09/11/2015

MACROECONOMICS REPORT

How China's risks affect Vietnam?

In 2015, Investment Strategy Report named "Use a rod, drop the net", we have discussed our perspectives on Vietnam macroeconomy, which we all "hope for the best" to come. Indeed, the movement of the economy remained on track in 1H2015 when real GDP growth improved to 6.3% yoy; manufacturing and consumption advanced on expansion. However, recent turning points of global macro-economic factors support our idea to finish a full sentence: "Hope for the best, prepare for the worst". For this topic, we aim to explain impacts of new China exchange rate regime on Vietnam's economy. We will focus on analyzing risks arising from new China's policy and how they affect commercial activities, management policies of SBV as well as their external effect on TPP Agreement negotiation, which is an important expectation of many investors. Beside, we will try to explain the impact of China's declining growth rate on foreign capital inflows in Vietnam and the possibility of Fed hiking rates in 2015 September.

It is commonly said that China is "the root of all fears". However, delving into major motivation of FX policy change, China's enormous foreign reserves and its escalating trade surplus , we think investors may have some beliefs in a scenario that PboC will not let its currency depreciate so fiercely.

Investors in Vietnam always have a mindset of overvalued VND, so concerns of depreciation never ends. The question is how much would be an acceptable rate and not a significant risk for the economy. So far, VND has dropped more than 5% in correlation with a 5% devaluation of CNY. Not until the end of 2015 that we expect another FX rate adjustment from SBV. Though risk of devaluation is likely to step in next year, we do not think policy makers get ready for a floating system. Another scenario that is worth concerning is +/-5% volatility for VND along with adjusted average exchange rates and SBV's regulations at some time or another.

Taking in exchange rate and commercial activities connection, we expect Vietnam will be able to maintain progress in developed markets meanwhile relative trade deficit with China could be dwindled after 2 previous adjustments in exchange rate of SBV. For this year, we estimate a hefty USD7-8 billion trade deficit for Vietnam.

Next, we want to clarify influence of currency devaluation on national debt. Actually, devaluation does impact national debt to some extent. Ability to balance sources for debt payment must be taken into consideration before quantifying exactly the effect. However, we can imply that authorities will face tougher situations and there will be high possibility of postponing TPP. Therefore, instead of depending on externalities, economic growth will bet its bottom dollar on expanding manufacturing, private sectors and efforts to restructure the economy.

Assessing the macro outlook of Vietnam, We do not worry about impact from Fed lifting interest rates. Nevertheless, we are in favor of a conservative rate-hiking scenario, in which Fed will pledge an insignificant rate or will wait further until 2015 December. Thus, psychological impact will a certain but if Vietnam market strongly declines due to Fed, we think this is an opportunities to enter a long position. Actually, a dull picture of global economy, especially China's continuous plunging notwithstanding in-progress stimulation policies as well as restructurings are the worst. Global conditions do not support for Vietnam's prospects. After further discussions below, we hope investors can have a widen point of view and pay attention to suitable risks for individual investment decisions. Buffet used to say: "Risk comes from not knowing what you're doing". We think this shall be a best guideline in the context of escalating uncertainty. The most important thing, as we want to share, is that investors should identify situations, possibilities of occurrence and risks before placing any bet on any trading deals.

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China devaluated Renminbi or changed the exchange rate policy?

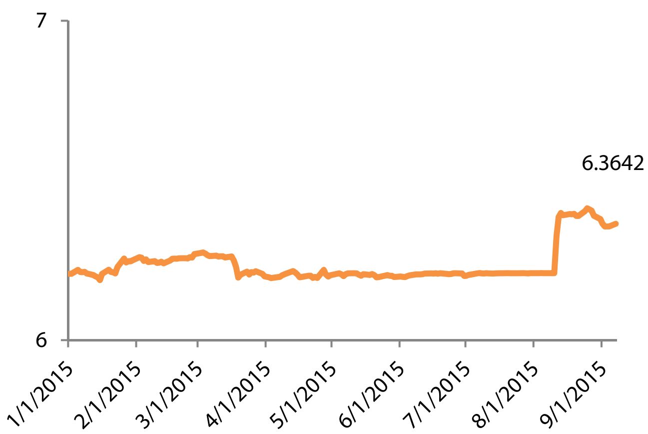
In a statement for 11/08/2015 morning, People's Bank of China (PBoC) announced the implementation of preference price mechanism for Chinese Renminbi. New mechanism bases on the closing price of interbank foreign exchange market on the previous day within +/- 2% margin instead of pegging into global currency basket.

According to the explanation from PBoC, the purpose of this amendment is to support Renminbi for a closer reflection of the demand-supply from foreign exchange market. This is also more suitable for the movements of other currencies and helps the State bank to be more flexible in term of monetary policies.

New policy from PBoC which was the unexpected factor to the global financial markets along with the significant fluctuation from Renminbi after the amendment raised many concern about further devaluation. Under this circumstance, PBoC continuously announced the commitments to take necessary actions when market volatility reaches a high level. Early 9/2015, PBoc asserted that the mandatory required reserve for forward transactions in foreign currencies will be 20% of total trading value without interest rate for 1 year, being effective since 15/10/2015. New regulation could limit the speculating activities betting on the depreciation of Renminbi; simultaneously, reduce the requirement for PBoC to use foreign reserve to intervene the market.

After exchange rate policy amendment from PBoC, the highest depreciation of Renminbi was 3.3% and cooling down to 2.4% compared with the period before adjustments (as of 03/09/2015). New regulation seemed to be effective, however, according to the assessments from several institutions, the depreciating trend could continue in intermediate.

Figure 1: USDCNY exchange rate



Source: Bloomberg

Figure 2: Several important statements from PBoC after the exchange rate policy amendment

11/08/2015	Change in exchange rate policy was the one time-action and the part of exchange rate mechanism reform
13/05/2015	There is no argument to reach the conclusion that Renminbi depreciation could be maintained Basically, the adjustment for the difference between fixed and market exchange rates have been completed.
25/08/2015	PBoC decreased 1-year lending and deposit rates by 25 basis points; simultaneously, dropped the required reserve ratio by 50 basis points.
01/09/2015	Regulation about the minimum reserve ratio for forward transactions in foreign currency

Source: RongViet Research

Reasons for policy amendments

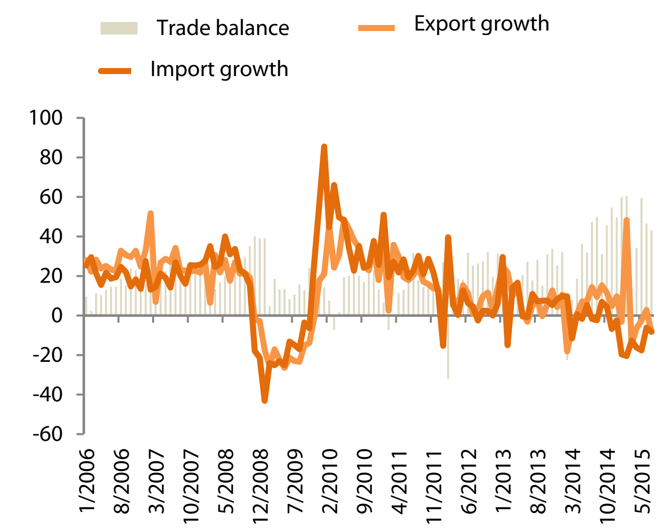
Boosting exports could not be the main motive

The recent depreciation of Renminbi was implied to be the method of PBoC to promote exports under the slowdown of global economy. However, we believe this not the main motive based on several arguments:

Commerce contributes more to GDP due to sharp decline of imports. During 2006 – 2008, the export growth rate from China had been stable at high level (monthly average at over 25%) and net-exports contributed 8% to GDP. However, after the global financial crisis in 2008 – 2009, the exporting activities suffered high damage. The consequence of prolonged crisis over the last few years restrained the export growth to 6 – 7% monthly average since 2011. This situation has been parallel with the orientation to shift the development model with the key aspect to expanse the domestic demand and reduce the dependence on external demand. During 2011 – 2014, the contribution of commercial activities to Chinese GDP had been approximately 2.6%.

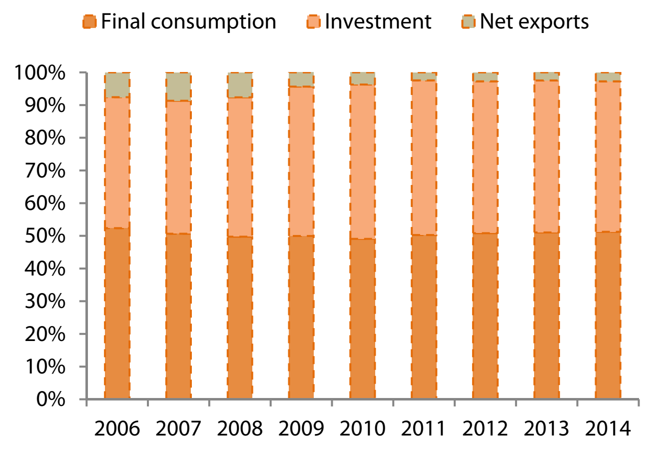
Accumulate for the first 7 months of 2015, China's export value declined by 0.8% y.o.y while import value dropped by 14.6%. The significant decrease in imports (equivalent to the drop in domestic production and consumption demand) resulted in the trade surplus of USD 305.2 billion over the last 7 months. This figure is twice as high as the same period in 2014 and equivalent to 5.4% of GDP. Thus, the trade surplus of China has been expanded even though the reason came from the decline in imports. With the slow growth rate of domestic consumption and fixed asset investment, the contribution of exports in Chinese economic growth is expected to increase in 2015.

Figure 3: China balance of trade



Source: Bloomberg

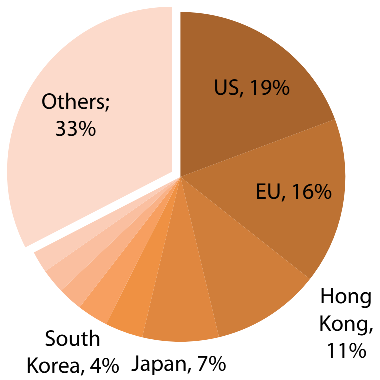
Figure 4: Components' contribution to China GDP (2006-2014)



Source: Bloomberg

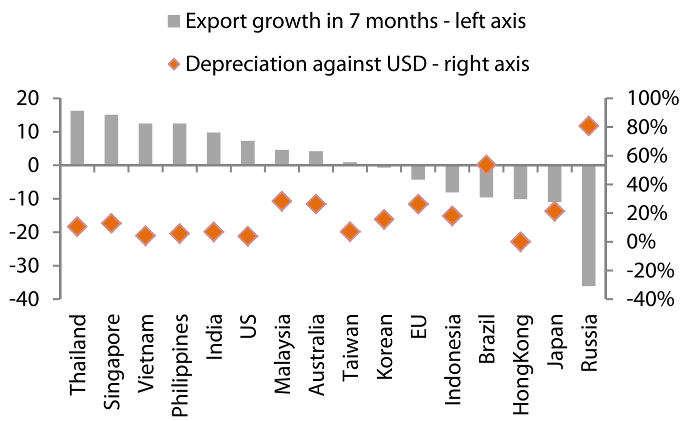
Compared with other markets, Chinese exports could be more optimistic. Under exchange rate perspective, we noticed that exporting activities from China could receive negative impact from several trading partners who have the depreciating currencies, particularly EU market (~16% of exports) and Japan (~7 of exports). For the first 7 months, exports to EU and Japan markets decreased by 4.3% and 11% respectively. However, with new exchange rate mechanism and recent movements, we believe that China does not want to devaluate Renminbi to deal with the domestic devaluation trend of several currencies.

Figure 5: China export structure by countries (2014)



Source: Bloomberg

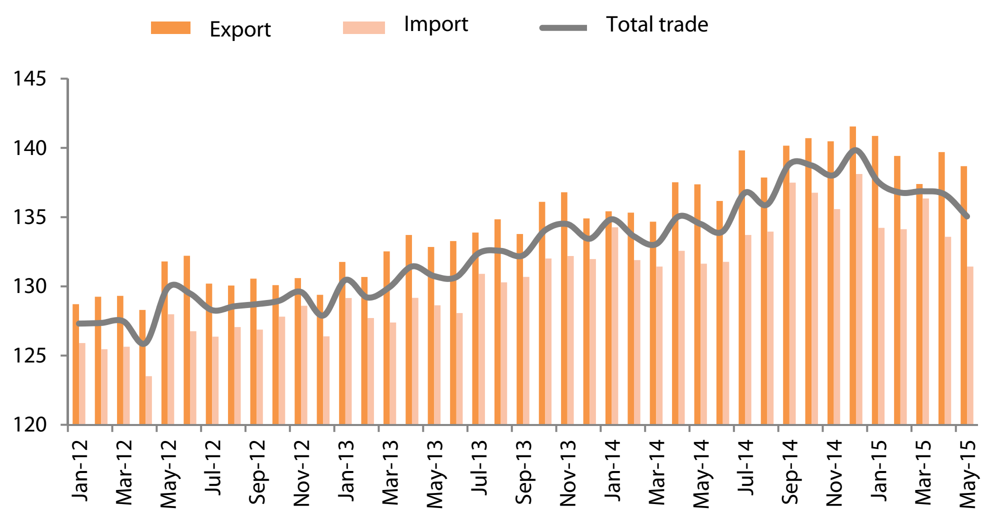
Figure 6: Export growth and exchange rate fluctuations



Source: Bloomberg

In addition, the common practice about global commerce over the first 5 months of 2015 has been the negative aspect from global consumption demand since 2009 financial crisis. Simultaneously, compared with other economies, exports from China is relatively more positive than BRICS and many countries in East Asia region (Appendix – page 19). Based on above arguments, we believe that promoting exports could not be the main motive for the exchange rate policy amendment from China.

Figure 7: Production of global trade in goods (monthly)



Source: WTM, RongViet Research

The ambition to internationalize the Renminbi

As usual, IMF would periodically review the global reserve basket of currencies once in 5 years. The upcoming review will occur at the end of 2015. Based on several arguments from IMF's first review report (04/08/2015), there are several determinant factors that decide the probability that Renminbi would be added into the basket, as follow:

+ Regarding operation, IMF believes that the difficulty to add Renminbi to the currency basket was the ability to approach countries holding SDR for domestic monetary market. However, IMF provided several solutions and considered combining with monetary market restructuring from China State Bank to overcome such issues.

+ The "free to be used" aspect of Renminbi could also be the critical factor that decides whether Renminbi could be added to SDR. Under the approach method of IMF and other considered criteria, Renminbi has not met the requirement. However, if we consider the alteration of above criteria vs. the review from 2010, the probability that Renminbi would be added into the SDR could be higher.

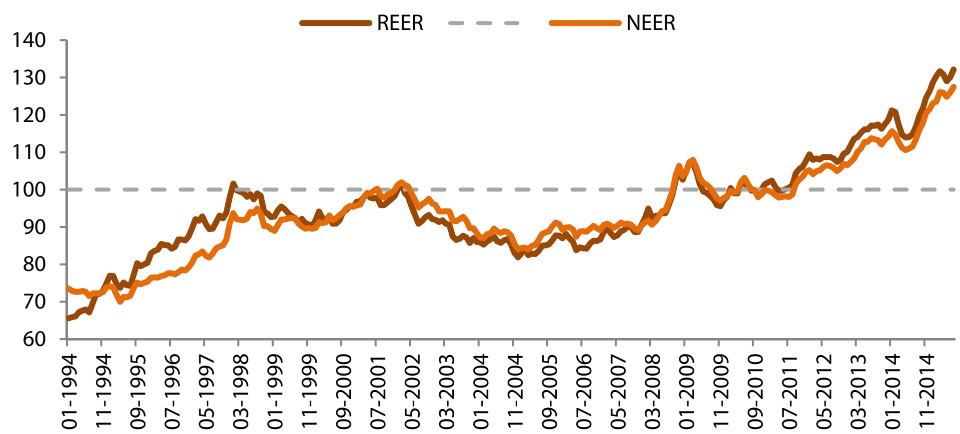
It is noteworthy that after the first review report from IMF, the State Bank of China reached the decision to change the exchange rate policy on 11/08/2015 with more flexibility in management. New regulation receives the support from IMF and demonstrates the response of China to meet the demand from US (one of the most significant entities in IMF) about floating the exchange rate and reform the financial depth in this country.

For the Chinese government, making the Renminbi into international currency reserve basket could be the vital step to fulfill the ambition to internationalize this currency. Therefore, it could be unreasonable for China to wait an additional 5-year period. This move could be the timely choice and under the calculation from Chinese government and appropriate as the motive to consolidate the position and political power that China has carried out recently. In the lasted announcement, IMF asserted that 09/2016 will be deadline for the Renminbi to be added to SDR.

The upcoming trend of Renminbi

Until now, the real value of Renminbi has been the controversial question for experts all over the world. For a long time, US have accused China for manipulating the Renminbi at low value compared to the real value to stimulate exports. In NEER/REER graph, such allegation could be accurate before 2010. However, since late 2011, NEER and REER of Renminbi have increasing trend. In 1-year frame, (since USD started the increasing trend), NEER has increased by 13.5% and REER improved by 15%. It could be seen that, the recent appreciation of USD could be the reason for Renminbi to be valued at higher level than real value.

Figure 8: NEER and REER of the Renminbi (1994-2015)



Source: BIS, RongViet Research

With new exchange rate policy, the movements of Renminbi could be less predictable in the future. NEER/REER results demonstrate the overvaluation of Renminbi. Comparing with other countries, the decline trend of Renminbi could be the logical forecast. The depreciation level of Renminbi could depend on several factors, including:

(1) The health of Chinese economy: In the latest report of Chinese economy, IMF asserted that China was under the adjustment period to achieve balance. The economic grows at lower pace but more stable. Accordingly, IMF forecasted the economic growth rate of 2015 at 6.8%, 2016 at 6.25% and 2017 at 6% under the assumption about the effects of economic restructuring in evaluation model. Morgan Stanley also assessed that if Renminbi depreciates by further 5%, the impact on Chinese economic growth could be low even

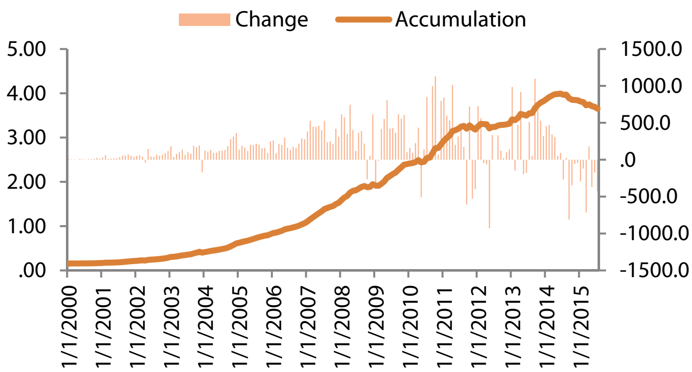
though this issue could support export activities for the upcoming 1-2 quarters. According to Goldman Sachs, 5% of Renminbi depreciation could help Chinese export to increase at 3.8% and provide additional 0.14% to GDP growth rate.

(2) China policies:

- Easing monetary policy: the deterioration of domestic demand could force China to be more aggressive to implement monetary easing policy, after that put the pressure into Renminbi. Since late 2014, Chinese policy makers has cut the interest rate 5 times and dropped the required reserve ratio 4 times to support the falling growth rate.
- The rate cut could be equivalent to the lending stimulation, however, credit demand in China has been relatively weak (especially after the recent credit bubble crisis). Therefore, PBoC could be forced for a further monetary easing. Several recent statements asserted that China has to drop the required reserve ratio to increase the liquidity in monetary market under the pressure from capital outflow after the devaluation of Renminbi. We believe the risk in this situation could be the vortex between exchange rate and capital outflow. As a result, the argument for the decline trend of China has been strengthened.

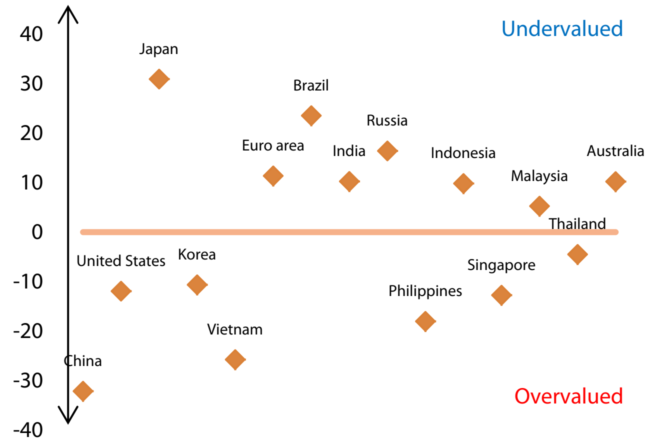
  The level of depreciation that PBoC desires: Despite of the announcement to lean towards the floating exchange rate, we believe that PBoC could still intervene into the movements of Renminbi with significant foreign reserve. Be the end of 7/2015, Chinese foreign reserve achieved over VND 3,651 billion, dropped by 5% compared to earlier this year. Chinese foreign reserve has continuously decreased over the last few months; however, this mattress could still be the effective tool for PBoC. In addition, we believe that trade surplus is the supportive aspect to control the depreciation level of Renminbi.

Figure 9: Change in foreign reserve of China



Source: Bloomberg

Figure 10: Value of several currencies that have commercial trading activities with China (7/2015)



Source: RongViet Research & BIS

Table 1: USDCNY exchange rate forecasts

	2015	2016
Morgan Stanley	6.6	6.9
Goldman Sachs	6.6	6.7
BNP Paribas	6.8	na
Deutsche Bank	6.4	6.7
Citibank	6.8	6.8
Credit Suisse	6.6	6.8

Source: RongViet Research

Table 2: Scenarios for the Renminbi at the end of 2015

	USD/ CNY	Devaluation compared to current rate	Devaluation compared to the time before policy changes
Scenario 1	6.5	2.3%	4.7%
Scenario 2	6.6	3.8%	6.3%
Scenario 3	6.8	7.0%	9.5%

Source: RongViet Research

According to the forecasts of analysts in China, USD/CNY exchange rate could be at 6.5 at the end of 2015. Combining with several reports from institutions, we believe that there are 3 depreciation scenarios with Renminbi which prolong until next year under the slowdown economic growth, Renminbi could depreciate by further 2-5% in 6-12 months.

**Depreciation compares with the closing value on 04/09/2015*

CHINA NEW EXCHANGE RATE POLICY AFFECTS ON

- Vietnam - China trade balance and other countries
- SBV exchange rate policy
- Will TPP likely affected after renminbi devaluation?

Vietnam trade balance after dong devaluation

From mid-2014 to now, the US dollar index has risen 17%, because of the Vietnamese dong pegged to the dollar and the commitment that the dong would depreciate less than 2%, Vietnamese dong also rose against many currencies. Goods exports have lost price competitiveness at some markets. Generally, the reaction of consumers on price changes lagged 3-6 months. Since the beginning of dollar rally, we find some key points in trade in the first 7 months of this year: (1) dong appreciated against Australian dollar and ringgit Malaysia may be the reasons for the deterioration in trade balance between Vietnam and these two countries; (2) Exports to developed market (excluding Japan) are better, the positive growth in major markets like US, Canada and EU partially offset the negative growth in the rest; (3) Trade deficit with China is a weakness of Vietnam's trade.

Table 3: An overview of exchange rate and commerce of Vietnam over the first 7 months of 2015

Countries	Currency	VND compared to others currencies **		7 months trade compared to the same period			Trade	Trade proportion
		Since August,10 2015	Since June, 30 2014	Exports	Imports	Trade balance	Surplus (+)/ Deficit (-)	
Australia	AUD	-2%	19%	-25%	-2%	-47%	+	2%
Malaysia	MYR	2%	19%	-11%	3%	2.156%	-	2%
Canada	CAD	-2%	15%	28%	20%	29%	+	1%
Europe	EUR	-6%	13%	12%	10%	13%	+	13%
Japan	JPY	-5%	12%	-6%	24%	Na*	-	9%
Indonesia	IDR	1%	11%	6%	1%	67%	+	2%
Korea	KRW	0%	11%	21%	32%	37%	-	11%
Singapore	SGD	-1%	6%	17%	-6%	-21%	-	3%
India	INR	1%	5%	13%	-22%	-85%	-	2%
Thailand	THB	-2%	4%	0%	18%	38%	-	4%
Taiwan	TWD	0%	4%	-8%	5%	8%	-	4%
UK	GBP	-4%	4%	25%	14%	27%	+	2%
Philippines	PHP	-1%	2%	-21%	27%	-40%	+	1%
China	CNY	0%	-2%	5%	21%	30%	-	20%
US	USD	-3%	-5%	19%	17%	20%	+	13%
Hong Kong	HKD	-3%	-6%	54%	39%	59%	+	3%

Sources: Customs, Bloomberg, RongViet Research

Na: trade balance with Japan shifted from surplus in 2014 to deficit over the first half of 2015, the depreciation of Yen could be the reason.*
***: on 21/08/2015*

In Vietnam's trade structure, China is the largest export partners, with a total value accounted for 10.4% of total exports, by contrast, 1/3 of imported goods of Vietnam comes from China (2014). This suggests a close relationship in terms of trade between Vietnam and China. In the first 7 months of 2015, exports to China grew by only 5.24% yoy, while imports increased dramatically by 30.5%. With over USD19 billion trade deficit with China in 7 months (+ 30% yoy), this is one of the main reasons for trade deficit in recent times.

According to Rong Viet Research, risks from China's new exchange rate policy towards Vietnam commercial activities include:

(1) The direct competition with Chinese goods (domestic and foreign) because the majority of Chinese products is at low-medium segment and the elasticity of demand for those goods is relatively high.

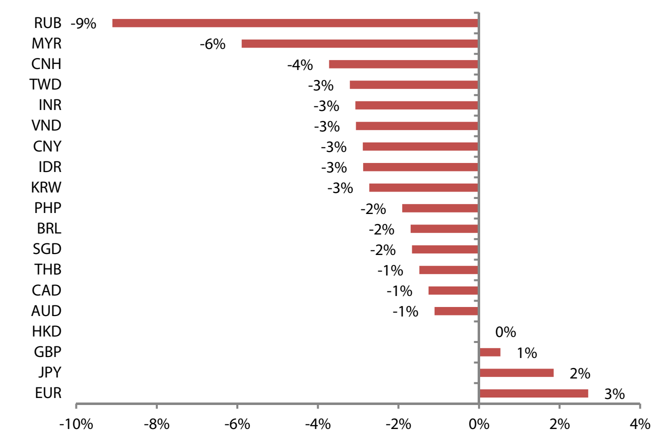
(2) **Trade deficit between Vietnam and China** will increase due to the dependence on raw materials;

(3) **The balance of trade between Vietnam and other countries** get better than harm.

(4) A currency depreciation race will cause instability **in trade and increase trade barriers**.

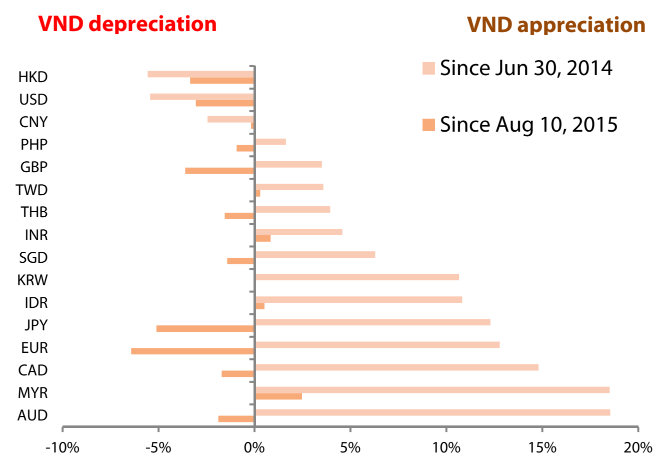
In the above risks, we believe that the first risk has been mitigated due to the recent change in exchange rate policy of SBV. After PBoC had changed exchange rate regimes, a variety of other currencies reacted in a similar trend of the renminbi, the level of devaluation of the RUB and MYR is remarkable, -9% and -6%, respectively. Under the above movements, SBV also made adjustments to loosen exchange rate band to +/- 2% (08/12/2015), followed by adjusting the amplitude to +/- 3% and increased the interbank exchange rate by 1% (19/08/2015). Looking through the cross currency pairs, we could see that SBV has helped to eliminate mostly the effects of renminbi's devaluation on the trade balance between Vietnam and China. Simultaneously, with two adjustments, the degree of dong appreciation with some other currencies (since the beginning of dollar rally) is scaled down - mainly the currencies of developed countries (AUD, EUR, JPY, CAD and AUD).

Figure 11: Currencies* after the amendment of exchange rate policy from China (11/08)



Source: Bloomberg

Figure 12: Pair of nominal exchange rate* between other currencies and VND



Source: Bloomberg **since August 21st, 2015*

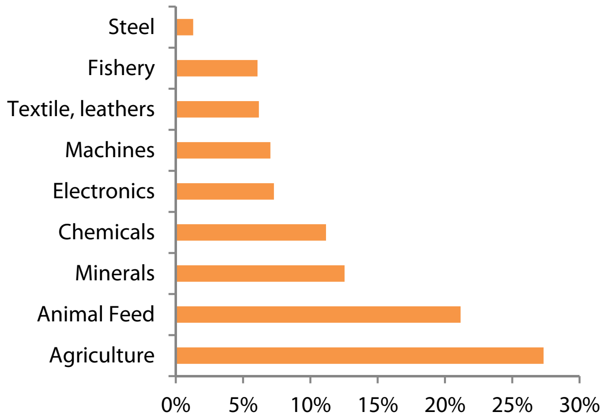
China is the world's largest consumers of raw materials; we saw most commodity prices (agricultural products, crude oil, and metals) fell sharply on concerns about the decline of economic growth in China after August 11, 2015. For crude oil, China's consumption accounts for about 11% of global demand. The weakening of China economic growth is one of the reasons why oil price has dropped dramatically. The impacts of the commodity prices' drop on the Vietnam trade balance could be seen from two angles below:

In term of exports, China is the largest consumers in agriculture and minerals (accounts for 27.3% and 12.5% of the total value of each goods, respectively). If the exchange rate risk is offsetted, the decline of raw materials plus concerns about China's consumption could impact negatively most to Vietnam agriculture and mineral industry (coal and crude oil). Moreover, the strong decrease of agricultural commodities could affect exports to other markets. Agricultural commodities and minerals made up 1/3 of the total exports in the first

6 months in 2015.

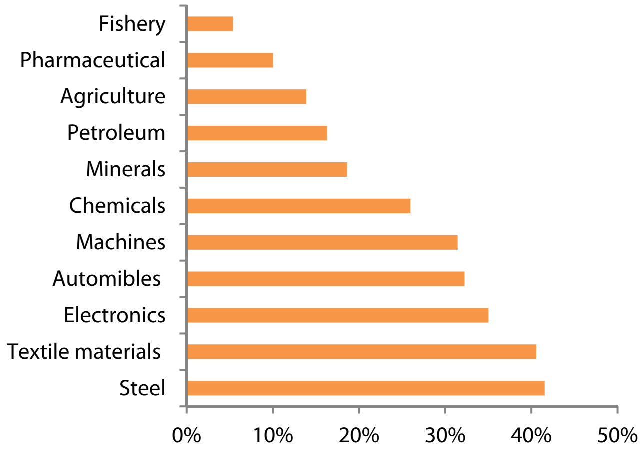
In term of imports, Vietnam depends a lot on raw materials from China at many industries like construction, textile, electronics, automotive, machinery, chemical materials,…The slump on raw materials could benefit some Vietnam producers, by contrast, domestic companies which compete directly with above goods may face difficulties. When domestic demand weakens, China producers will find the way to export more. Being a dependent on raw materials from China, trade deficit between Vietnam and China will definitely increase.

Figure 13: The dependence of Vietnam exports on China



Source: RongViet Research

Figure 14: The dependence of Vietnam imports on China



Source: RongViet Research

Vietnam's trade with other countries: more good than harm

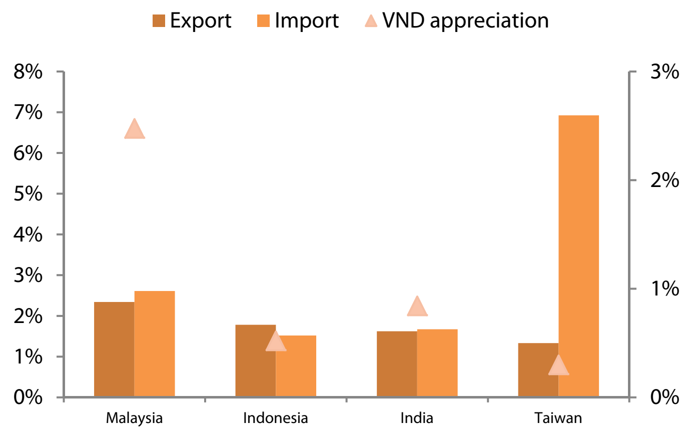
Based on current movement, some currencies which devalued more than Vietnam dong after the China policy adjustment including MYR, IDR, INR and TWD. Amongst them, Vietnam only has trade surplus with Indonesia. Due to the FX movement, we suppose that trade deficit between Vietnam and those countries will increase. Total trade of four markets accounts for 10% of trade turnover.

On the other hand, Vietnam dong has narrowed the appreciation gap with other currencies, especially developed countries. Before the exchange rate adjusments, Vietnam dong has appreciated against other currencies (HKD, EUR, CAD) but exports from Vietnam to those countries has continued to rise. This shows that Vietnam goods still have competitive in above markets. In addition, Vietnam also has trade surplus with those countries. Based on this, we expect exports to developed countries will continue to rise after the Vietnam dong devaluation. Total trade of four markets accounts for 30% of Vietnam trade turnover. To sum up, we expect Vietnam's trade with other countries will get better than harm after Vietnam dong devaluation.

Figure 15: Trade structure and the appreciation level of

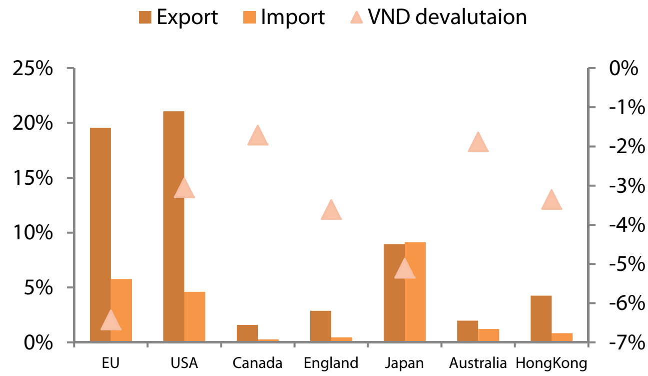
Figure 16: Trade structure and the appreciation level of

VND against other currencies



Source: RongViet Research

VND against other currencies



Source: RongViet Research

The final risk - a currency depreciation race will cause instability in trade and increase trade barriers – can be the worst. China has finally entered the game of monetary easing and changed the exchange rate policy, many events indicate an ongoing war on global currency. In 2010, the game began with undervalued renminbi, US accused China of manipulating its currency. In 2011, the weaken dollar after Fed launched two packing of quantitative easing QE1 and QE2. In late 2012, the weaken JPY with the monetary easing policy named Abenomics. Due to the difficulties situation of EU, the euro began to weaken in the mid-2014. In the early of 2015, ECB announced the program of purchasing assets worth USD1,300 bn. Until recently, the PBoC has entered the race. Currency devaluation could benefit in the short run, however, in the long run, it can lead to serious risks including: (1) Increasing the protection for domestic producers; (2) Increased input costs cause difficulties for domestic producers; (3) Deflation, slump demand. Ultimately, it could lead to a global recession, the currency war usually lasts for a long period of 15-20 years. Moreover, the war does not just happen in big countries but also affects negatively in countries which are their trade partners.

The amendment in exchange rate policy from China could put the pressure on the exchange rate management in Vietnam

New mechanism exchange rate from China could make the Renminbi's fluctuation less predictable. To counterweight the recent devaluation of Renminbi, SBV allowed the equivalent depreciation. However, it should be noted that the exchange rate policies from Vietnam and China have been operated in two different methods. In 3 scenarios which we considered for Renminbi, based on the foreign reserve and the operational mechanism in Vietnam currency market, fully floating USDVND could not been an appropriate choice. The next possible solution would be continuing to control USDVND in allowed rage. The model that analyzes the correlation between VND and other currencies during 2012 – 2015 demonstrated that VND highly correlates with (1) USD; (2) CNY and (3) EUR. High correlation pointed out that the up/down fluctuation from the Renminbi could affect the appreciation/depreciation of VND. However, we believe that the appreciation/depreciation could not be equivalent.

Table 4: Correlation between VND and strong currencies (2012-2015)

	EUR	JPY	USD	CNY	VND
EUR	1				
JPY	-0.2973	1			
USD	0.7636	-0.0080	1		
CNY	0.7907	-0.1251	0.9887	1	
VND	0.7349	0.0604	0.9942	0.9767	1

Source: RongViet Research calculates

In recent years, solution for currency exchange rate policy problem is the balance between: (1) trade balance; (2) inflation and interest rate; (3) national debt. On the other hand, a main tool to intervene FX rate is the foreign reserve, which is quite lower than other countries' sources. Hence, it would be a harder task when a new variable, movement of CNY is added.

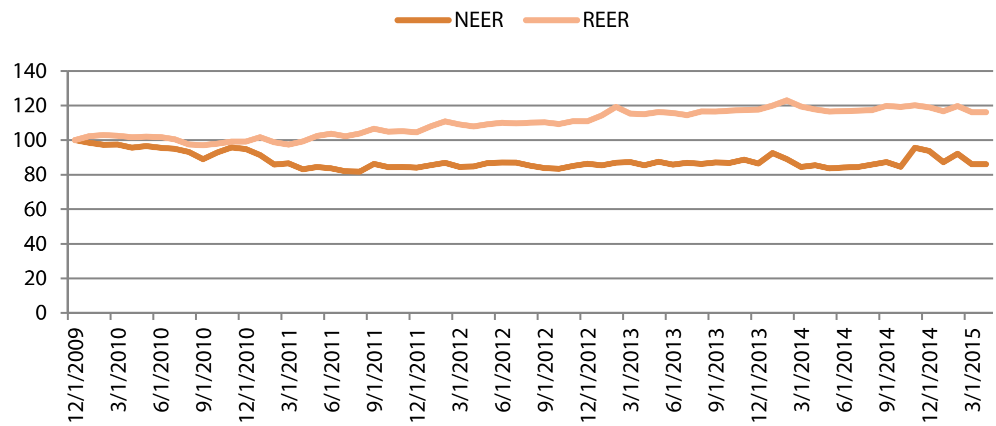
- Trade balance: temporarily stabilizes after recent exchange rate adjustment and is expected to grow in developed markets.

- Inflation: commodity prices, which are on steady decline, are factors to maintain inflation rate at low level.

- Interest rate: is not materially affected due to low inflation rate; however, VND depreciation expect might disinterest VND deposits in the context of growing borrowing demand till the end of 2015. These two elements might encourage depository rate to climb up 0.5-1%/year and threaten the possibility of slowing down lending rates.

- National debt: recent currency exchange rate adjustment boost up risk of debt crisis to 1 year earlier. (Box 1)

Figure 17: NEER/REER of Vietnam Dong since 2010



Source: RongViet Research

According to RongViet Research, the most risky scenario is the sharp devaluation of renminbi (scenario 3), then the macro-economic stability will be seriously affected. For the remaining two scenarios (1&2), we think that the SBV may continue to adjust flexibly in ways that has been used recently.

So far, VND has dropped more than 5% in correlation with a 5% devaluation of CNY. Not until the end of 2015 that we expect another FX rate adjustment from SBV. Though risk of devaluation is likely to step in next year, we do not think policy makers get ready for a floating system. Another scenario that is worth concerning is +/-5% volatility for VND along with adjusted average exchange rates and SBV's regulations at some time or another.

Will TPP likely be affected after Renminbi devaluation?

After Renminbi devaluation, the devaluations of renminbi and other currencies likely stir intense concern, as US officials have complained the currency controls in free trade agreements. This leads to the more and more challenge of TPP prospect.

According to Peterson Institute for International Economic' s estimates, in recent years, growing US trade deficit with China and other Asian countries (Singapore, Malaysia, Japan - these countries are supposed currency manipulation to support their own exports) led to an employment loss of 2.3-2.8 million in the US. It is the reason for US two parties had a strong support for the regulations on currency manipulation when considering the free trade agreements. Based on the recent renminbi movement, a research supposed that if renminbi devaluates 10%, US GDP growth rate will fall 0.32%, the trade deficit will increase to USD44 billion and 430,000 jobs will be cut in the next 2-3 years. Besides, although China is not TPP membership, some concerns related to the impact " a series of competitive devaluations" after renminbi devaluation to some TPP members (Vietnam, Malaysia ...) cause the argument for the regulations on the currency controls.

It seems that exchange rate is the major factor towards trade and economic growth between two economies in the context of recent globalization. However, we believe that if the regulations in terms of currency control are implemented in the free trade agreements, they will become the "poison pill" that leads to the fail of Trade liberalization. In essence, it might unlikely reduce US trade deficit if implement the regulations of currency controls, because the reason likely came from the debt as well as consumer features there. Furthermore, due to the market size of TPP and other economic characteristics as well as exchange rate mechanisms, putting into action currency controls could lead to the fail of negotiations. Another fact is that after Chinese exchange rate moved into a managed floating exchange rate regime, NDT movement seems contrary to US allegations that renminbi is undervalued. Thus, although having many supporters, the US, which is the country established TPP, likely will fail to achieve TPP deal if implement the regulation of currency controls.

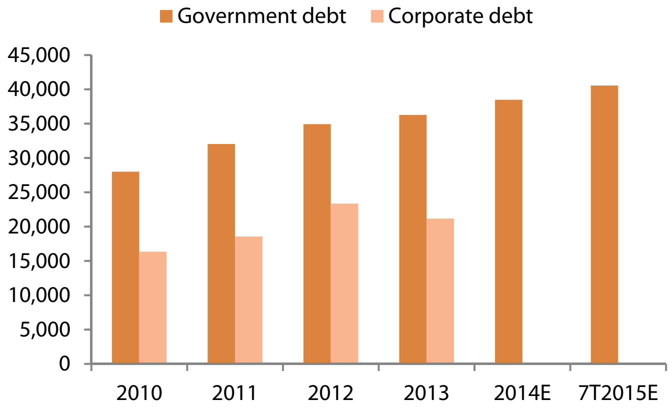
Also, to determine whether TPP prospect has been affected by new arguments given, we need to consider more information when Congress approved vote on fast-track TPA. The result of the currency manipulation amendment offered by Stabenow and Portman fail by a vote of 48 to 51. Therefore, it is positive when TPA approved and will put into action since 2020. It means that after achieving TPP deal, US Congress has only right to approve or reject, but without right to change terms in TPP deal.

Currently, the appropriate period to achieve TPP deal in 2015 has passed through after TPP Trade Ministers can unlikely resolve existed disagreement on July meeting. TPP protest wave in many countries as well as the scheduled Canada and US elections might become a barrier to achieve TPP deal. Therefore, it seems that at the end of 2015, TPP deal might delay. TPP has not only consist of economic , but also political factors in terms of the US's strategy transferring pillar towards Asian, which results in controversy over TPP. In our opinion, the preparation of Vietnam is more important to achieve TPP's terms and conditions rather than the time when TPP deal complete.

Box 1: The recent exchange rate adjustment could make the public debt crisis come 1 year earlier

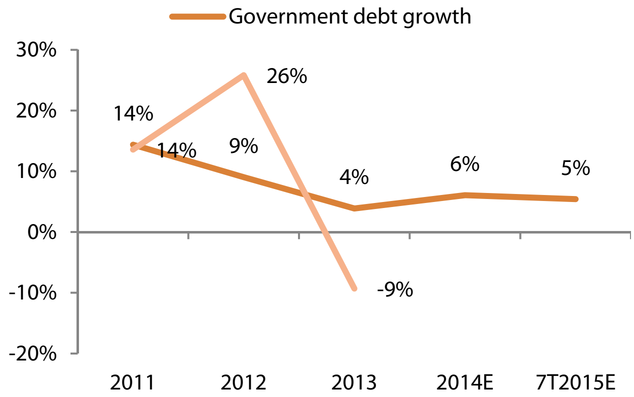
According to World Bank, by the end of 2014, total outstanding public debt of Vietnam has been estimated at USD 110 billion, equivalent to 59.6% of GDP. Regarding debt structure, foreign debt of the Government is stable around 27-28% of GDP, accounts for ½ of total outstanding debt of Vietnam. Over the last few year, the rate of domestic debt has rapidly increased but the growth rate of foreign loan slowed down at 5% average.

Figure 18: Foreign government and corporate debt



Source: MoF, RongViet Research estimates

Figure 19: Foreign debt growth



Source: MoF, RongViet Research estimates

According to our estimation, debts in USD accounted for approximately 30-35% of foreign debt structure. Loan in JPY has been equivalent to loan in USD and EUR debt accounted for 6-7% of total outstanding loan. Based on the movement of currency pairs since earlier this year, the principal repayment obligations in domestic currency could increase by VND 15,000 – 20,000 billion after the exchange rate fluctuation. However, this impact could be distributed over time based on repayment period. In short-term, Vietnam has to pay about USD 1.5 billion in order to meet the principal and interest obligation on foreign debts. Relative estimation demonstrated the possible VND 1,000 billion increase in debt repayment after recent currency adjustments. In 2016, principal and debt repayment of USD 2.5 billion with exchange rate risk could create significant pressure on the budget if there will be no solution for additional funding in the upcoming year.

Based on the research of National Assembly Economic Committee and UNDP about Public debt and the stability in Vietnam, we believe that the basic budget deficit/GDP in 2015 will be estimated at 2%. Under the positive* scenario, Vietnam public debt could reach the threshold at 65% in 2019. Simulation of public debt ratio under exchange rate demonstrated that 1% of depreciation in domestic currency could increase the public debt by 0.8%. Therefore, after the exchange rate adjustments, the risk of debt crisis could come a year sooner.

** Positive scenario during 2012 – 2020 as follow:*

+ Economic growth: 6%

+ Inflation: 6%

+ Change in USDVND: 4%

+ New interest rate for new domestic debts: 9%

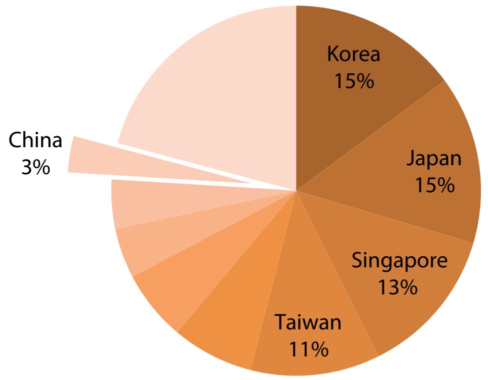
+ New interest rate for new foreign debts: 3%

THE EFFECTS OF CHINA SLOWDOWN

- For Vietnam FDI
- For FED rate hike

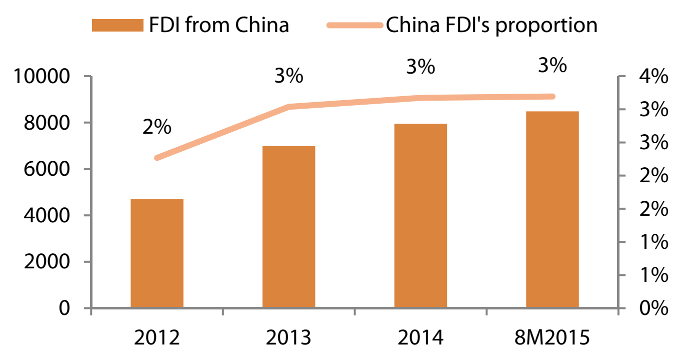
The decline in Chinese economic growth could not affect the foreign capital flow in Vietnam. According to the statistics from Foreign Investment Agency until the end of 08/2015, total registered direct capital reached approximately USD 266 billion. Particularly, the registered capital from China only accounted for 3% of total capital with 1,177 projects which value at USD 8.5 billion. Compared to early 2015, FDI growth mainly came from Korea (+15% compared to late 2014). Meanwhile, the growth of registered capital from China recorded the second highest figure (~7% compared to late 2014). With such results, the decline in China economic growth could not affect the foreign investment in Vietnam. In Asia region, Vietnam is in the second rank in term of attracting FDI thanks to the cheap and young labor force, large and potential consumer markets. As a result, based on current conditions, we are still optimistic about the prospect of attracting FDI in short-term and intermediate.

Figure 20: Vietnam FDI by countries



Source: RongViet Research

Figure 21: FDI flow from China



Source: RongViet Research

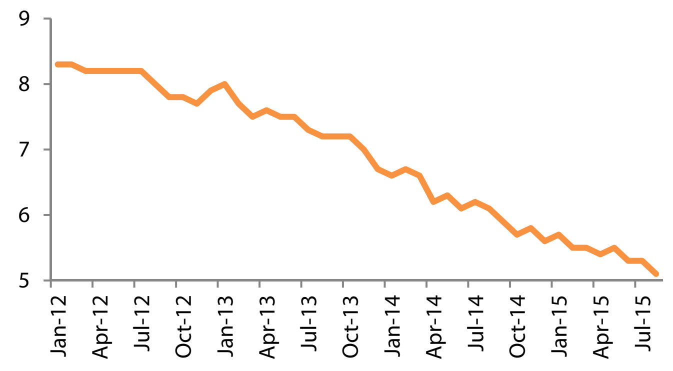
FED hiking rates affected by slower growth of China's economy

After PBoC's currency change, concerns due to FED hike interest rate at next FOMC's meeting in September are mainly on: (1) commodity plunge affecting FED's target inflation; (2) negative global economic prospect causing problem for US economic recovery. According to CMEGroup's survey, probability of FED's decision on lifting interest rate was 45% before PBoC's announcement but is currently 23.6%, with the probability calculated on data of futures contracts.

Investors gave hope on The August report released by the US Bureau of Labor Statistics could unveal some information relating to timing of FED raising interest rate. However, the mixed signals from the jobs report did not give a clear view on the ability that the rate could be increased. Specifically, total nonfarm payroll employment increased by 173,000 in August, which was lower than the forecast of 220,000 jobs and was the lowest growth rate in five months. However, the US unemployment rate decreased to 5.1%, its lowest level since April 2008. Moreover, the US's core inflation as counted to July 2015 remained low at 1.2%, below the Fed's 2% target.

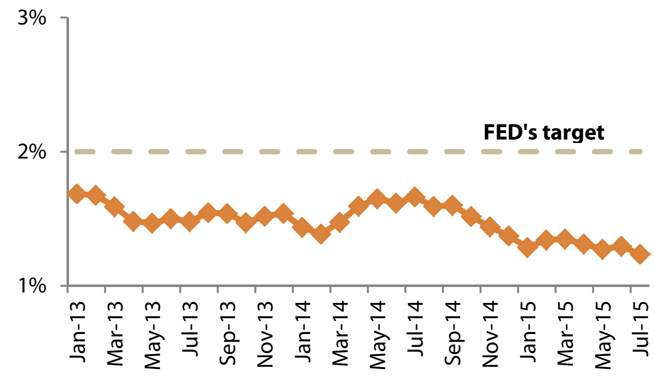
There are currently three scenarios due to Fed hike interest rate: (1) the Fed will raise interest rates with a modest increase in September, 2015; (2) Fed will wait until releasing Q32015 US GDP growth and might hike interest rate in December, 2015; (3) Fed will raise interest rates next year.

Figure 22: Unemployment rate



Source: BLS

Figure 23: PCE core inflation



Source: BEA

Fed rate hike in September cause the strengthen USD while China has changed the exchange rate policy which could be the risk for Vietnam. In contrast, the delay to hike the interest in US could the positivity in short-term. Particularly, there are 3 factors could be expected to maintain the stability if FED will not increase the interest rate this year: (1) exchange rate; (2) interest rate; (3) indirect capital flow. But we think it is not a significant risk now.

Arguments for FED raises interest rate

+ US interest rate has remained at 0% for a long time (six years). Extending this condition might lead to unpredictable risks for the financial market.

+ US labor market witnessed a positive recovery. Unemployment rate plunged to 5.1% and Q2/2015 GDP growth rate increased by 3.7%. US economy has reached full employment.

+ The US average wage growth increased by 0.3% in August, compared to the same period of 2.5%

Arguments against FED raises interest rate

+ China and EM 's economic slowdown had negative effects on the recovery of US economy.

+ Lowering commodity prices might affect US targeted inflation rate. US core inflation rate remained at 1.2%, lowering than 2% FED's target.

+ Regarding Goldman Sachs, a 10% decrease in stock market will lead to a 0.15% decrease in US interest rate. S&P 500 index went down 9% since PBoC's new exchange rate policy.

Table 5: Where every Fed member stands on raising interest rates

Voters	View
Chairwoman Janet Yellen	Told Congress in July that a rate hike this year would likely be appropriate.
Vice Chair Stanley Fischer	In an interview Friday, he said it is early to tell if case for rate hike was more compelling or less compelling. Before China renminbi move, Fischer said case for September hike was "pretty strong" but not conclusive. He says level of confidence "pretty high" inflation will return to 2% target.
Gov. Lael Brainard	Said in June that the Fed should give the data time to show labor-market progress, inflation rising.
Gov. Jerome Powell	Said in early August that he's not sure whether to support a September rate hike.
Gov. Daniel Tarullo	Said in June that the U.S. economy has lost momentum.
New York Fed President William Dudley	In August, 26, a rate hike is "less compelling" than a few weeks ago.
Chicago Fed President Charles Evans	Didn't want rate hikes until middle of next year, as of July.
Richmond Fed President Jeffrey Lacker	Lacker said the labor market was strong enough and inflation running fast enough to justify a rate hike.

Atlanta Fed President Dennis Lockhart	Sees even odds of a September rate increase.
San Francisco Fed President John Williams	He's not even sure the Fed will raise rates once this year— and previously, had said two hikes were possible.

Source: Marketwatch

Appendix: China export growth with important trade partners (01/2014-07/2015)

	China	US	Japan	Korean	Vietnam	EU	Brazil	India	Russia	Philippines	Indonesia	Singapore	Malaysia	Thailand	Australia
Jan-14	11	3	9	0	-11	0	0	4	2	-4	-6	4	12	-2	19
Feb-14	-18	0	10	1	12	2	2	-5	-13	11	-3	11	12	2	16
Mar-14	-7	4	2	4	14	1	-9	-5	6	12	1	8	8	-4	11
Apr-14	1	4	5	9	17	0	-4	5	7	1	-3	6	19	-1	9
May-14	7	5	-3	-2	15	0	-5	12	8	16	-8	-1	16	-2	-2
Jun-14	7	3	-2	2	15	1	-3	10	-3	22	4	4	8	3	-1
Jul-14	14	4	4	5	14	2	11	7	6	12	-6	-2	1	-1	1
Aug-14	9	4	-1	0	14	-1	-4	2	-3	10	11	-1	2	-7	-4
Sep-14	15	3	7	6	14	5	-6	3	-15	16	4	-2	2	3	-4
Oct-14	12	2	10	2	13	2	-20	-5	-4	2	-2	-7	-3	4	-2
Nov-14	5	1	5	-3	14	1	-25	7	-22	20	-15	-3	2	-1	-1
Dec-14	10	1	13	3	14	3	-16	-4	-23	-3	-14	-1	3	2	-4
Jan-15	-3	-2	17	-1	10	-4	-14	-11	-30	0	-8	-2	-1	-3	-7
Feb-15	48	-1	3	-3	9	1	-24	-15	-20	-3	-17	-16	-10	-6	-6
Mar-15	-15	-4	9	-5	7	6	-4	-21	-30	2	-10	1	2	-4	-6
Apr-15	-6	-3	8	-8	8	2	-23	-14	-34	-4	-8	-9	-9	-2	-10
May-15	-3	-4	2	-11	7	1	-19	-20	-30	-17	-14	-10	-7	-5	-3
Jun-15	3	-4	10	-2	9		-4	-16	-26	-3	-13	-6	5	-8	1
Jul-15	-8			-3	10		-20	-10				-4			

Source: Bloomberg. RongViet Research

09/11/2015

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