Vietnam Macro

July 2016

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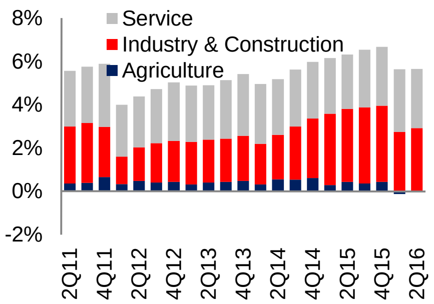
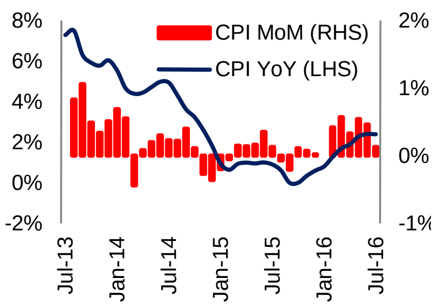
Except for slowing export growth, a solid July augers well for Vietnam's macroeconomy

Monthly Data	June	July
CPI (% YoY)	2.4	2.39
Real retail sales (% YoY)	7.5	7.4
IIP (% YoY)	7.4	7.2
Export val (USD bn)	14.8	14.7
Import val (USD bn)	14.9	14.6
Disbursed FDI (USD bn)	1.5	1.3
5Y G-bond Yield (%)	6.2	6.2
Yearly Forecasts	**2015**	**2016F**
Nominal GDP USD bn	191.3	204.2
Real GDP (% YoY)	6.7	6.27
CPI (end, %YoY)	0.6	4.0
Exports val (% YoY)	8.1	9.0
Imports val (%YoY)	12.0	8.9
Trade bal /GDP (%)	(1.6)	(1.8)
M2 / GDP (%)	140.3	154.5
Total credit / GDP (%)	111.0	118.5
Disbursed FDI (USD bn)	14.5	16.0

GDP Growth, % Contribution by Sector



Vietnam Headline Inflation



This month we take a special look at the historical resiliency of Vietnam's export performance relative to destination country's economic performance (page 6).

Inflation reached a six-month low in July with price decreases in food and foodstuffs.

- July CPI jumped slightly by 0.13% MoM and 2.39% YoY. The monthly inflation rate in July reached the lowest level since January 2016. The increase of CPI in July was mainly attributed to price hikes of transportation (+1.19% MoM), other goods & services (+0.17% MoM), and housing & construction materials (+0.14% MoM). Meanwhile, price decreases of the food, foodstuff & catering service category by 0.05% played a critical role in mitigating inflation this month.
- Since the beginning of the year, CPI has risen 2.48%. Sharp price increases in healthcare (+25.4% YTD), education (+2.27% YTD), and food, foodstuffs & catering services (+2.26% YTD) were the key contributors to YTD CPI. Concurrently, declining oil prices led to deflation in transportation (-2.38% YTD).
- August CPI is expected to rise 0.31% vs July 2016 because of increases in healthcare costs (starting from August 1) and education fees. In the meantime, the downtrends of food and transportation prices will have a positive impact on inflation next month.

Export growth continued to slow but the return of a monthly trade surplus increased the YTD trade surplus to USD1.8 billion.

- In July, export and import turnovers were estimated to reach USD14.7 billion and USD14.6 billion, respectively. After two months of trade deficits at USD180 million in May and USD20 million in June, a trade surplus returned with an initial estimate of USD100 million.
- In 7M 2016, Vietnam's trade surplus of USD1.8 billion derived from export turnover of USD96.8 billion (+5.3% YoY) and import turnover of USD95 billion (-0.9% YoY). The trade surplus in 7M 2016 was mainly caused by the negative growth of imports, especially given the low growth rate of exports.
- The export growth rate of 5.3% YoY in 7M 2016 was much lower than in previous years (7M 2015: +9.2% YoY; 7M 2014: +15.1% YoY). Sharp decreases in exports of coal (-72.8% YoY) due to higher domestic consumption and crude oil (-45.5% YoY) due to declining global oil prices were the main contributors to the slowdown of export growth in the first seven months of this year. Vietnam still maintained a trade deficit of USD16.7 billion with China in the first seven months of the year.
- Imports in 7M 2016 had a negative growth of 0.9% YoY (7M 2015: +16.8% YoY; 7M 2014: +11.3% YoY). Imports of the domestic sector rose 1.2% YoY while that of foreign sector declined by 2.4% YoY. The drop in imports of the machinery and equipment category, which has historically been the largest proportion of the total import turnover, by 5.8% YoY was one of the reasons for the imports to shrink in 7M 2016.

- With a current trade surplus of USD1.8 billion in 7M 2016, to reach our trade deficit forecast of USD3.7 billion at year end, trade balance is expected to be in deficit of an average USD1.1 billion per month for the rest of the year. Anything less than a USD500 million deficit in August will force us to revise our FY16 forecast.

Disbursed FDI accelerated while registered FDI decelerated.

- In 7M 2016, disbursed FDI increased by 15.5% YoY to USD8.55 billion (7M 2015: +8.8% YoY) and registered FDI rose 46.9% YoY to USD13 billion (7M 2015: -7.6% YoY). Although registered FDI in 7M 2016 still continued high YoY growth, the rate was not as high as in the previous six months (H1 2016: +105.4% vs H1 2015; 5M 2016: +136% vs 5M 2015).
- Manufacturing and processing continued to be the leading sector in terms of registered FDI with 1,083 projects and USD9.1 billion, occupying 70% of total registered FDI and increasing by 49% vs 7M 2015. Real estate ranked second with 35 projects and USD957 million, declining by 44% YoY.
- South Korea was the leading foreign investor in Vietnam with invested capital of USD4.2 billion, nearly 33% of total registered capital. Most of the top ten cities and provinces experienced strong YoY growth of registered FDI in 7M 2016. Only Ho Chi Minh City suffered a sharp decline by 58% YoY in registered FDI.

USD/VND exchange rate is expected to preserve its stability at VND22,300/USD in the following weeks amid "goldilocks" BOP dynamics.

- The USD/VND exchange rate retained its stability around VND22,300/USD throughout the month. The value of the VND slightly appreciated at the end of July when the interbank exchange rate decreased to VND22,295/USD as of July 29. The VND has appreciated by 0.85% since the beginning of this year thanks to the SBV policy actions that have helped limit speculative actions amid global fluctuations and prompt interventions to balance USD supply and demand in the market.
- In the last month, the SBV continued to purchase about USD500 million from commercial banks to enhance the forex reserve and inject VND into the market. Vietnam's foreign reserve is currently estimated at USD38 billion, or 12 weeks of import, a level that still has some way to go to match SE Asia peers. At the same time, the SBV also continued treasury issuance to absorb VND surplus in the market with a view to stabilizing VND value.

Banks predisposed to raise rates in H2 2016 but competitive pressure may contain rises.

- Q2 2016 banking results released so far show increases in funding costs during H1 2016 at five of the six banks that we cover at VCSC. Banks would naturally be pre-disposed to raise rates to protect NIM but the same Q2 2016 results also paint a picture of increasing competition to grow credit. Our view is that Vietnamese banks already operate on low NIM given the credit cost structure of Vietnam and hence continual upward movement in funding costs must eventually have a corresponding reaction from lending rates.

The Macro Picture

Consumer Price Index

Price increases of transportation abated and the food, foodstuffs & catering service category's CPI decreased after two months of strong price surges.

Figure 4: Inflation in July

	On-month CPI (July 16 vs June 16)	On-year CPI (July 16 vs July 15)	Average CPI (7M 2016 vs 7M 2015)
Headline inflation	0.13%	2.39%	1.82%
Core inflation	0.1x%	1.85%	1.81%

Source: GSO

- Prices of nine of the eleven categories in the CPI basket rose in July, however to a lesser extent than in the previous month. Apart from price increases of traditional movers – transportation and housing & construction materials – the contribution of other goods & services was the new catalyst for inflation in July.
- Transportation continued to be the category which had the highest monthly inflation, however it was much lower than the rates of 2.39% in May and 2.99% in June. This group's CPI rise by 1.19% MoM in July was mainly due to higher petrol prices and stronger travel demand. Despite two decreases in gasoline prices on June 20 and July 5 with a total reduction of VND540/liter, the sharp increase of VND680/liter on June 4 still made the average petrol price in July higher than the previous month.
- The CPI of the housing & construction materials category increased by 0.14% MoM because higher electricity and water usage during the heatwave in the summer caused the electricity price index and water price index to rise 1.16% MoM and 0.14% MoM. Price increases of diesel and other oil items on June 20 were also a main factor driving inflation of this group. On the other hand, gas price decreases by VND14,000/12-kg cylinder (gas price index: -3.02% MoM), and decreasing steel prices together with falling overseas price benchmarks (construction material price index: -0.44% MoM) made inflation of this group in July much lower than previous months (May: +0.88% MoM, June: +0.55% MoM).
- The key player in the CPI basket – food, foodstuffs & catering services – encountered deflation of 0.05% MoM after two months of sharp increases mainly because of the abundant supply of the Summer-Autumn rice crop amid low export demand caused the food price index to decline by 0.64% MoM. This was the second consecutive month in which the food price declined after rising for seven straight months.

August inflation forecast – CPI next month will increase more than in July

August CPI is expected to rise by 0.31% MoM for the following reasons:

- Healthcare cost increases implemented in 17 cities and provinces start from August 1 and will put more pressure on inflation next month.
- Education fees are expected to increase in August when the new school year is about to start with higher demand for textbooks and stationary.
- The anti-dumping tariffs imposed on long steel imports, taking effect from August 2, should drive domestic steel prices higher, thus having an unfavorable effect on CPI of housing & construction materials.

Meanwhile, there will also be some factors that curb inflation next month:

- With the most three recent petrol price declines in June and July by the total decrease of VND1,200/liter, we believe that transportation fees in August will be stable or on a slight downtrend.

- The profuse supply of food will lessen the pressure on food prices. Therefore, we expect that CPI of food, foodstuffs & catering service will slightly decline vs July 2016.

Year-end inflation forecast – We reiterated our year-end inflation forecast of 4%. Besides such factors as healthcare cost jumps in August, October, November, and December and education fee increases when the new school year starts, the lagged effects of the government's monetary easing policy in the first half of 2016 may at the end of the day be subsumed by subdued global commodity prices in 2H 2016.

Vietnam's top export countries

Growth deceleration in export destination countries shows no correlation with Vietnam's export performance. In economic literature, the most common pairing of words is "growth slowdown" and "export headwinds". Our analysis of the top five export destinations for Vietnam demonstrates to the contrary that 1) a degree of resilience to the economic growth slowdown of the destination country and 2) high growth destinations, defined here by at least double digit growth rates, have a tendency to maintain that growth elevation in our focus 2013 to 2015 review period.

Our analysis focuses on the three years of 2013, 2014 and 2015 as the high base effect of more recent years raises the bar of difficulty on maintaining certain trends. We also strip oil out of the export numbers as ex-oil is more reflective of the underlying export performance of Vietnam and displays less volatility. The table below displays export growth rates ex-oil and GDP performance:

Figure 5: Export growth rate (crude oil excluded) of top export countries in 2012 – 2015 (%)

Countries	2012	2013	2014	2015
US	17.0	20.9	21.0	19.0
China	17.5	6.0	9.4	17.3
Japan	14.6	8.6	15.0	3.4
Korea	22.4	24.6	16.8	26.2
Total	18.2	15.3	13.7	7.9

Figure 6: GDP growth rate of top export countries in 2012 – 2015 (%)

Countries	2012	2013	2014	2015
US	2.2	1.5	2.4	2.4
China	7.8	7.7	7.3	6.9
Japan	1.7	1.4	0	0.5
Korea	2.3	2.9	3.3	2.6
Germany	0.4	0.3	1.6	1.7

We note in our focus years we see a growth slowdown for the US in 2013 yet growth ex-oil marked one of the highest growth rates in the period and accelerated from 2012. China saw a growth slowdown in 2014 and 2015, yet Vietnam's export growth accelerated in both years. Japan experienced a growth slowdown in 2013 and 2014, yet Vietnam's export growth rate remained positive in 2013 and in fact exhibited sizzling growth in 2014. South Korea saw a growth slowdown in 2015, yet again export growth peaked in 2015. Germany saw growth falter in 2013, yet Vietnam's exports to Germany grew at double digit rates that year.

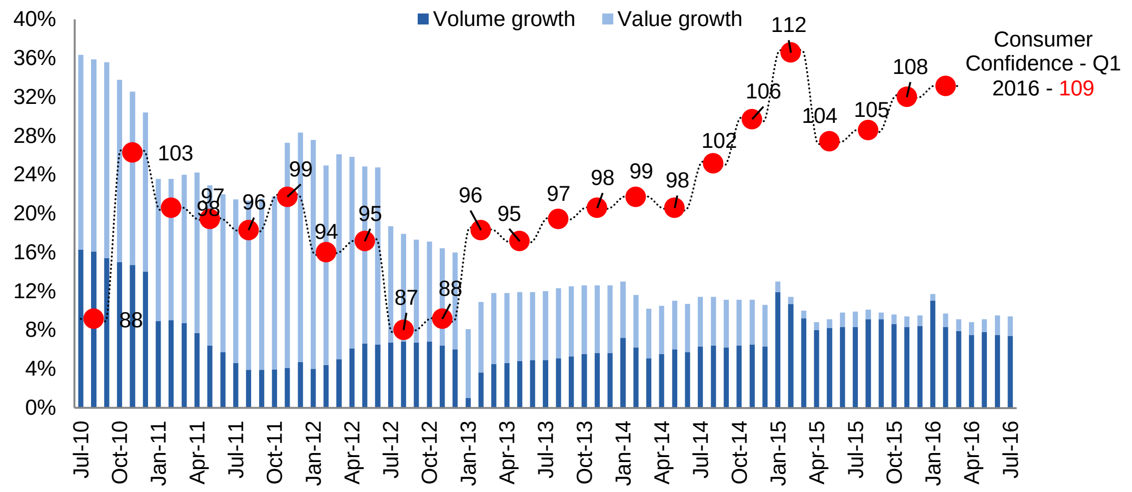
The US and South Korea are high velocity growth destinations for exports. The US is a particularly compelling example, especially after stripping out oil, as an ever increasing base effect only shows a partial decline to growth rates. The party has somewhat slowed down in 5M 2016, with the US losing some steam as a destination for Vietnam's exports, but it nevertheless still registers double digit growth rates. South Korea however grows ever more luminescent and a growth rate of 40.3% YoY is also a reflection of the profound benefits that come with implementing a FTA.

With export growth for 7M 2016 growing at 5.3% YoY may prompt some to doubt whether such observations are valid signals for what will happen for the remainder of 2016, we know that H2 2016 will see the operational commissioning of several large FDI projects and if these observations do not hold for 2016 then its underlying value remains the multi-year patterns that it informs.

Domestic Activity

Real retail sales grew by 7.4% in 7M 2016, lower than 8.3% in the same period last year, indicating that domestic consumer demand continued to increase but at a slower pace than in 7M 2015.

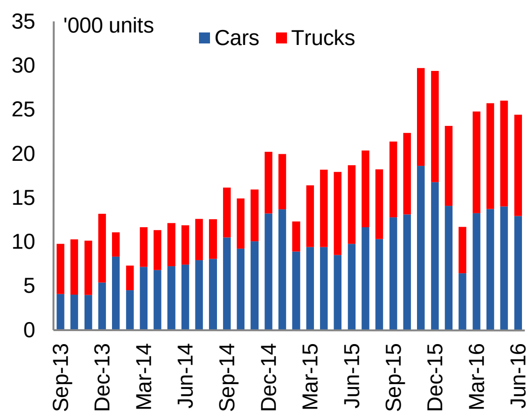
Figure 7: Retail sales and consumer confidence



Source: GSO, AC Nielsen

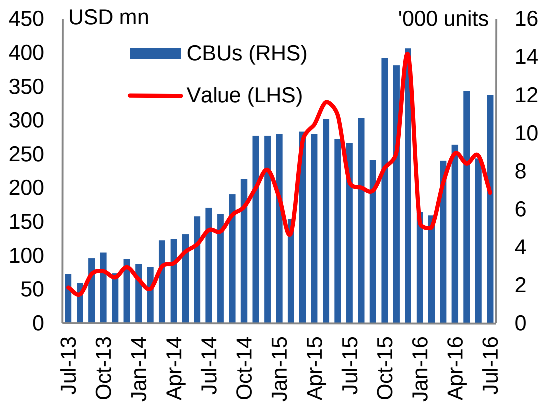
Sales of cars and trucks in June endured a downtrend from May after three consecutive months of sales expansion. Estimations of imported CBUs in July showed an increase in volume but a reduction in value.

Figure 8: VAMA sales



Source: VAMA

Figure 9: Imported CBUs



Source: Customs Office, GSO

Industrial Production

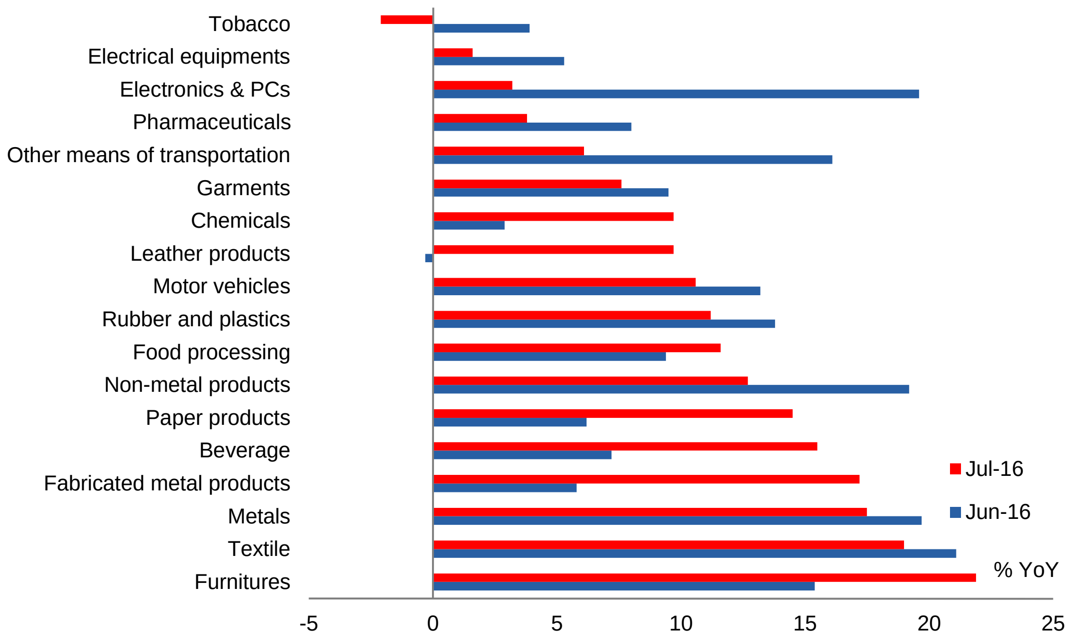
The slowdown of overall industrial production growth in 7M 2016 was caused by mining output reduction. The manufacturing sector continued to expand but at a lower rate than the same period last year. Vietnam's PMI in July was 51.9, lower than 52.6 in June and marking the eighth consecutive month of an above-50 reading. This implied that manufacturing activities continued to expand but in a slightly decelerating pace compared to the previous month.

Figure 10: IIP growth in 7M 2016 – a comparison

	July 16 vs July 15	July 16 vs June 16	7M 16 vs 7M 15	7M 15 vs 7M 14
Overall IIP	7.2%	2.1%	7.2%	9.9%
Mining	-2.9%	-0.1%	-2.7%	9.2%
Manufacturing	9.7%	2.7%	9.9%	10.1%

Source: GSO

Figure 11: IIP of Manufacturing Sub-industries



Source: GSO

Macro Indicators

Figure 1: USD/VND Exchange Rate

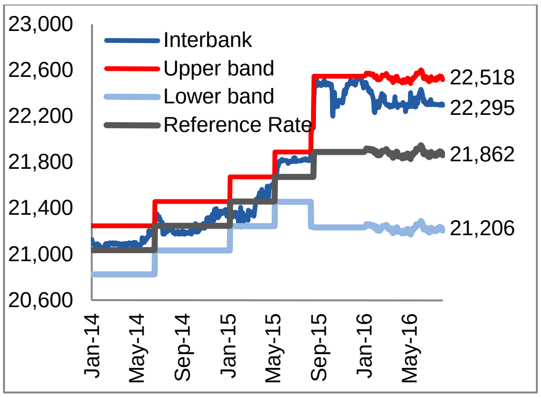


Figure 2: Vietnam G-Bond Yields

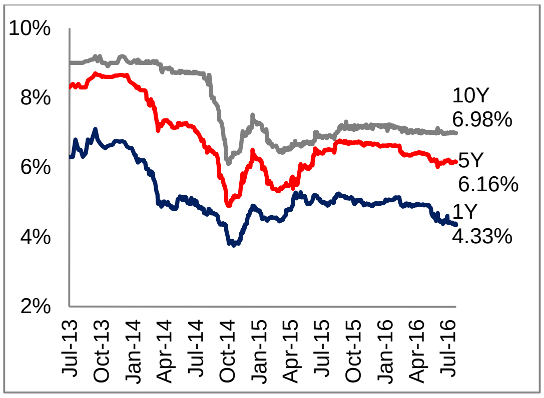


Figure 3: Trade Balance

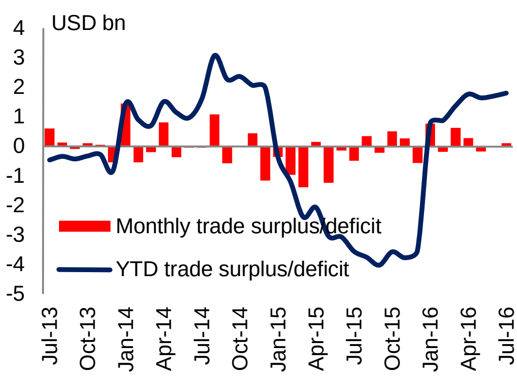


Figure 4: Foreign Direct Investment

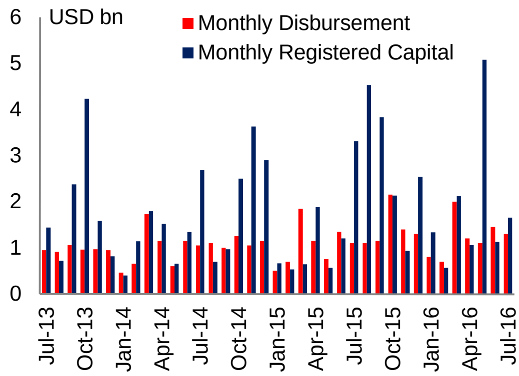


Figure 5: Retail Sales Growth

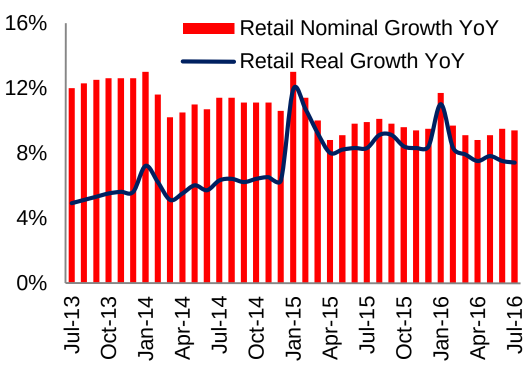


Figure 6: Index of Industrial Production

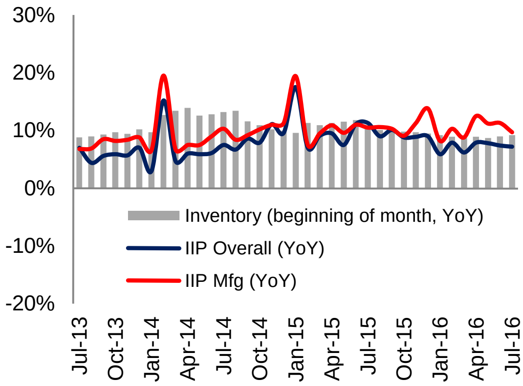


Figure 7: Credit Growth*

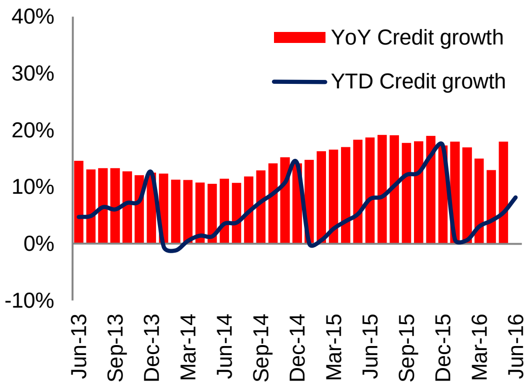
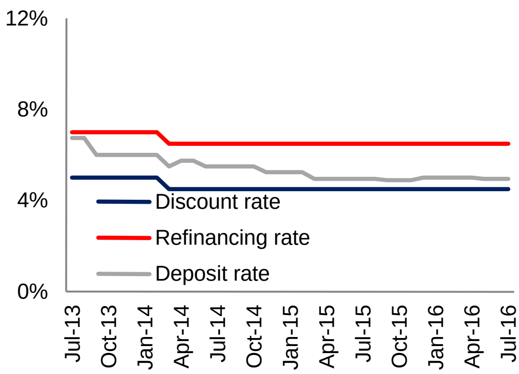


Figure 8: Key Policy Rates



Source: GSO, SBV

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