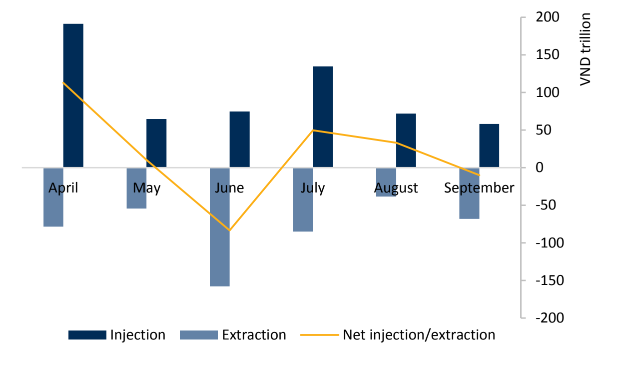
Liquidity in banking system was not abundant in Q3 as in the first 6 months due to SBV's intervention in the foreign exchange market to stabilize exchange rate and M2 growth was much slower in Q3. However, open market operations has been used smoothly to support the liquidity. Specifically, in our calculations, via OMO, SBV had net injected about VND 72.5tn into the system (Figure 8). There was a VND 66.6tn worth of Reverse Repos 7 days newly issued to inject cash into the system while about VND 125 tn of SBV – Bills were issued with terms ranging from 7 – 91 days. SBV-Bills interest rate was up to bridge the gap with Reverse Repos rate.

Figure 7: Interbank interest rate



Source: SBV, KBSV

Figure 8: Net injection/extraction in OMO



Source: SBV, KBSV

Deposit rates, especially in the longer term were up again from August

Deposit rates in the commercial banks have seen an increase recently, especially the long-term maturities, after constant decreases in 1H2018. The average deposit rate for over 12 months was 6.5 – 7.3%, up by 0.1 – 0.2%. In our opinion, they could be explained by (1) in the first 9 monhts credit growth (9.52%) was going up faster than deposit growth (9.15%), while banks need to prepare for the demand of capital which has been increasing sharply in the last few months of the year; (2) banks also need to prepare for the medium-and-long-term capital to meet the requirement of Circular 19/2017-TTNNNN, to be officially effective from January 1, 2019, which allows the maximum ratio of short-term capital used for medium and long term loans of banks to be 40% instead of the current ratio of 45%.

❖ **Monetary policy forecast – prudent in Q4**

M2 and credit growth are forecasted to be at 13% and 15%, respectively

In the last 3 months of 2018, we expect a moderate M2 growth compared to that in 2017 due to pressure from inflation and exchange rate, and a slowdown in credit growth under the impact of Directive 04 and to balance with the money supply. Especially GDP in Q3 remained at relatively high level and giving SBV more incentive to conduct prudent monetary policy.

Besides, given the global central banks moving from easing to tightening monetary policy, accordingly Fed's rate hike will impact on global capital flows and put pressure on exchange rate. Those all together will have a considerable impact on SBV's policy.

We forecast M2 and credit growth in 2018 will be at 12 – 14% and 14 – 16% respectively. Those figure are relatively high in the region and considered as loosing policy to support the economy.

Interest rates (lending and deposit) will be less volatile in Q4 given macroeconomic indicators such as inflation and exchange rate are under control. In the worst scenario, inflation will be over the target of 4% and VND depreciates more than 3%, SBV will tighten the monetary policy faster and raise interest rates to stabilize the economy.

BALANCE OF TRADE

❖ **Balance of Trade remained surplus in the first 9 months thanks to stellar export growth**

Surplus trade balance but mainly from the FDI sector contribution

Accumulated to September, Vietnam's trade balance gained a surplus of USD5.39bn, in which FDI sector not only offsets deficit trade balance by domestic sector but contributed the most to the surplus of total trade balance (Figure 10). FDI export turnover in the first 9 months posted at USD127.84bn (+14.6% YoY), accounting for 71.5% total export turnover, slightly down compared to same period last year (71.9%). This shows that Vietnam's exports are still highly dependent to FDI sector.

Exports grew robustly in Q3, contributing significantly to growth in first 9 months thanks to Samsung's launch of new products

According to GSO, export turnover reached USD178.91bn in the first 9 months, an increase of 15.4% YoY, largely contributed by export growth in Q1 and Q3 (Figure 9). In Q3, Vietnam posted a total export revenue of USD64.73bn, up 10.4% QoQ and 13.9% YoY. In our opinion, Samsung's launch of new flagships (Galaxy Note 9 and Note 9+) resulted in an increase in exports in August, contributing significantly to export growth in the first 9 months and Q3 particularly. Within August, export turnover reached the highest of USD23.5bn, of which FDI sector accounted for 71.6% and mobile phones and components accounted for 22%.

Key export products grew at 2-digit figure

Mobile phones and components continued to be the key export product with export turnover of USD36.1bn (+14.6% YoY) in the first 9 months. Textiles and garment came second at USD22.6bn (+17.1% YoY). Electronics, computers and components posted at USD21.6bn (+16.7% YoY); machinery and accessories (USD12.1bn, 28.7% YoY); footwear (USD11.8bn, 10.5%).

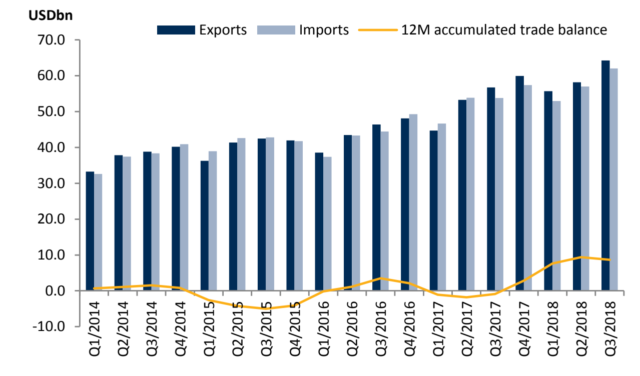
Crude oil exports declined sharply due to a drop in output and an increase in domestic demand

It is worth noting that in the first 9 months, although the average export price was up by 37.5%, crude oil exports experienced a sharp drop in both volume and value. In particular, export turnoverd of crude oil posted at USD1.7bn, down by 24.6% YoY (down by 45.2% in volume). According to our analysis, domestic crude oil output dropped and domestic demand hiked due to the operation of refineries, especially Nghi Son refinery (has been operated sine Q2/2018) were the mains reason for a decrease in crude oil exports.

Imports also grew significantly due to higher demand in raw materials and semi-manufactures intended for production of export products, higher level of FDI disbursement and higher demand in importing consumer goods

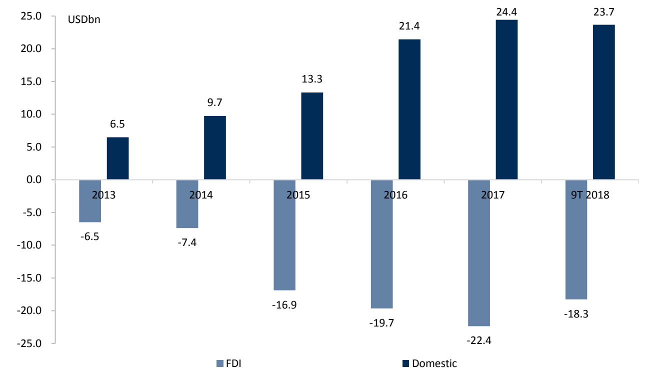
On the other hand, import turnovers to Vietnam also improved in the first 9 months, at an estimate of USD173.52bn, up 11.8% over the same period of 2017. According to our assessment, key reasons for increasing in imports are (1) Demand in importing raw materials and semi-manufactures hiked for the productions of key export products such as mobile phones, electronics, textiles, footwear; (2) The scale of FDI disbursement improved (USD13.25bn, 6% YoY); (3) An increase in domestic consumption in line with favourable economic conditions.

Figure 9: Exports/Imports by quarters



Source: GSO, Customs Office, KBSV

Figure 10: Trade balance of FDI and Domestic sectors



Source: GSO, KBSV

❖ Trade balance might record a deficit in Q4

Samsung's manufacturing acivities may cause a trade deficit in Q4

Monitoring the seasonal factors in recent years, we realize that both exports and imports activities increased in the last months of the year. However, while in Q4/2017 the successful launch of new Samsung products of Galaxy Note 8 resulted in an improvement in export turnovers, the contribution of new Samsung products of Galaxy Note 9 and Note 9+ on exports already reflected in Q3/2018. In stead, Samsung may have to increase imports of raw materials in Q4 to prepare for the production of new products Galaxy S10, expected to release in Q1/2019.

Exports of some Vietnamese products could benefit from US – Sino trade war

Export growth of key export products could benefit from FTA. In addition, the US already imposed tariffs on Chinese export products, thus Vietnam's products could expand its shares in the US market. Electronics, fisheries, textiles and furniture, etc are products highly competitive with China and could benefit from the US sanctions.

Overall, after assessing and evaluating 2 above factors, we expect that Vietnam's trade balance could post a deficit in Q4. However, balance of trade in 2018 will still enjoy a surplus of **USD4 – 5bn.**

EXCHANGE RATE

❖ Exchange rate fluctuated wildly in Q3

After the stable movement in the first 5 months, from June to August, interbank and unofficial exchange rates advanced; gap between those 2 markets was widening and central rate also increased. In September, the exchance rate was stabilized thanks to SBV's flexible policy and pressure from external factors cooling down (Figure 11).

Despite the tendency of depreciation, VND remained relatively stable compared to other currencies in the region

By 28/9/2018, YTD depreciation of the Dong against USD is 2.72% (interbank rate) and 1.29% (central rate), compared to an average of 4.40% in the major Asian currency basket. At this stage, the Dong is still seen as a stable currency in the region, one of the least depreciated currencies while as since January, Rupee (India) depreciated by 13.49%, Peso (Philippines) by 8.21%, Yuan (China) by 5.57% and Won (Korea) by 3.61%.

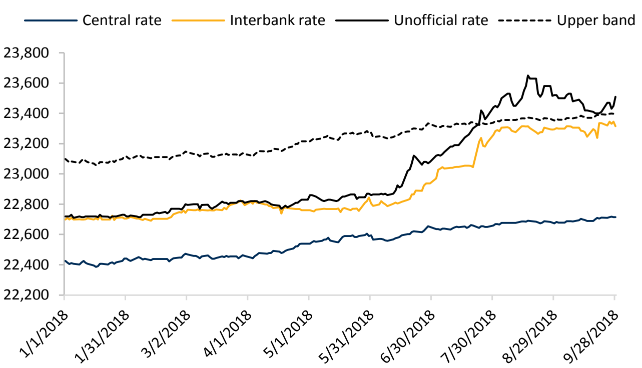
NEER and REER were temporarily stable in Q3 after a sharp increase in Q2

Theoretically, in our model, we looked at NEER (nominal effective exchange rate), which measures the value of VND against a basket of eight reference currencies under the central exchange rate regime and REER (real effective exchange rate), adjusted NEER by domestic and foreign prices. NEER and REER were temporarily stable in September after a sharp increase from June – August (Figure 12). From 2014, whenever NEER and REER hit a certain high level (105, in particular), SBV actively devalued VND to stabilize the market and avoid negative impact on exports. During the June – August period, those 2 ratios were up with a faster pace, reflecting that VND appreciating against other currencies, SBV actively adjusted VND down to stabilize the market. Currently, NEER is at 97.8 and REER stays at 103.7, pressure on VND devaluation is not significant.

Gap between the interbank and unofficial market has been bridged

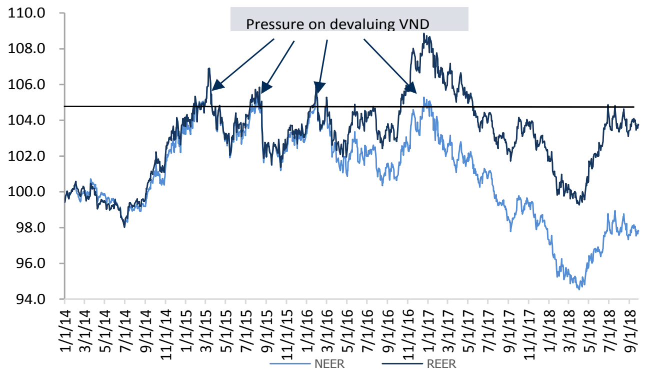
The gap between the unofficial market rate and the interbank rate - the measure of the Dong devaluation expectation is narrowing, only about VND100. Therefore, in our opinion, the foreign exchange market has remained temporarily stable, speculative sentiment is insignificant, external factors such as trade war, the Fed's rising interest rates already reflected via exchange rate at the beginning of the third quarter and stable macroeconomic indicators supporting the exchange rate (positive current account; relative high level of FDI disbursement and foreign exchange reserves at reasonable level to intervene when necessary).

Figure 11: USD/VND movement in the first 9 months 2018



Source: Bloomberg, FinnPro, KBSV

Figure 12: NEER & REER

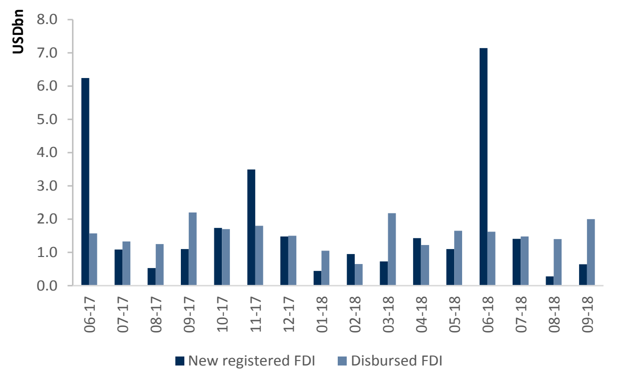


Source: Bloomberg, KBSV

❖ **Baseline scenario: VND depreciated about 3% for the whole year 2018**

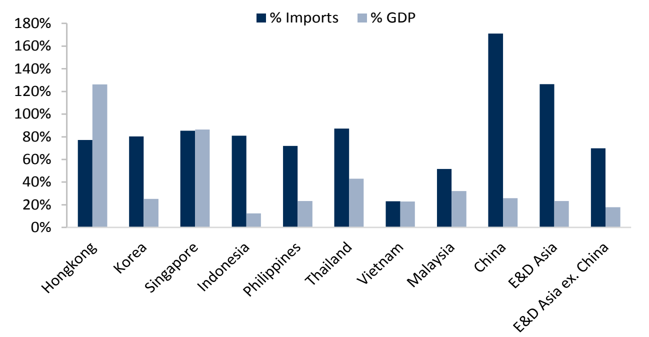
In Q4, it is noted that USD/VND exchange rate movement continues to depend on external factors, including Dollar Index and CNY movement. In particular, in the NEER and REER calculations, the weight of CNY and USD are 30% and 16%, respectively, thus fluctuations in those 2 currencies are the main factors for NEER and REER. In our baseline scenario, if Dollar Index fluctuates around the **95-97** band and CNY/USD does not rise far above **7.0**, NEER and REER are in the stable zone and the Dong is expected to depreciate within 2.8 - 3% for 2018.

Figure 13: FDI registered and disbursed



Source: GSO, KBSV

Figure 14: Vietnam FX reserves in the region



Source: IMF, WB, KBSV

External factors will put high pressure on exchange rate in Q4

Main factors affecting the Dong in the short – term are the escalating trade war (unlikely to cool down at least till 2019); Fed's rate hike schedule and PBoC monetary policy.

The US – Sino trade war have been escalated, especially after the United States announced it would raise its tariffs to 25 percent from 10 percent from the beginning of 2019, applying for USD200bn worth of goods imported from

China. In the worst scenario, the US will continue to levy an additional USD267 bn in goods imported from China when China retaliates. This will have a strong impact on the dollar (bullish) and CNY (bearish) immediately.

Fed’s rate hike three times this year (March, June and September) has been reflected in exchange rate movements in the first 9 months. In addition another interest rate rise in December is expected and will not have much impact on the exchange rate in Q4. However, in case that the US macro-economic situation is better than expected and inflation exceeds the target of 2%, the Fed signal faster interest rate hike in 2019, the Dollar will tend to rise and will therefore put pressure on VND.

PBOC's monetary policy was more easing in Q2 and Q3, when PBOC lowered the required reserves ratio (RRR) for commercial banks and injected a large amount of money into the system through medium-sized loans as trade war escalated. In the next 3 months, especially at the end of Q4, in the scenario of the US imposing tariffs on additional USD267bn worth of Chinese goods, we expect PBOC to conduct the monetary policy in a more loosen way and CNY will be more depreciated.

Vietnam’s foreign currency supply is abundant and FX reserves are adequate to support the Dong

Vietnam’s foreign currency supply is considered to be quite excessice, supported by a surplus current and financial account. Current account maintained positive thanks to a surplus in balance of trade (an estimated **USD4 – 5bn** for 2018) and a gradual increase in remittances, especially in Q4 (seasonal factors). Financial account will be supported by the stellar growth of FDI disbursement (Figure 13) and FII inflows to Vietnam.

Vietnam’s foreign currency reserves though is not high in terms of months of imports (recording a minimum 3 months of imports) but is considered as adequate in terms of GDP’s size and economic conditions (Figure 14). Specifically, by the end of September, according to our updated figure, FX reserves is at USD59bn, accounting for about 24% GDP. In the optimal FX reserves calculations (Jeanne and Rancière model, 2011), Vietnam’s optimal FX reserves (cost and benefit approach) is at about 18.5% of GDP. Thus, with the current ratio of 24%, Vietnam is considered to resist external shocks at a relative good level.

3 scenarios for USD/VND exchange rate in next 3 months

	Positive	Baseline	Negative
DXY	93 - 95	95 - 97	97 – 99
USD/CNY	6.6 - 6.8	6.8 - 7.0	7.0 - 7.2
USD/VND*	2.6%- 2.8%	2.8% - 3.0%	3.0% - 3.5%

* VND depreciation for 2018

DISCLAIMER

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