3rd August 2022

Special Report

TAKE A SHORT BREAK BEFORE TRYING AGAIN

- *Currently, we expect the low base effect to show more clearly in Aug-Sep 2022 for industrial production. However, tracking monthly fluctuations and PMI movements will be more important in assessing the growth dynamics of the manufacturing sector in the coming months.*
- *While industrial production has shown signs of a slowdown in growth, the service sector continues to recover positively in the post-pandemic period.*
- *Looking forward we expect that 1) the SBV will strictly control the liquidity of the dong in the system from now until the end of the year to ease pressure on the exchange rate and 2) the borrowing from the SBV will is no longer as cheap as before because banks with liquidity shortages are forced to bid to borrow at a higher cost, and 3) a tightening of monetary policy environment even though the State Bank has not taken any action to raise the key interest rates.*
- *The advantage is that Vietnam's inflation is still moving within the acceptable range thanks to the recent fall in global oil price, economic growth in 2022 is not worrying thanks to the low base effect. However, the economic picture in 2023 is gradually revealing with many difficulties ahead, prioritizing inflation control and stabilizing growth is unlikely to go hand in hand next year.*

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MAIN CONTENTS

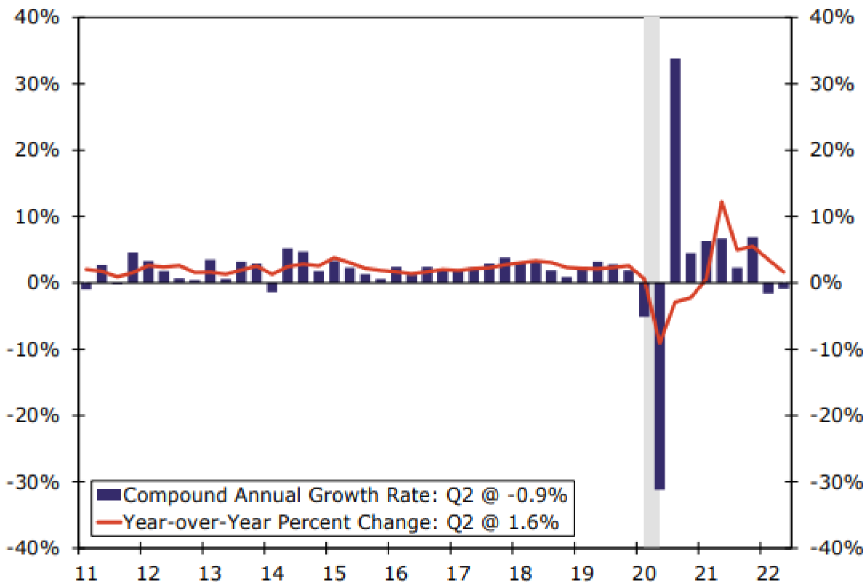
The end of aggressive Fed tightening?

- Data released in late July showed that US economic growth modestly contracted in Q2.
- Fed tightening expectations peaked in mid-June.
- Bond yields have collapsed in certain economies.

Over the past several months, concerns about the global economic outlook have intensified, and predications of possible recessions around the world have become more widespread. Official recessions are determined using several economic indicators and not just GDP. Some of these other indicators, such as nonfarm payrolls or employment, industrial production and so on, have been decisively strong in recent months in many countries. In our view, debates around the exact definition of a recession misses the forest for the trees. It appears the global economy is decelerating but not collapsing at present.

The baseline forecast for global growth is for it to slow from 6.1% last year, to 3.2% in 2022 – 0.4% lower than forecasted in the last IMF Outlook update in April. As for the current state of the US economy, it is hard to make a conclusive case that it has entered a downturn even though the last two quarters have seen GDP decline (Figure 1).

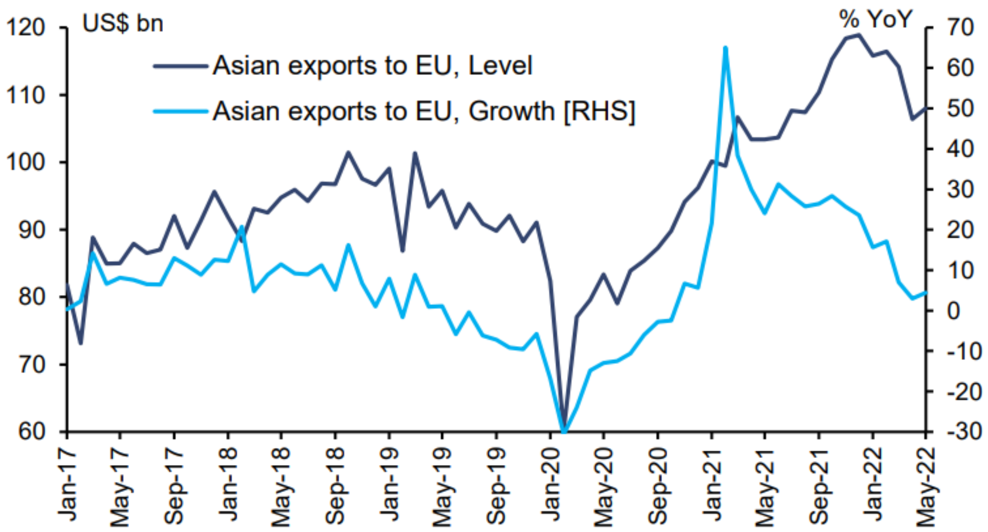
Figure 1. US real GDP growth



Source: Wells Fargo Economics

In Asia and the Pacific, the IMF projects that economic growth will decelerate to 4.2% this year, 0.7 percentage points less than forecasted in April and slower than the 6.5% growth in 2021. As can be seen from Figure 2, Asian exports to the EU has been trending down in the past few months, reinforcing the point that there is definitely a slowdown.

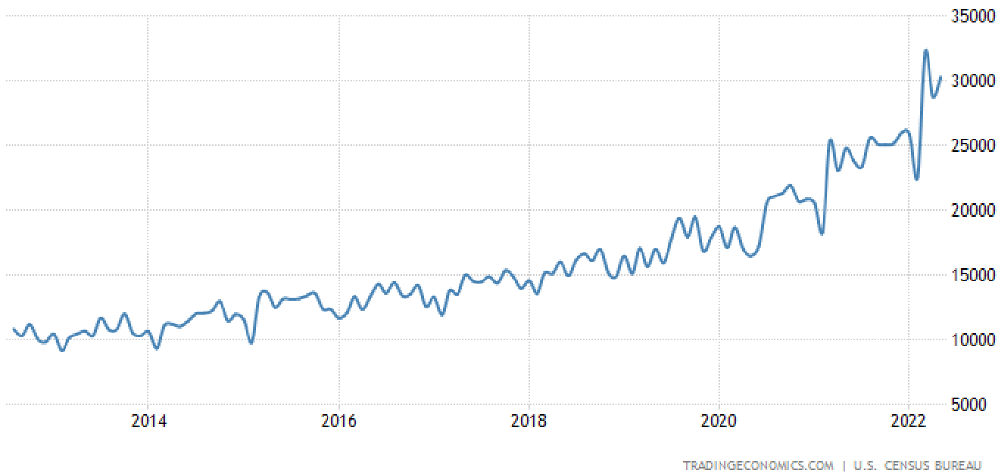
Figure 2.



Source: Alatheia Capital

US imports from ASEAN are still running strong but the momentum appears to be slowing (Figure 3).

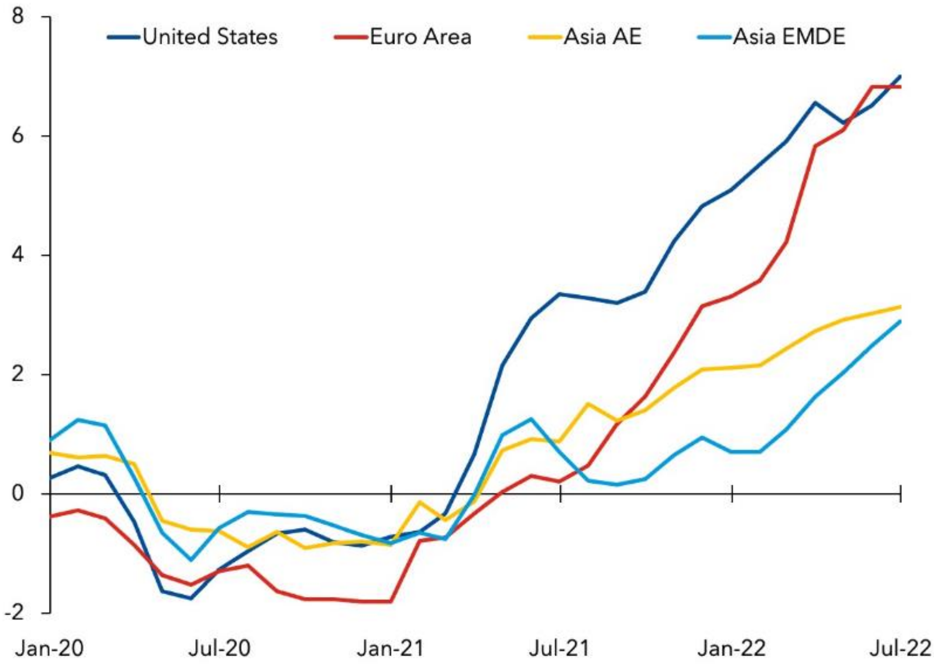
Figure 3. US imports from ASEAN, nominal USD bn



Having talked about economic slowdown or recessions, the fact of the matter is that the Fed remains a long way from its goal of 2% inflation. The PCE deflator, which is the Fed's preferred measure of inflation, rose to 6.8% on a year-over-year basis in June. This marked yet another cycle high for the measure. The Employment Cost Index was also released in late July and showed the cost of labor was up 1.3% over the quarter in Q2. We believe wage growth and inflation more broadly will start to slow in Q3, but we think it will take time to fully revert to more sustainable levels, and as a result the road ahead for the economy looks to be a bumpy one.

Asia's growing inflation pressures remain more moderate compared with other regions, but price increases in many countries have been moving above central bank targets (Figure 4). Maybe central bank targets in the US and EU are/ were way too low…

Figure 4. Annual inflation deviation from central bank targets, %

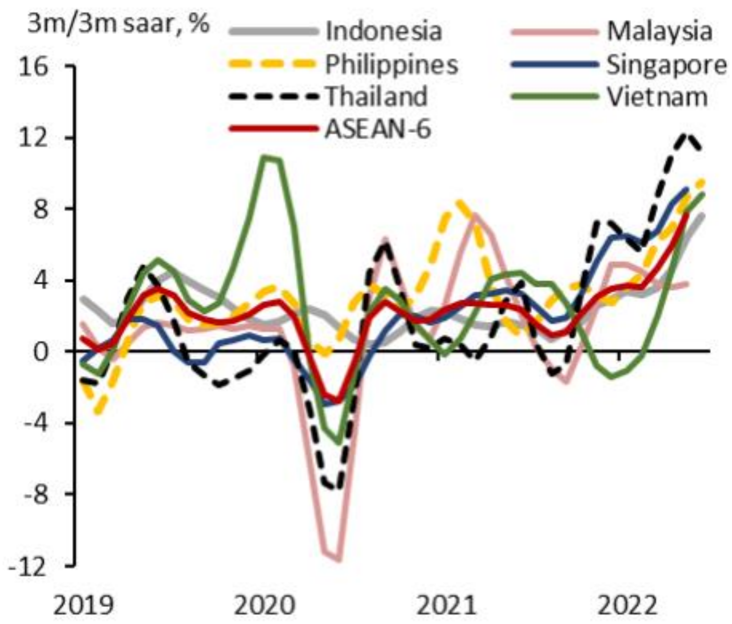


Source: IMF

Notes: Advanced Asia includes Australia, Hong Kong, Japan, Korea, NZ, Singapore, Taiwan. Asia EMDE includes China, India, Indonesia, Malaysia, Philippines, Thailand, Vietnam.

Having said that, inflation momentum in the ASEAN-6 countries continues to push north into mid-year (Figure 5) as the lagged impact of higher commodity prices feeds through headline readings. With commodity prices down 10%-40% in recent weeks, momentum is likely to peak in 3Q22.

Figure 5. CPI inflation momentum in ASEAN 6



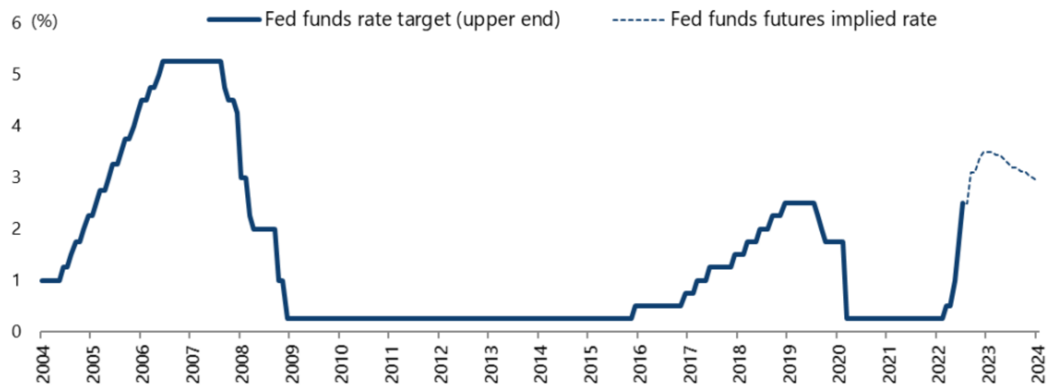
Source: DBS

The current juncture resembles the 1970s in three key aspects: persistent supply-side disturbances fueling inflation, preceded by a protracted period of highly accommodative monetary policy in major advanced economies, prospects for weakening growth, and vulnerabilities that emerging market and developing economies face with respect to the monetary policy tightening that was needed to rein in inflation.

However, the ongoing episode also differs from the 1970s in multiple dimensions: the US dollar is strong, a sharp contrast with its severe weakness in the 1970s; the percentage increases in commodity prices are smaller; and the balance sheets of major financial institutions are generally strong. More importantly, unlike the 1970s, central banks in advanced economies and many developing economies now have clear mandates for price stability, and, over the past three decades, they have established a credible track record of achieving their inflation targets.

There is no doubt that financial markets have been in an awful hurry to price in the peaking out of inflation and the end of Fed tightening. Fed tightening expectations peaked in mid-June at 4% in early 2023 (Figure 6) while money markets are now discounting 50bp of easing next year after the federal funds rate peaks at an assumed 3.25-3.5% in December, or 100bp above the current level following the 75bp hike in July to 2.25-2.5%.

Figure 6: Fed funds rate target and Fed funds futures implied rate



Source: Bloomberg

There was, however, unsurprisingly no change in language, in terms of a significant increase in dovishness, at the July Fed meeting. Still the Chairman did enough to raise hopes of a moderation in the Fed's stance by stating in his post-meeting press conference: "While another unusually large increase could be appropriate at our next meeting, that is a decision that will depend on the data we get between now and then ... As the stance of monetary policy tightens further, it likely will become appropriate to slow the pace of increases."

Bond markets in many countries, rightly or wrongly, seem to be pricing in a recession. Hence in Germany, 10-yr bond yields have fallen over 50% since their highest level in June (Table 1). This is quite a reversal and might lead to the Fed and ECB to be a bit more moderate on the 'language' they adopt in the next few weeks.

Table 1. 10-yr bond yields, % change since June

	July 29	June top	% change
Germany	0.83%	1.77%	-53
France	1.39	2.40	-42
Japan	0.18	0.26	-31
US	2.65	3.47	-24
Korea	3.13	3.78	-18
Singapore	2.65	3.22	-18

Source: TradingView

Bottom line:

With higher-than-expected inflation – especially in the US and the largest European economies – global financial conditions are becoming tighter. This implies that at this point either the bond market is right (lower yields) or confused by the language and message that central banks are sending.

Since 1955 the US economy has always experienced a recession within two years from every quarter in which inflation was above 4% and unemployment was below 5%, as they are today…

VIETNAM ECONOMY

- Signaling the modest growth momentum of the manufacturing sector
- The exchange rate pressure has cooled down in the short term, but there are still many challenges in monetary policy management ahead

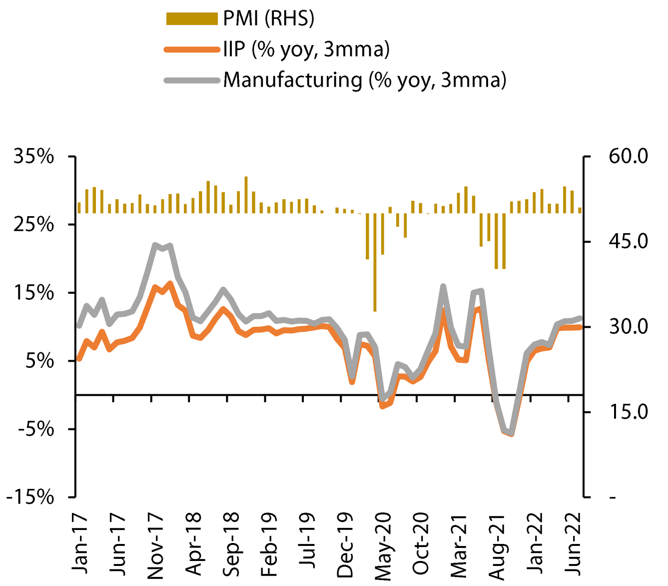
Signaling the modest growth momentum of the manufacturing sector

Industrial production growth in Jun was revised down to 9.1% compared to the estimate of 11.5%, of which, the manufacturing and processing industry only increased by 9.9% compared to the estimated number of 13.1%. Industries with a sharp decline in industrial output compared to estimates in order from highest to lowest include metal manufacturing, bed and furniture manufacturing, motor vehicle manufacturing, textiles, and food processing. According to GSO estimates, industrial production growth in Jul is estimated to increase by 11.2%, and 1.6% higher than the adjusted data of Jun. Most industries in the manufacturing and processing industry all grew sharply over the same period due to low base effects, however, there were still some sectors recording negative growth in Jul such as rubber products and other means of transport. Particularly, the metal production industry in Jul 2022 recorded negative growth of 6.4% over the same period, partly due to a relatively high growth rate in the same period last year. Even so, the month-on-month trend also confirmed the weakness in the metal manufacturing industry with a decline of 8.6% mom.

Vietnam's main export sectors such as electronics, textiles, and footwear are still showing signs of expansion in manufacturing activity. However, it should be noted that the picture of new orders growth in the coming months is quite challenging, with global PMI data showing new orders in Jul 2022 falling for the first time since June 2020. In Asia, new orders fell to the lowest level since Aug 2021, for Vietnam, the expansion of new orders is not as strong as at the beginning of the year. Currently, we expect the low base effect to show more clearly in Aug-Sep 2022 for industrial production. However, tracking monthly fluctuations and PMI movements will be more important in assessing the growth dynamics of the manufacturing sector in the coming months.

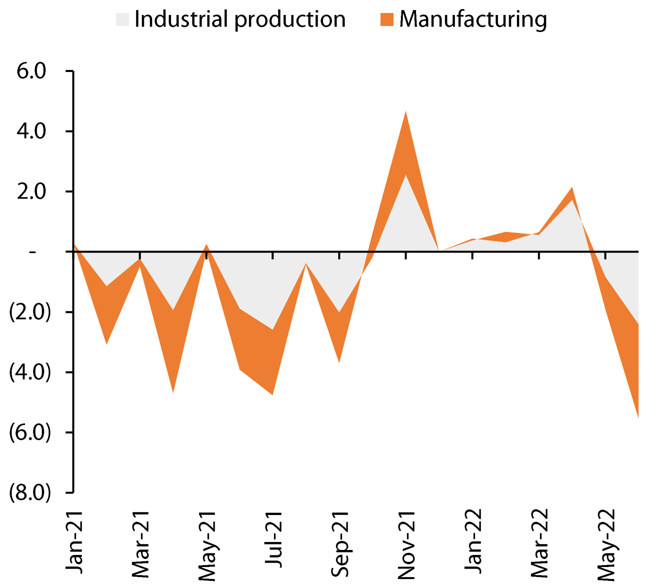
While industrial production has shown signs of a slowdown in growth, the service sector continues to recover positively in the post-pandemic period. The growth of retail sales of goods and services reached 42.6% over the same period, of which the growth of retail sales of goods was 29.4% and services was 127.8%. Retail sales of catering and accommodation services have returned to their pre-pandemic scale, while tourism is also close to pre-pandemic levels, barring the international arrivals in Jul 2022 equivalent to only 27% of visitors in the same period in 2019.

Figure 7: Vietnam's manufacturing growth



Source: GSO, Rong Viet Securities

Figure 8: Gap between the official and estimated data for industrial production*

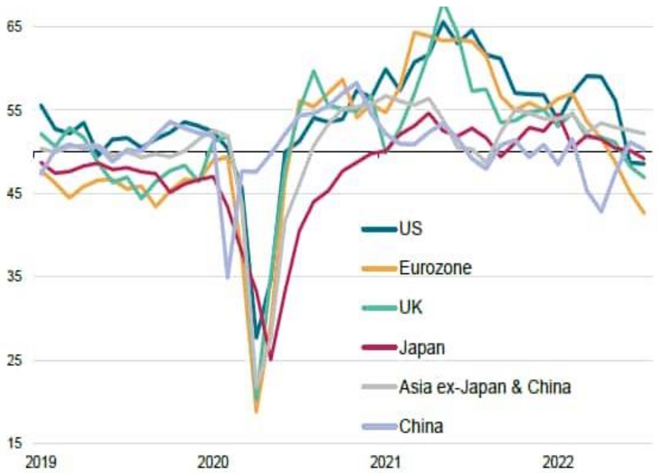


*Source: GSO, Rong Viet Securities, *negative gap indicates a slowdown in manufacturing activities*

Figure 9: Global trade growth

Source: S&P Global, CPB World Trade Monitor, Rong Viet Securities

Figure 10: Manufacturing new orders by economy



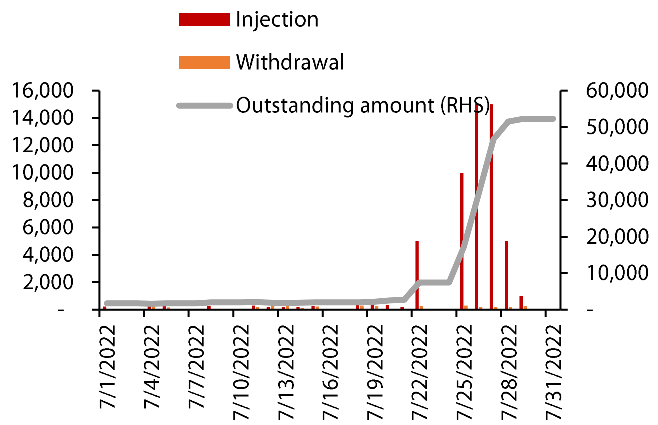
Source: S&P Global, Rong Viet Securities

The exchange rate pressure has cooled down in the short term, but there are still many challenges in monetary policy management ahead

July ended with many important macro events and data around the world, notably that both the Fed and the ECB in the latest meeting decided to raise their regulatory interest rate by 75 basis points and 50 basis points, respectively to cope with persistent inflation, which set a new record in Jul with a year-on-year increase of 9.1% in the US and 8.9% in the EU. Meanwhile, the economic growth picture is not very positive as shown by the GDP growth figures in the second quarter of 2022 in the world's two largest economies, the Chinese economy grew only 0.4% yoy, while the US economy recorded a negative growth rate of 0.9% qoq SAAR. With rising fear of economic recession, Brent oil price in Jul decreased by 3.7% compared to the end of last month and approached the level of $100/barrel in the early days of Aug, the DXY index increased at the beginning of the month but decreased slightly after the Fed meeting, for the whole month of Jul 2022, the USD gained 1.6% against other currencies in the DXY index basket. During the rest of the year, the global economic picture still has many risks and uncertainties surrounding: 1) risks of economic recession; 2) whether inflation can be dragged down; 3) the race to raise interest rates among global central banks and 4) prolonged political instability related to the Russian-Ukrainian war. In the baseline scenario, the world outlook is fundamentally shaped by: firstly, global economic growth would decline, recession risks are especially high in the EU but the recession story in the US is still questionable; secondly, inflation remains at a high level and therefore, pressure to raise interest rates from central banks will continue; finally, oil prices may fall in the short term but can rebound strongly as the tension between Western countries and Russia has not ended.

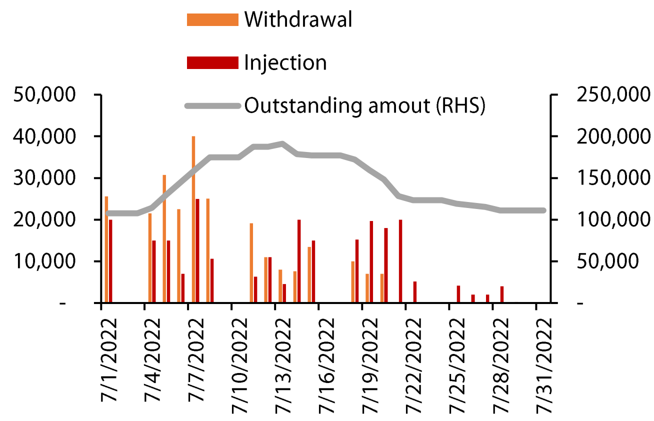
As for Vietnam's developments, in Jul 2022, the State Bank actively intervened through the open market and issued bills to regulate the liquidity of dong in the banking system; at the same time, helped to control the exchange rate pressure. Specifically, the issuance of bills is used continuously for one month from June 22 to July 21 in order to withdraw VND from the banking system across many tenors. As of Jul 31, the outstanding amount of bills is approximately VND111,000 billion, of which about VND87,000 billion will mature in the first half of Aug 2022, and the rest will mature in mid-Sep 2022. SBV-bills issuance started with short maturities and then extended to longer terms of 28 days and 56 days. In July, the State Bank also increased the selling price of USD from 23,250 VND to 23,400 VND and switched from selling USD through a 3-month term forward contract to a spot contract. The amount of USD sold in the past month was estimated at US$3.5 billion, equivalent to VND81,900 billion. As the amount of dong withdrawn from the system was too large from both T-bill and USD sales channels, in the last week of July, the SBV restored liquidity through reverse repo. The remarkable point is that the SBV withdrew money for long tenors but only injected liquidity support for the short-term tenor of 7 days; at the same time switched from volume bidding to interest rate bidding. The outstanding amount of reverse repo as of the end of July was over VND52,000 billion, a sudden high compared to the first half of the year, however, because they are all short tenor and the amount of money pumped back tends to be lower. As a result, the outstanding amount of reverse repo decreased to about VND29,500 billion as of Aug 2, 2022. The above developments give us some important implications: 1) the SBV will strictly control the liquidity of the dong in the system from now until the end of the year to ease pressure on the exchange rate and 2) the borrowing from the SBV will is no longer as cheap as before because banks with liquidity shortages are forced to bid to borrow at a higher cost. In addition, in Jul 2022, with the State Bank's announcement to keep the credit growth target for the whole 2022 at 14% while credit growth until July 26 was 9.4%, signaling a tightening of monetary policy even though the State Bank has not taken any action to raise the key interest rates.

Figure 11: The SBV's actions on the reverse repo channel



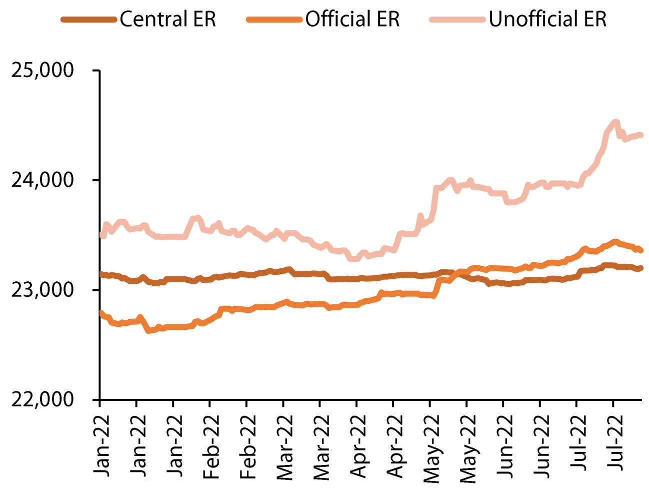
Source: SBV, Rong Viet Securities

Figure 12: The SBV's actions on the SBV bill channel



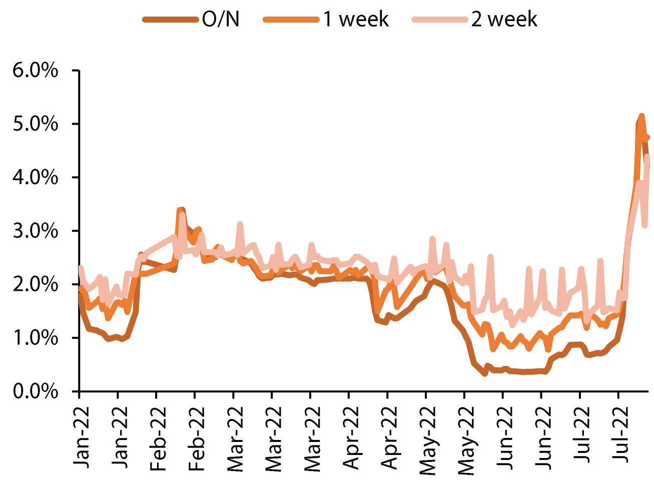
Source: SBV, Rong Viet Securities

Figure 13: USDVND exchange rate movements



Source: Bloomberg, FiinPro, Rong Viet Securities

Figure 14: VND interbank rates by tenor

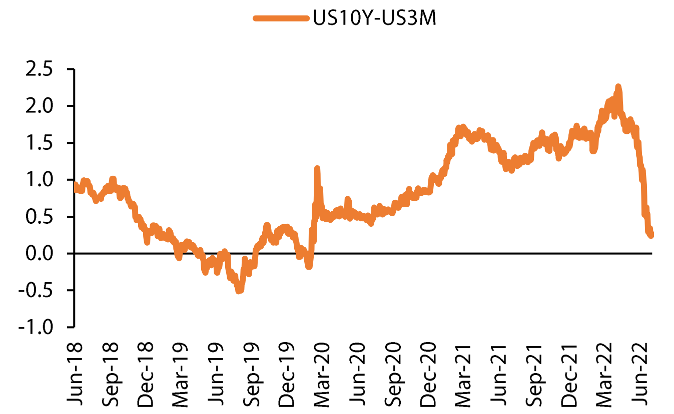


Source: SBV, Rong Viet Securities

Following the SBV's actions, the dong depreciation pressure showed signs of cooling down, as the interbank interest rate increased sharply to 4.0-5.0% range, making the difference between USD-VND in the interbank market reverse from negative to positive. The USDVND exchange rate narrowed its upward momentum from a peak of 2.7% to 2.3% at the end of Jul. From now until the end of the year, the SBV's monetary policy management still faces many challenges including 1) Fed will have a few more rate hikes with an expected increase of about 1.5-1.75% points in September, November, and December meetings, which will continue to be a supportive factor for USD demand; 2) deposit interest rates continue to increase, deposit growth catching up with credit growth, which will put pressure on liquidity regulation in the banking system; 3) the timing and extent of granting more credit room, if not skillfully, will affect the growth prospects in 2023 and 4) the poor outlook for exports and the global economy will make the supply of USD not abundant compared to previous years. The advantage is that Vietnam's inflation is still moving within the acceptable range thanks to the recent fall of global oil price, economic growth in 2022 is not worrying thanks to the low base effect. However, the economic picture in 2023 is gradually revealing with many difficulties ahead, prioritizing inflation control and stabilizing growth is unlikely to go hand in hand next year.

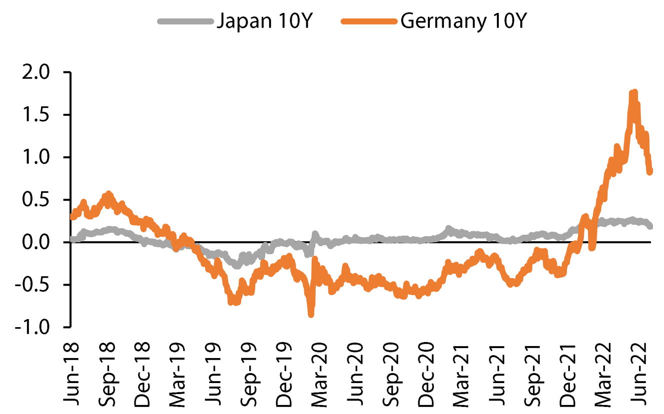
GLOBAL ECONOMIC INDICATORS IN JULY

US G-Bond yields gap (%/year)



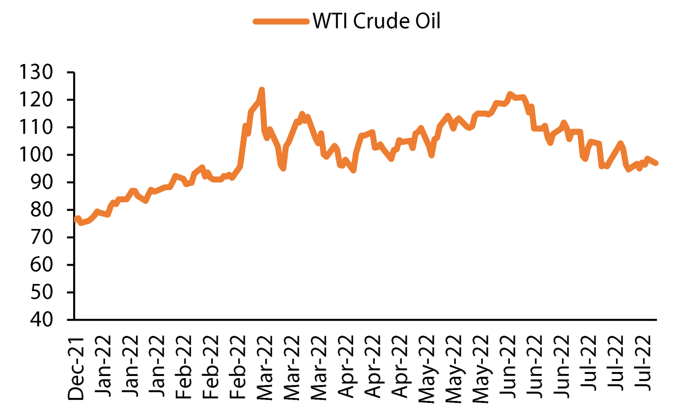
Source: Bloomberg, Rong Viet Securities

Germany and Japan 10Y G-Bond yields (%/year)



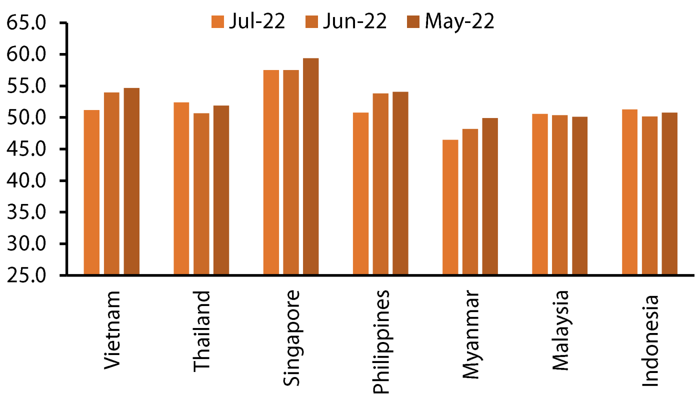
Source: Bloomberg, Rong Viet Securities

WTI crude oil price (USD/barrel)



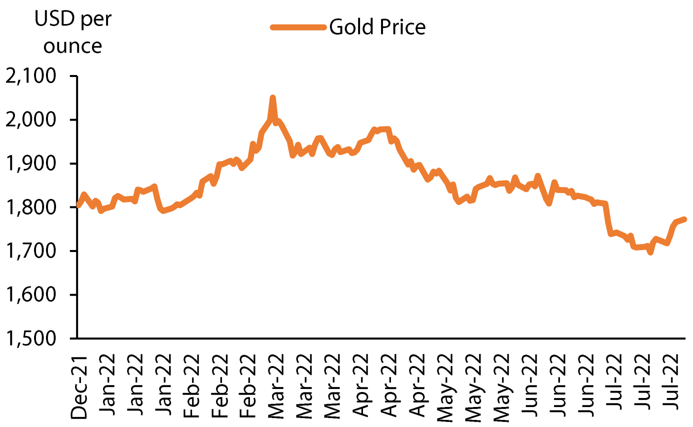
Source: Bloomberg, Rong Viet Securities

ASEAN's PMI



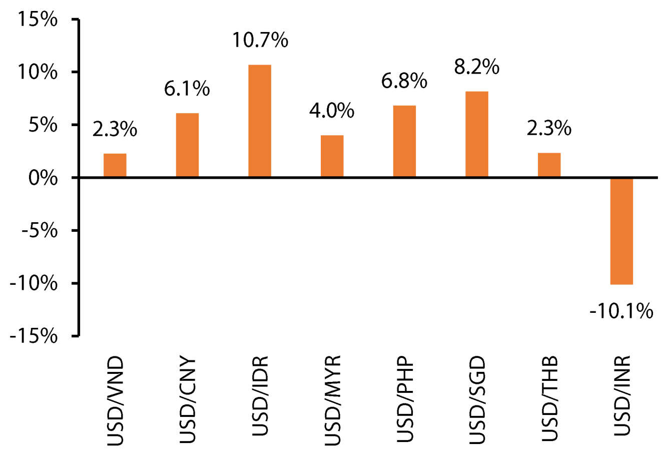
Source: Markit Economics, Rong Viet Securities

Gold prices (US$/ounce)



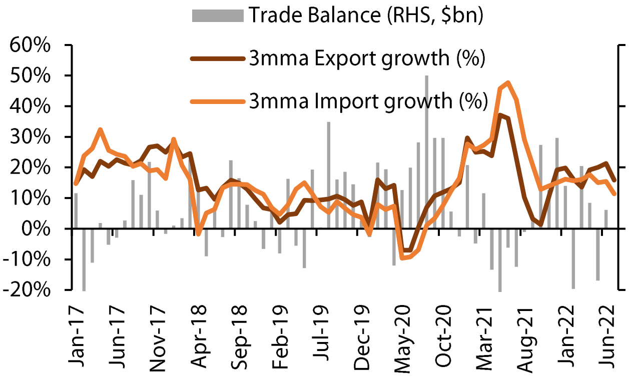
Source: Bloomberg, Rong Viet Securities

FX rates (%, YTD)



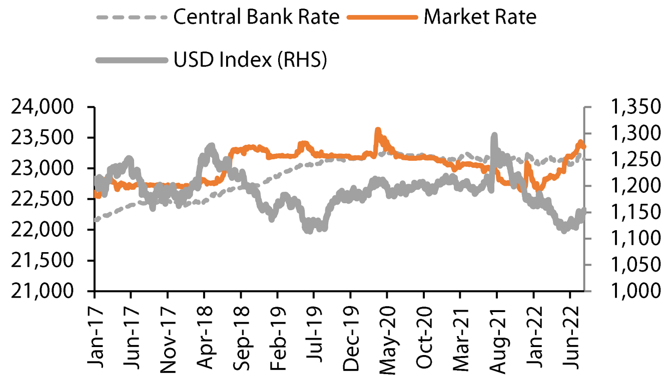
Source: Bloomberg, Rong Viet Securities

Trade balance



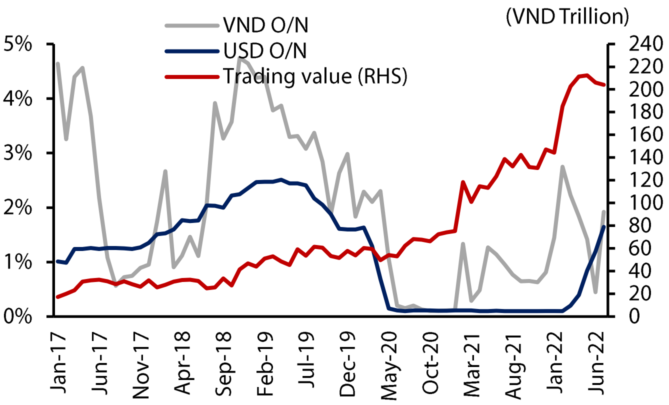
Source: GSO, Rong Viet Securities

USDVND exchange rate



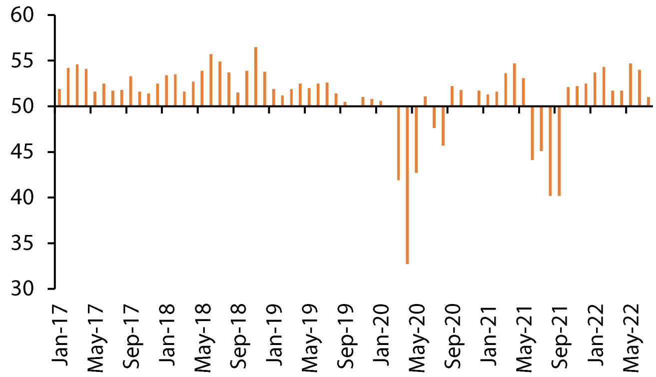
Source: SBV, Bloomberg, Rong Viet Securities

Interbank interest rate (%/year)



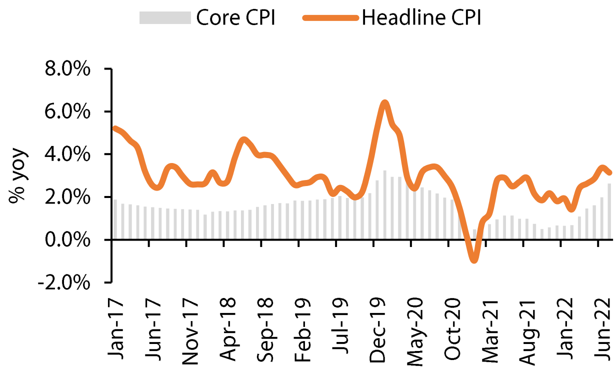
Source: SBV, Rong Viet Securities

Vietnam PMI



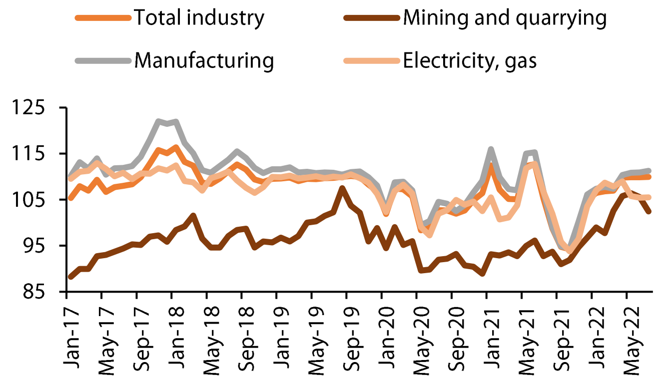
Source: IHS Markit, Rong Viet Securities

Vietnam CPI



Source: GSO, Rong Viet Securities

3-month MA Industrial Production Indices



Source: GSO, Rong Viet Securities

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