VIETNAM OUTLOOK 2H2018

GAIN OR PAIN?

Growth: GDP's growth strengthened with the highest 1H growth rate since 2011, however it is estimated to slowdown till year-end.

Inflation: CPI reached highest June's CPI since 2011, high pressure on SBV's inflation target of 4%.

Interest Rate: SBV's monetary may show sign of tightening up in 2H2018.

Exchange Rate: Under control if depreciation within 2% movement. Trade deficit, pressure on Balance of Payment.

VIETNAM OUTLOOK 2H2018

OPPORTUNITIES AND RISKS IN FOCUS

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EXECUTIVE SUMMARY

Macro-economic stability remains intact

GDP Growth

GDP growth displayed prospective, with strong economic growth from manufacturing sector. We forecast that GDP will grow by 6.8% in 2018.

Inflation

Inflation was swift up in May and June due to an increase in fuel and pork prices. However, it is forecasted to remain under control, as government priority objectives are to sustain macroeconomic stability and to absorb any shocks in the economy. We predict that average inflation will be 3.9% this year.

Interest Rate

M2 and credit growth was rising within government FY's target in 1H. However, they are expected to be lower than those in 2017. Monetary policy will be more prudent to balance rising inflation pressure and keep up with global economic conditions.

FDI – Exports/Imports

FDI remains a long-term economic growth driver, distributed FDI is predicted up by 5.7%. Vietnam improved to USD2.7bn trade surplus in 1H2018 from USD2.1bn in 1H2017 and is expected to remain slightly surplus of USD100bn for FY2018.

Exchange Rate

During June the Dong movement was hiking and reached a threshold of over VND23,000 a dollar as escalating trade tensions between major economies and dollar hike. VND is forecasted to fluctuate around VND 23,150-23,379 a dollar in 2H2018.

Table 1. Vietnam selected macro indicators

	Unit	2013	2014	2015	2016	2017	2018		2018F		2018F
							Q1	Q2	Q3	Q4	
Real GDP Growth Rate	%YoY	5.42	5.98	6.68	6.21	6.81	7.45	6.79	6.7	6.5	6.8
Inflation Rate	%YoY	6.60	4.10	0.62	2.67	3.52	2.66	4.67	4.65	4.13	3.9
Credit Growth	%	12.5	14.2	17.3	18.3	18.2	2.2	4.0	3.8	4.2	18.0
Money Growth	%	18.9	17.7	16.2	18.4	16.9	4.0	3.8	3.8	3.5	17.0
Government Bond Yield 10Yr (as of last day in the period)	%			7.1	5.4	5.2	4.3	4.8	5.0	5.2	5.2
Export Growth	%YoY	15.4	13.7	7.9	9	21.2	21.6	8.7	7.5	6.5	11.0
Import Growth	%YoY	16.1	12.1	12	5.2	20.8	13.7	7.0	9.0	10.5	10.5
Exchange Rate (as of last day in the period)	USDVND	21,095	21,388	22,485	22,761	22,698	22,794	22,938	23,150	23,379	23,379

Source: GSO, SBV, WB, IMF, KBSV.

GROWTH

1. GDP's Growth in 1H2018 - speeded up in Q1 but slowed down in Q2

The economy grew 7.08% in the 1H of 2018, highest figure for the period since 2011. After gaining a remarkable growth rate at 7.45% in 1Q, GDP growth in the 2Q decelerated to 6.79%. That depicts an opposite trend as Vietnam's economy generally records an upward year-over-year (YoY) growth trend in which Q3 and Q4 often record higher growth than Q1 and Q2. Building on the buoyant growth of all sectors in 2017, 1H 2018 still recorded significant results but it will experience a slowdown as no abnormal factors are predicted to boost the economy in the 2H2018.

Industry and construction sector expanded in 1H2018 at a rapid pace

The industrial sector grew at a rapid pace, thanks to a surge in exports, which translated into manufacturing output. The industry and construction sector expanded at a marked pace of 9.28% in 1H, significant rise compared to 7.01% and 5.42% in the same period of 2017 and 2016 respectively.

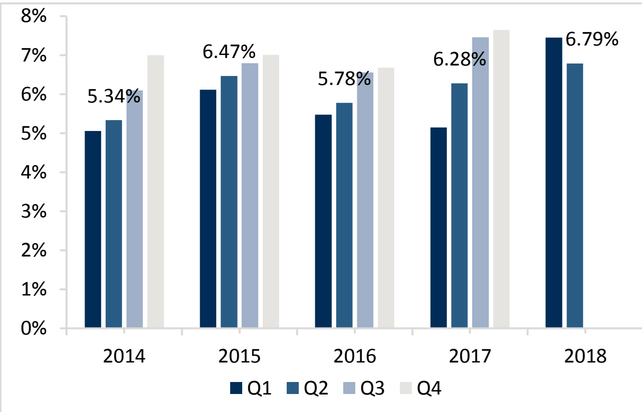
Processing and manufacturing showed an advance in 1Q, before slowing down 2Q

Processing and manufacturing were the pillar of the growth, which scaled up 13.02%, the highest level in recent 7 years. However, within the 1H, after surging by 12.9% in 1Q, the industrial production index slowed down to only 8.4% in 2Q (Figure 2). Likewise, within the processing and manufacturing sector in which accounted for over 80% of the whole industry, the index increased 15.7% in Q1 and 10.1% in Q2. This strong growth was mainly contributed by the impressive business performance of Samsung Group in Vietnam. In Q1.2017, Samsung's profit was impacted by the recall of Galaxy Note 7 but in Q1.2018, Samsung's export surged with the successful launch of Galaxy S9.

PMI shot up to 55.7, highest since 2011 reflecting improved business conditions

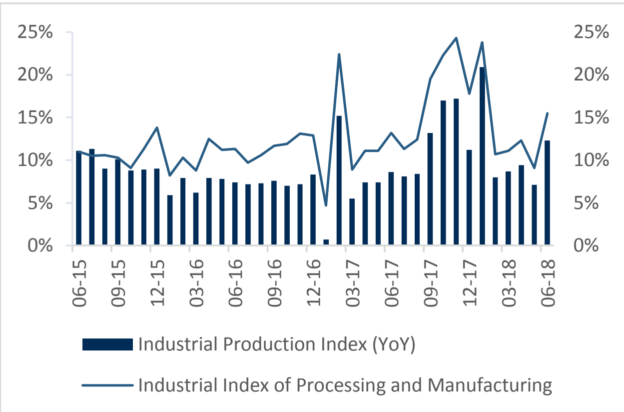
The Nikkei Purchasing Managers' Index (PMI) grew up to 55.7 in June from 53.9 in May and was the highest readings since March 2011. Remaining above the critical 50-point threshold, 1H's reading reflected improved business conditions in the manufacturing sector and marked thirty-one consecutive months of expansion. That was underpinned by strong upturns in output and new orders, thanks to business confidence in the sector remained upbeat.

Figure 1: GDP by quarters



Source: GSO, KBSV

Figure 2: Industrial Production Index



Source: GSO, KBSV

Agriculture-Forestry-Fishery sector (AFF) experienced a flourish period with the help of good weather conditions

AFF sector impressed by their recovery in 1H2018 thanks to good weather conditions, picking up 3.93%. Agriculture grew 3.28%, contributing 0.45 percentage points, while fisheries grew 6.41%, the highest rate for 8 years and forestry 5.12%, higher than the 4.31% posted in the 1H2017 and contributing 0.04 percentage points. Vietnam's AFF export turnover reached USD22bn in the first six months, which is on track to achieve the target of USD42bn, according to the Ministry of Agricultural and Rural Development.

Service is the highest share in GDP's structure with rapid growth in wholesale/retail sale and tourism sector

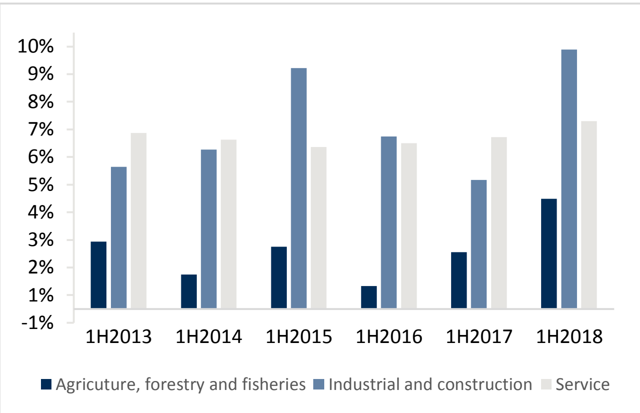
1H results showed Vietnam has been driven by all sectors, with gradually constructive move in GDP's structure. Service accounts for 41.82% of GDP's structure, followed by 33.78% in Industry and Construction and 14.15% in Agriculture-Forestry and Fishery. Service sector expanded by 6.90% in the 1H, highest since 2012. Wholesale and retail sale continued to be the highest contribution, grew by 8.21%. Revenue from tourism sector was VND19.6tn in 1H2018, rising by 19.5% YoY. Besides, data from Vietnam National Administration of Tourism showed that foreign visitors to Vietnam reached 7.9 million arrivals, 27.2% YoY increase with highest rise in Korean visitors (60.7%).

2. GDP's Growth Forecast – relatively high for 2H2018; risks do exist

For the 2H 2018, we do observe some inherent risks but the short-term GDP growth outlook for Vietnam remains relatively high at 6.8% for FY2018 and industry sector is expected to rise by 7.92%. Factors may boost GDP growth consist of improving business environment by recent government administrative reforms; positive impact from recent signed FTA CP-TPP.

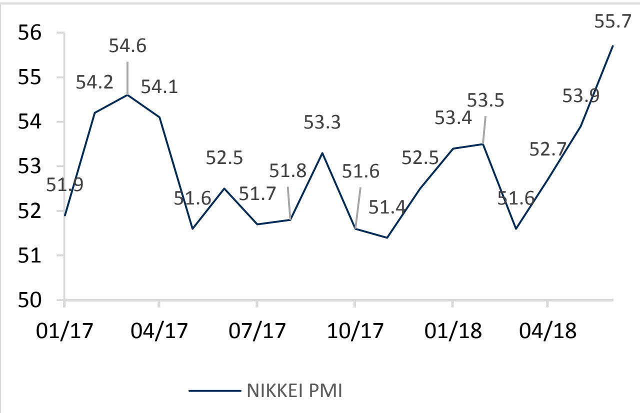
Factors may constrain GDP include: Trade tensions between major economies escalated; Vietnam's growth relies heavily on exports, with the dominance of FDI firms (SAMSUNG, FORMOSA) while global uncertainty will affect capital inflows to Vietnam. Growth in electronic and machine manufacturing would suffer from slower pace. SAMSUNG's revenue, surged in 2H2017 and 1Q2018 thanks to a successful launch of Galaxy Note 8 will unlikely to continue in 2H.

Figure 3: GDP by sectors



Source: GSO, KBSV

Figure 4: Vietnam PMI



Source: HSBC, NIKKEI, KBSV

INFLATION

1. 1H's Inflation highlight – on the rise in 1H 2018, with significant increase in May and June

Inflation pressure returned as of recent, average CPI in the 1H hiked 3.29% YoY - the fastest pace in 7 years. Inflation started to advance in May. June's CPI rose by 0.61%, the highest pace for June since 2011, which marked a slightly bigger increase than the 0.55% MoM rise in May. CPI in June 2018 increased 2.22% against December 2017 and 4.67% YoY.

Food sector remained the key driver for CPI increase

Most CPI increase was derived from rising prices during the May and June period, with key drivers of inflation originating from the fuel and food prices The base CPI in 2017 was unexpectedly low while 2018 was in opposite way with the highest rise belonging to the food sector. Prices for food and foodstuff rose the most at 1.75%. Pork price advanced by 40% against same period in 2017. Within June, it rose by 3.4%, was one of main driver for the advance of June CPI. Also there was a high demand in rice exports to China and South East Asia that pushed the rice price up.

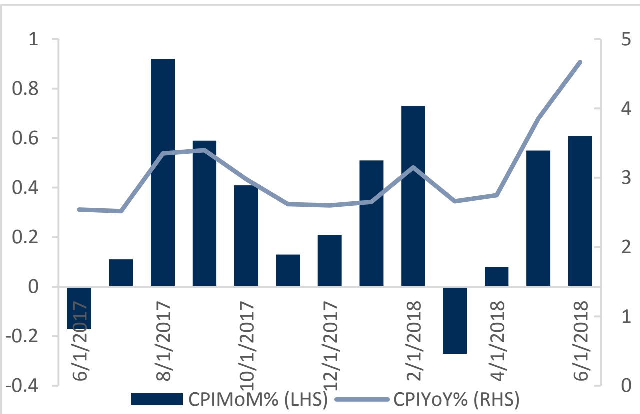
Core CPI remained under control

Core CPI, which excludes prices for food and fuel, increased 0.10% over the previous month, following a 0.11% rise over the previous month in May. Core CPI YoY remained stable at 1.37% in June, on track with the target range of 1.5-1.7% of the government.

2. Inflation forecast - expected to maintain at government target of 4% for FY2018

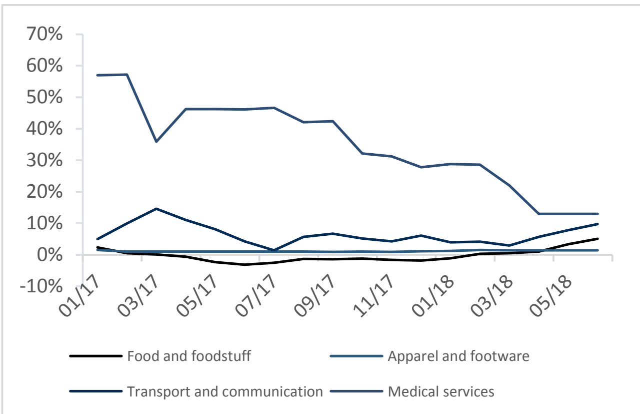
We do see some pressures in inflation in 2H2018. However, they could be controlled and balanced by the government as government priorities are to sustain macroeconomic stability and to absorb any shocks in the economy. We predict that average inflation will be 3.9% this year basing on following main points:

Figure 5: CPI



Source: GSO, KBSV

Figure 6: Price movements of key product lines



Source: GSO, KBSV

Inflation pressure on 4% target: higher fuel and food prices and gradual increases in administered prices

In the 2H2018, factors will affect inflation continue to be fuel and food prices. Eco-tax is planned to reach its ceilings in October, by VND1000/1l of petrol and VND500/ 1l of diesel. Petrol price will rise by VND1,000 per liter, diesel oil price will increase by VND500 per liter. It is calculated to increase transportation price by 5%, contributing CPI to increase by 0.3%.

Fuel price is expected to fluctuate at around USD65-72/barrel compared to around USD55 same time last year (up by 30%), as geopolitical fears cause concerns to rise over potential disruption to supplies.

Food and foodstuff price always accelerate in 2H due to droughts and flooding which have been seriously affecting some regions in Vietnam. Pork price is expected to remain at a relatively high level in the 2H2018, as the limitation in domestic supply (resulted from significant drop in 2017). However the market will be more balanced to the year-end when the pork supply may be improved by from the U.S producers (China imposed tariff on U.S meats as parts of trade tensions).

The roadmap of raising minimum wage in 7/2018, by an additional VND90,000 (USD4). Meanwhile, under the government's Decree 86/ND-CP/2015 on collecting and managing fees in educational establishments, increasing tuition fees starting in 9/2018 (by 0.07%).

Deeper depreciation in the Dong will adversely impact on CPI

Furthermore, deeper depreciation in the Dong (analyzed in more details in Exchange Rate part) is not a positive signal, which adversely impact on inflation. This will directly affect the input costs of production and business activities, especially the importers for products intended directly for the consumer market as well as raw materials and semi-manufactures intended for production of consumer goods. A 1% depreciation of the Dong will cause CPI to increase by 0.15 percentage point as an estimation from National Financial Supervisory Commission.

Government actions to prevent any shocks in CPI.

Government has decided to suspend the price adjustment of commodities to prevent rising prices, typically requesting the Ministry of Industry and Trade to keep electricity prices unchanged 2018. Also, the Ministries are instructed to closely monitor price movements, making timely supply of essential commodities to control inflation. The move indicates the Government's objectives on stabilizing the macro-economy with the priority on inflation. SBV also uses it discretion to actively set monetary policy in response to changing economic conditions by limiting credit growth and stabilizing money supply.

The two-step roadmap of adjusting medical service prices has been completed

The newly issued Circular 15 activating on July 15 about downward adjustment of some medical service fees will halt CPI growth in July. Medical service rate was shifted by 47.6% and 25.2% in 2016 and 2017 respectively, contributing nearly 50 percentage point of the CPI growth. In 1H2018, it only rose by 4% and is expected to experience no further increase until year- end.

INTEREST RATE/MONETARY POLICY

1. Monetary policy overview - regulated in SBV's discretion in 1H2018

Credit growth was on track with the FY government's target of 17%

By 20/06/2018, credit growth was estimated at 6.35% against the end of 2017, far below 9.01% in the same period last year. Meanwhile, deposit growth was 7.78%, much higher than 2017 of 5.89%. On the QoQ basis, credit growth was on the rise from 2.23% in Q1 to 4.03% in Q2.

M2 growth was slightly slow down, reflecting transition in SBV's monetary policy

M2 experienced a slight decrease from 4.01% in Q1 to 3.80% in Q2. By the end of June, money growth was expected at 7.96%, higher than 6.89% in 2017. Faster M2 growth derived from the injection of VND to purchase FX to increase FX reserves in the first 6 months (FX reserves have reached USD63.5bn).

Interbank interest rate remained at low level thanks to high banking system liquidity

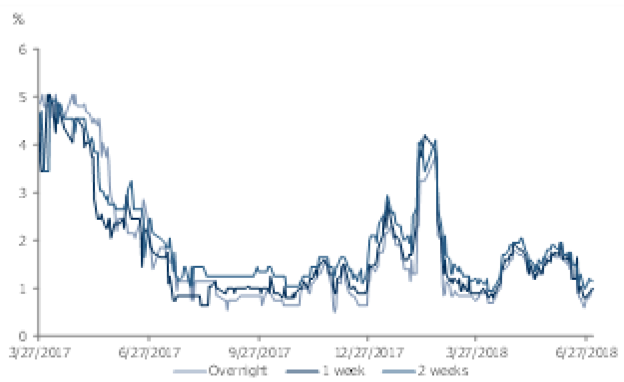
Banking system liquidity remained high in 1H2018. Short-term interbank rates, including overnight, 1 week and 2 weeks rates, plunged to a low level of below 1%. Also liquidity was boosted by SBV's purchase of around USD11bn while only extraction of around USD3bn via OMO and T-note channel.

However, the banking was less liquidated in 2Q, as in April and May, SBV was injected money of VND58.6tn and VND10.9tn respectively and outstanding T-note reduced to only VND55.8tn. Interbank interest rate at that time increased significantly. High M2 growth and high liquidity of the banking system can support G-bond issuances (the offering value was VND74.2tn while the bidding value was only over VND34.1tn). G-bond yields advanced by 2 bps in June in all maturities.

2. Monetary policy forecast - a slower pace for M2 growth and acceleration in credit growth for 2H2018

Given the global central banks moving from easing to tightening monetary policy (2 more upcoming Fed rising rates in 2018, ECB will be likely to end bond purchases by Dec 2018 and BoJ remains highly accommodative), together with rising in inflation, monetary policy will be likely more prudent. M2 growth is expected to be slower, while credit growth may accelerate in the next 6 months. We estimate a 17% growth in M2 and 18% in credit by the end of 2018.

Figure 7: Interbank interest rates



Source: SBV, KBSV

Figure 8: M2, Credit balance and QoQ growth

M2 and Credit Growth

(VNDbn)	31/03/2017	30/06/2017	30/09/2017	31/12/2017	30/03/2018	20/06/2018
M2	7,374,307	7,616,856	7,877,753	8,192,548	8,521,098	8,844,675
Growth rate QoQ	3.49%	3.29%	3.43%	4.00%	4.01%	3.80%
Increase in M2 amount by quarters	248,506	242,549	260,897	314,795	328,550	323,577
Credit outstanding balance	5,746,188	6,001,383	6,177,691	6,509,858	6,655,028	6,923,234
Growth rate QoQ	4.37%	4.44%	2.94%	5.38%	2.23%	4.03%
Increase in lending amount by quarters	240,782	255,195	176,308	332,167	145,170	268,206
Difference between M2 and lending growth	7,724	-12,646	84,589	-17,372	183,380	55,371

Source: GSO, SBV, KBSV

EXPORTS/IMPORTS

1. Exports/Imports highlight - maintained a stellar stride in H1

Stellar export outcomes with an increase of 16% YoY

Export turnover reached USD19.6bn in June, an increase of 31.4% YoY, contributing to USD57.9bn in Q2, a rise of 8.4% YoY. Vietnam posted a total export revenue of USD113.93bn in 1H2018, up 16% over the same period of 2017, of which FDI sector accounted for 71%. More than USD33.1bn came from domestic sector, an annual rise of 19.9%, while the remaining came from the FDI sector (including crude oil), up 14.5% (Figure 8).

Key export products include technology products and textiles and footwear

Key export products enjoyed an export turnover of over USD1bn, with telephone and accessories (USD22.5bn), electronics, computers and components (USD13.5billion), textiles (USD13.4bn) and footwear (USD7.8bn).

Top export markets belong to US, EU, China and Korea

Vietnam has made good use of tariff preferences in signed free trade agreements (FTA) to expand its export market. This was reflected through the country's export turnover increasing by 9.2% to the US, 12.3% to the EU, 28% to China, 31.8% to South Korea, and 17.4% to ASEAN.

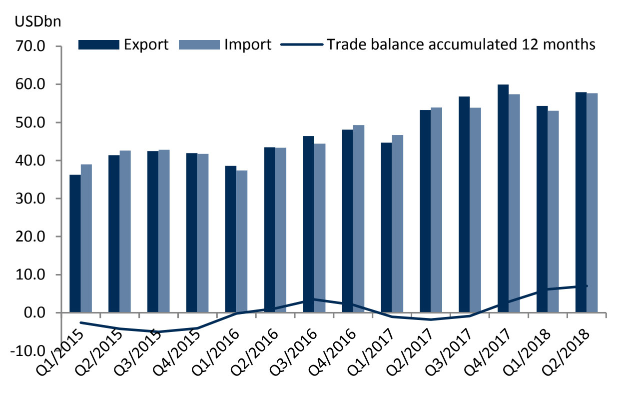
Imports was on the rise in Q2, reaching USD111.22bn for 1H2018

On the other hand, import turnover to Vietnam also improved in Q2, up to USD57.7bn. Total import revenue was USD111.22bn in 1H2018, up 10% over the same period of 2017, of which FDI sector accounted for 59%. Raw materials continued to be the key products, with machinery and equipment (USD45bn); electronics, computers and components (USD19.7bn); fabric (USD6.4bn). Vietnam's largest import markets are China (US$31.1bn) and South Korea (USD22.5bn).

Trade balance experienced a deficit in May and June

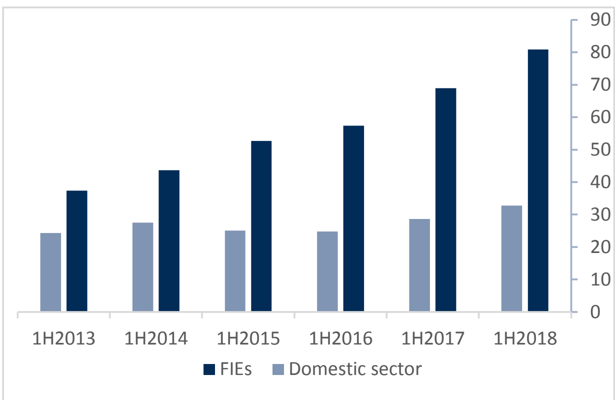
After the first 4 months of trade surplus, May and June experienced a trade deficit of USD814mn and USD100mn respectively. Reasons behind was the slowdown in export growth of FDI companies in mobile phones and electronics sector. To sum up, trade surplus hit USD2.7bn in 1H2018. The foreign sector posted USD15.7bn surplus while the domestic sector registered USD12.9bn deficit.

Figure 9: Trade Balance



Source: GSO, Customs Office, KBSV

Figure 10: Exports of FIEs and Domestic sector



Source: GSO, KBSV

2. Trade Balance forecast – expected to post a surplus for FY2018

We forecast that trade balance will be slightly down in 2H2018. FY2018 result is estimated to be surplus of USD3.0bn. Export growth may slow down while import will grow at a faster pace. Export turnover is estimated to grow by 11% in which exports in manufacturing sector will rise by 11.8% and agriculture-forestry-fishery sector will improve by 6.1%. Imports are expected to expand at around 10.5%.

FTAs and a rise in disbursed FDI will strongly support exports in 2H2018

Newly signed FTA CP-TPP and EVFTA brings an opportunity for Vietnamese exporters to penetrate the vast market in the member countries. Vietnam is currently having 16 bilateral and multilateral FTAs which boost the export and import activities.

2017 disbursed FDI was significantly increased by 10.8% YoY, in which largely invested in manufacturing sector. Their FDI factories will be able to operate in 2018, mostly contribute to the exports.

A slowing down in SAMSUNG production and further protectionism around the world will affect imports and exports

Factors that constraint trade balance include: SAMSUNG (we expect to contribute about 23.5% export turnover and 20% import turnover in 2018) will be slow down in 2H2018, as only Galaxy Note 9 is expected to be released in 3Q2018 with no significant difference with the old model.

The escalating trade tensions between major economies will adversely affect Vietnam, which currently has high openness of the economy. As a part of global supply chain, both exports and imports will be affected.

EXCHANGE RATE

1. The exchange rate highlights - reached a threshold of over VND23,000

In the first 5 months, the USDVND rate was stable, but during June its movement was hiking and reached a threshold of over VND23,000 a dollar on 27/06/2018. Main reason behind such volatility in the Dong is the dollar hike (we use Dollar Index as the benchmark) due to trade tensions between major economies and Fed's policy is expected gradually to move from easing to tightening orientation.

Dollar appreciated by 3.3% and trade tensions escalated

The recent strength of the US dollar, which is up 3.3% in Dollar Index since January has been supported by steady U.S growth momentum and rising Fed Fund rates. Fed's announcement to increase rates 4 times this year instead of 3, strongly supported the Dollar. Moreover, what affected the FX market most in June was the build-up of trade tensions. The trade war intensified into a barrage of tit-for-tat tariff increases against major trading nations was adding to near-term USD strength and exposing vulnerabilities for some EM countries.

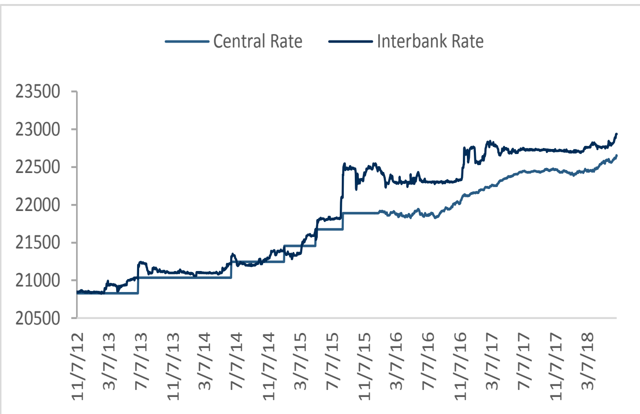
YTD the Dong depreciation of 1.53%, one of the least depreciated Asian currencies

By 18/7/2018, YTD depreciation of the Dong against USD is 1.53%, compared to an average of 3.37% 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, the Indian rupee depreciated by 7.32%, Philippine peso by 7.19% and Korean won by 5.76%.

Widening gap between OTC and Interbank exchange rate

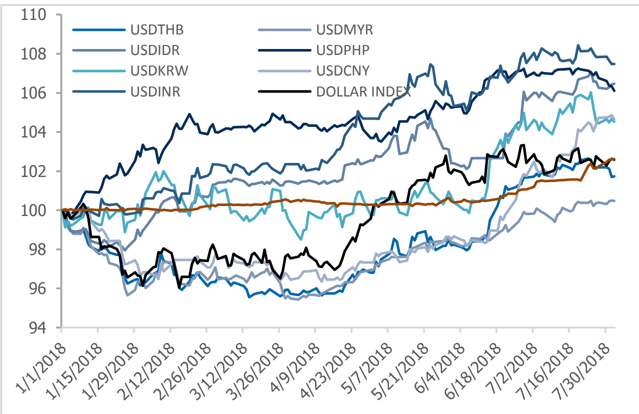
The gap between the OTC market rate and the interbank-mid rate has reached to 0.5%. It is not yet at levels that should cause concern although it should be monitored carefully. The State Bank of Vietnam (SBV) implemented a pegging regime on the official USD/VND exchange rate in the beginning of 2016 that effectively alleviated the speculative pressures on the Dong which triggered steep depreciations of the country's currency in the past.

Figure 11: Interbank Exchange Rate



Source: SBV, KBSV

Figure 12: Dollar Index and major currencies



Source: Bloomberg, KBSV

2. Exchange rate forecast – to experience a depreciation of around 2-3% in the near term

In the near term, the USD may strengthen as the Fed has recently signaling a slightly faster pace for interest hikes. In response to the market conditions, SBV has been intervening consistently, by selling foreign currencies. If Dollar Index fluctuates around the 94-97 band and CNY/USD does not rise far above 6.7, the Dong is expected to depreciate within 2-3%.

Complicated global environments will adversely affect USDVND rate

FX risk should be examined as a highly potential risk with the complicated global situations: Global trade tensions escalated and are unlikely to cool down till 2019; the Fed's plans to transition to a tightening monetary policy; Real yield differences impact on dollar-denominated debt and capital flows.

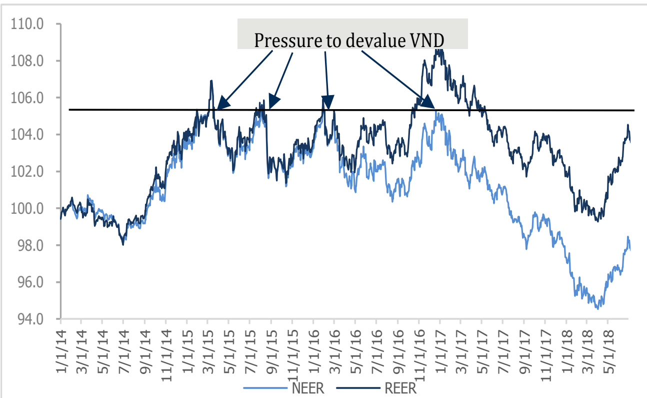
NEER was on the rise since June, pressure on devaluation the Dong is clear if the Dollar Index will appreciate by 3% or more

In theory, we should look at the NEER (nominal effective exchange rate), to fully examine the impact of both USD appreciation and CNY devaluation on the Dong. Our NEER is a measure of the value of the Dong against a basket of 8 foreign currencies. CNY accounts for 30% of the share, while USD takes up 16% in which their movements could highly put pressure on VND. A historical 105 point benchmark, is the level that SBV normally devalued VND when the Dong sharply appreciated against the basket. NEER was on the rise since June but it was still below the benchmark, pressure to devalue VND still low. However, when both the Dollar appreciation and the Yuan devaluation are expected to increase by 3%, our NEER will approach the 105 benchmark and pressure for SBV to devalue the dong is inherent.

Trade surplus, an increase in FDI and FII inflows will positively affect the Balance of Payment (BoP)

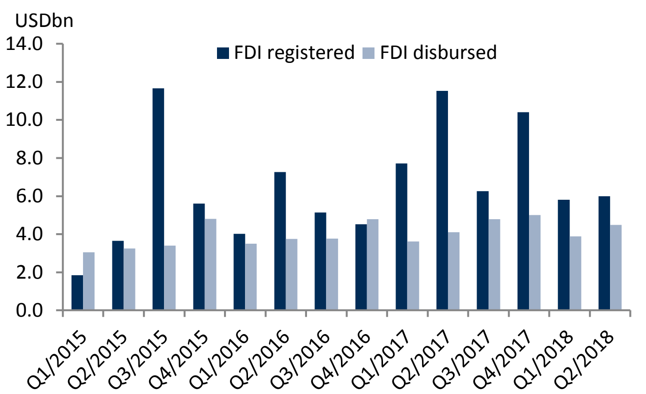
In reality, a significant increase in disbursed FDI and FII inflows (they are expected to increase by 15% and 20%, respectively) in 2018 and an estimated surplus of USD3bn in trade balance will positively improve the Vietnam's BoP.

Figure 13: NEER and REER



Source: Bloomberg, GSO, KBSV

Figure 14: FDI registered and disbursed



Source: GSO, KBSV

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