5th July, 2022

Special Report

# NAVIGATING THROUGH TURBULENCE

- *With economic growth in the second half of 2022 forecasted at more than 8.0%, we revise our forecast GDP growth this year from 6.5% to 7.5%. Some challenges that may restrain growth in the second half of the year include: 1) the negative picture of the world economy may negatively affect export growth and industrial production; 2) rising prices affect domestic demand; 3) some industry groups may not be as positive as the first half of the year such as finance, construction, and real estate and 4) risk of Covid-19 resurgence.*
- *The persistently high inflation is the factor that makes the growth picture of the world 2022-23 become less positive. This has led some analysts to forecast that the Fed's rate hike cycle may have to slow down or even lower rates as soon as this year if interest rates have been rising very quickly before.*
- *Looking to the second half of the year, USDVND exchange rate movements will depend heavily on the movements of two counterbalancing risks: 1) global inflation continues to remain at a higher level than expected and 2) recession risks in the US and world economies. Therefore, we still maintain the view that the dong may depreciate by 2.0-2.5% in the whole year of 2022. Therefore, we still maintain the view that the dong may depreciate by 2.0-2.5% in 2022. In the short term, as the gap between USD-VND interest rates was still high while other factors such as trade balance, USD inflows are not quite supportive, the USDVND exchange rate depreciation could be higher than our end-year exchange rate forecast.*
- *Currently, the SBV is still shouldering the burden of maintaining low-interest rates to support the economy's recovery in the post-Covid-19 period. With current inflation and exchange rate pressures, we think the SBV will need more time to observe before deciding to raise the regulatory interest rates. In the base scenario, we expect an increase in the regulatory rate to be done in early 2023 with an increase of 50 basis points. In a more cautious scenario, the SBV could raise interest rates sooner than expected in Q42022 if oil prices break $130/barrel and remain at this level long enough to push domestic inflation higher than we expected.*


Bernard Lapointe

bernard.lapointe@vdsc.com.vn

Ha My Tran

my.tth@vdsc.com.vn

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# GLOBAL ECONOMY

- Earning expectations are coming down… finally

## Earning expectations are coming down… finally

- The rise in global bond yields over the past six months has adjusted equity valuations.
- US consumer confidence fell in June to its lowest level since February 2021.
- Equity markets have become less correlated.

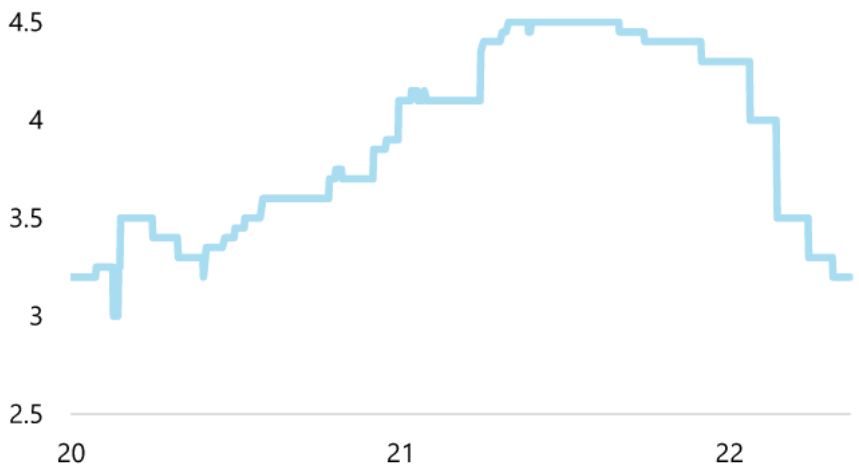
Global growth is trending down and is forecasted to stay soft well until 2023 (Table 1/ Figure 1). The Ukraine war adds to the series of supply shocks that have struck the global economy over the course of the pandemic, contributing to more shortages beyond the energy and agricultural sectors. Through closely integrated global supply chains, production disruptions in one country can very quickly cascade globally.

**Table 1: Real GDP growth, y/y, %**

| | 2021 A | 2022 F | 2023 F |
|---|---|---|---|
| **WORLD** | 6.1 | 3.6 | 3.6 |
| **US** | 5.7 | 3.2 | 2.3 |
| **EURO AREA** | 5.4 | 2.8 | 2.3 |
| **CHINA** | 8.1 | 4.2 | 5.1 |
| **JAPAN** | 1.6 | 2.2 | 2.2 |
| **INDIA** | 8.9 | 8.2 | 6.9 |
| **VIETNAM** | 2.6 | 6.0 | 7.2 |

*Source : IMF*

**Figure 1: World real GDP growth, y/y, %**




*Source: IMF, Bloomberg*

*Note: 2020-21 are actual, 2022 is forecasted*

We think the numbers above are way too optimistic. **We expect zero growth in developed economies in 2023.**

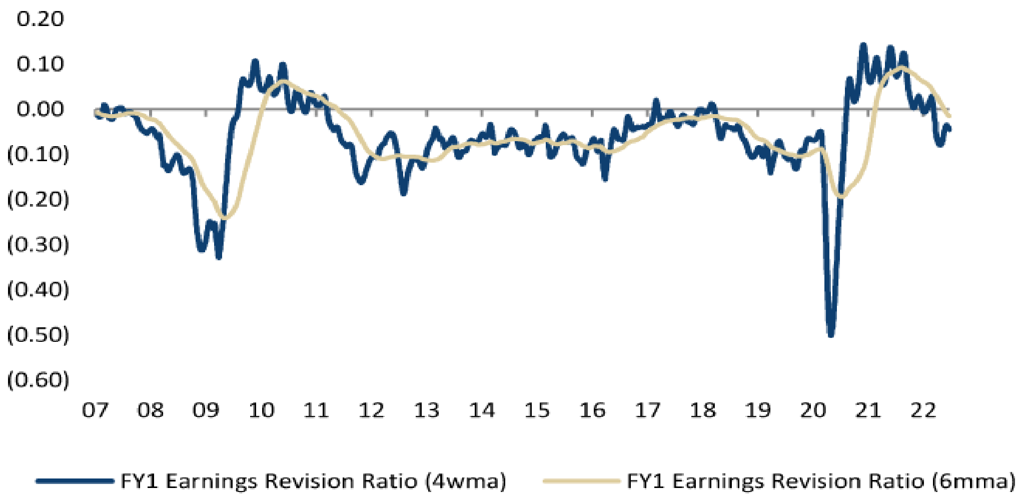
For Asian exporters both 2020 and 2021 were good years. Regional exporters benefited disproportionately from first, the pandemic lockdowns in advanced countries and then, the subsequent re-opening boom. Exports volumes soared and so did export prices. Many countries saw their market shares grow as demand shifted from services to goods and lockdowns hamstrung advanced country manufacturing sector activity.

The best is behind though. Exports are still rising but the rate of increase is lower (i.e. growth has been slowing steadily since March 2021). The risk now is that growth not only continues to slow fast but turns negative in coming months and quarters.

External debt distress will probably worsen in coming quarters. If this is the case, one should expect more IMF bailouts and restructurings. Sri Lanka's foreign debt default has dominated the news headlines. But other emerging market US dollar borrowers, including Pakistan, Belarus, Tajikistan, war-torn Ukraine, Ecuador, Kenya, Nigeria and Egypt are seeing bond yield spreads vis-à-vis US Treasuries widen and reach distress levels. Meanwhile Chinese property developers US dollar bond defaults have soared this year while Russia missed a final interest payment deadline of US$100m on its foreign-currency sovereign debt. China's defaults have been triggered by last year's property market regulatory crackdown and Russia's, the first since 1918, by international sanctions.

**So far in 2022 earnings deceleration has been relatively mild but is now appearing (Figure 2).** Hence, the danger is that investors are being misled by the sanguine slowdown with a glacial 'guidance' hinting at a soft-landing. Indeed, only China has seen actual EPS cuts over the past few quarters and accounts for the bulk of the global downgrades. Ironically, it is quite feasible that Chinese earnings will start to stabilize while the Rest-of-the World actually declines.

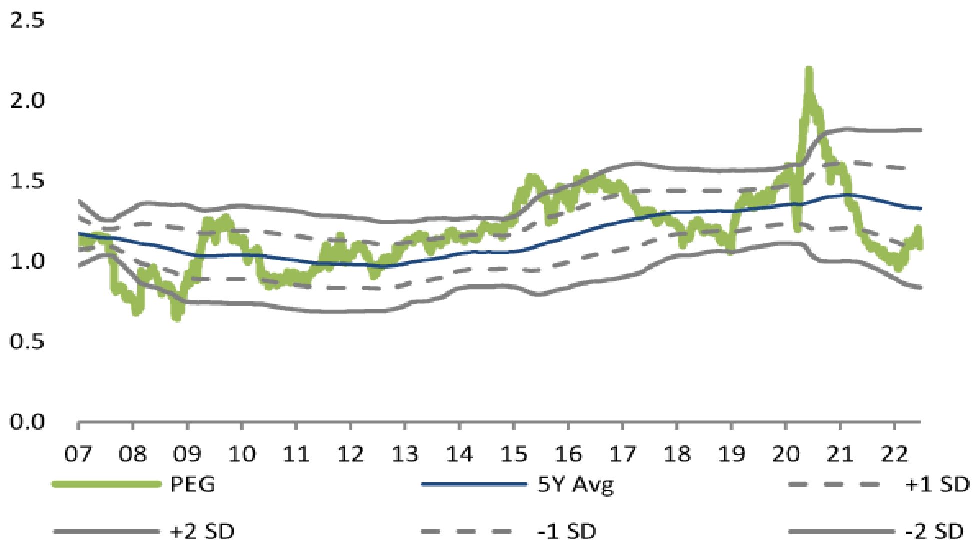
**Figure 2: Global EPS revision ratio**




*Source: FactSet*

Global equity valuations look more attractive than a few months ago with the 12-months PEG having retreated to around 1.0 from almost 2.0 (Figure 3).

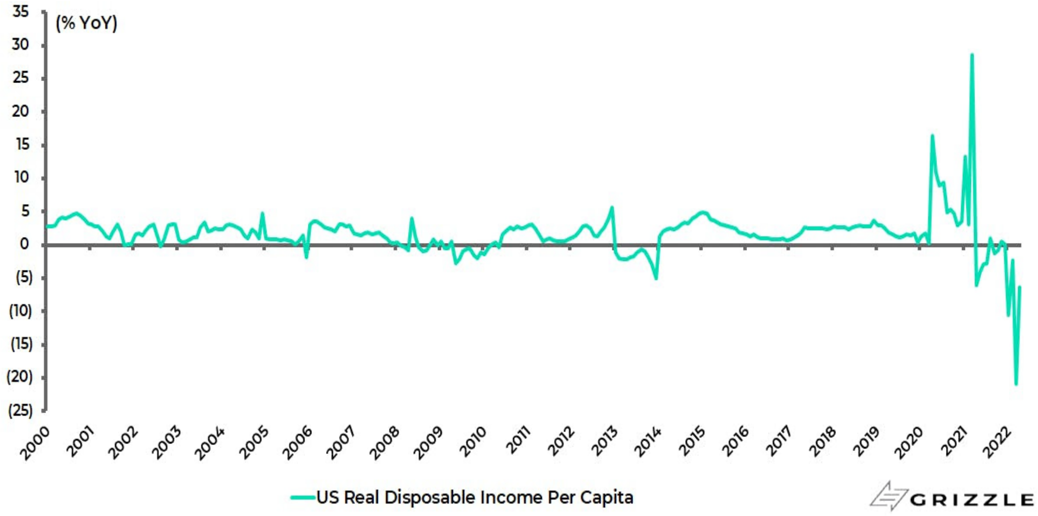
**Figure 3: Global PEG, 12-months forward**



The reality of stagflation has certainly been confirmed by the latest US data both as regards inflation and wage growth.

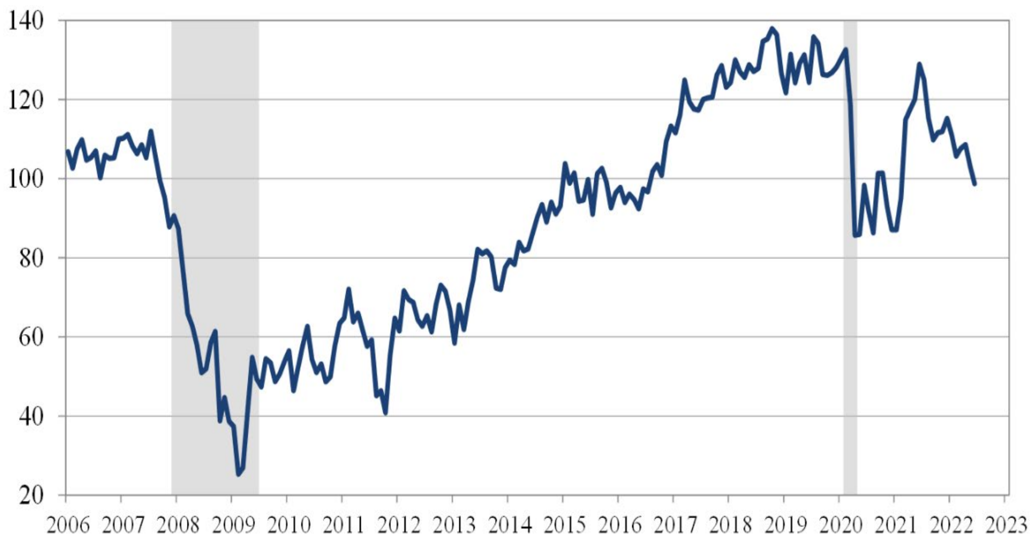
US headline CPI inflation rose from 8.3% y/y in April to 8.6% y/y in May, the highest inflation prints since December 1981. As a result, the growth in US real disposable income per capita is very negative (Figure 4).

**Figure 4: US real disposable personal income per capita, y/y, %**




The latest US Conference Board survey released June 28th shows that US consumers grew less optimistic in June with 14.7% of them expecting business conditions to improve, versus 16.4% in May. 29.5% expect business conditions to worsen, up from 26.4%. The overall index (Figure 5) is down below 100, a 20% drop from mid-2021.

**Figure 5: US consumer confidence index, 1985=100**

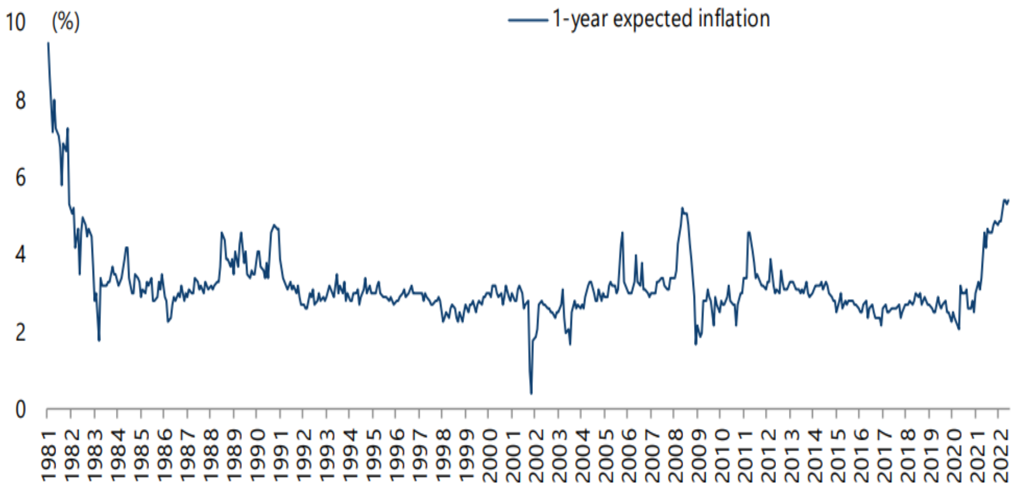



*Source: The Conference Board*

*Note: Shaded areas indicate a recession*

US inflation expectations remain well above the long-term average (Figure 6).

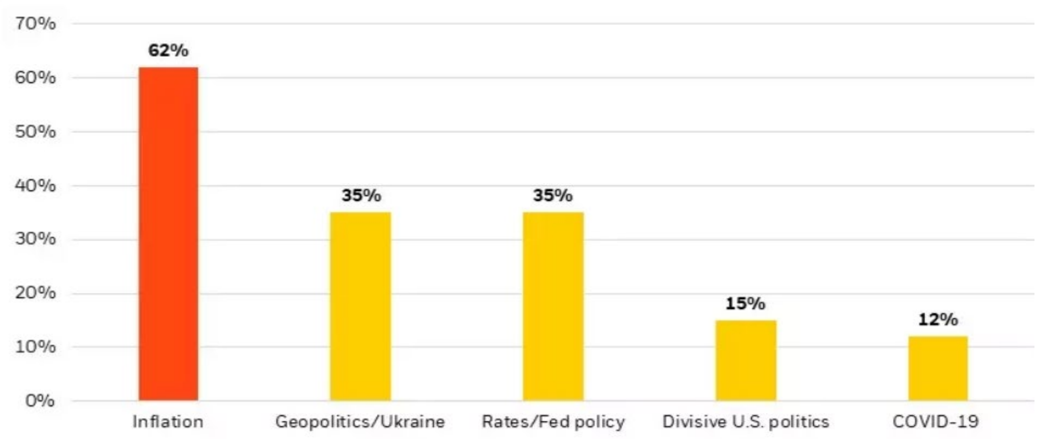
**Figure 6: University of Michigan consumer survey: One-year median expected inflation rate**




*Source: University of Michigan*

According to a recent survey, inflation is seen as the biggest threat to US stocks (Figure 7).

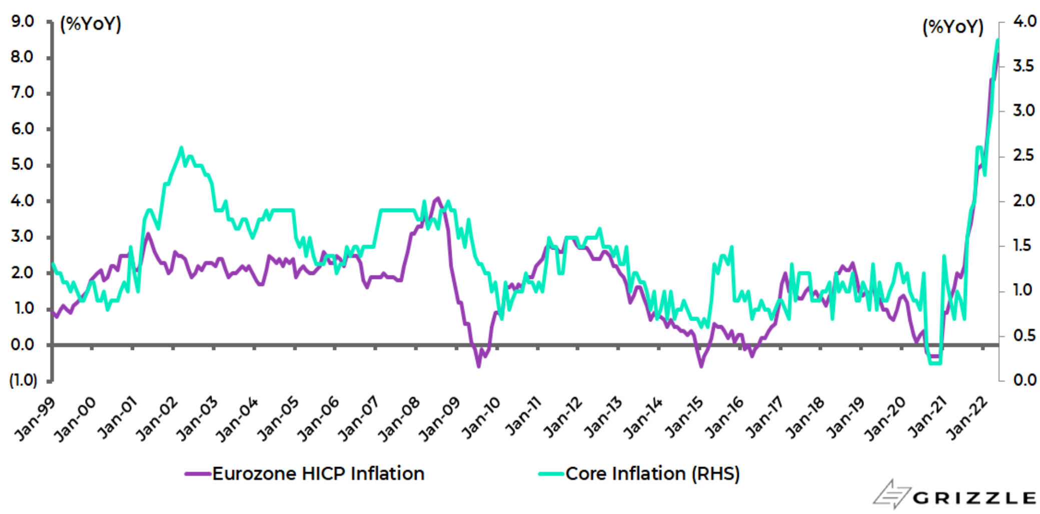
**Figure 7: "What is the biggest threat for US stocks?", May survey**




*Source: BlackRock*

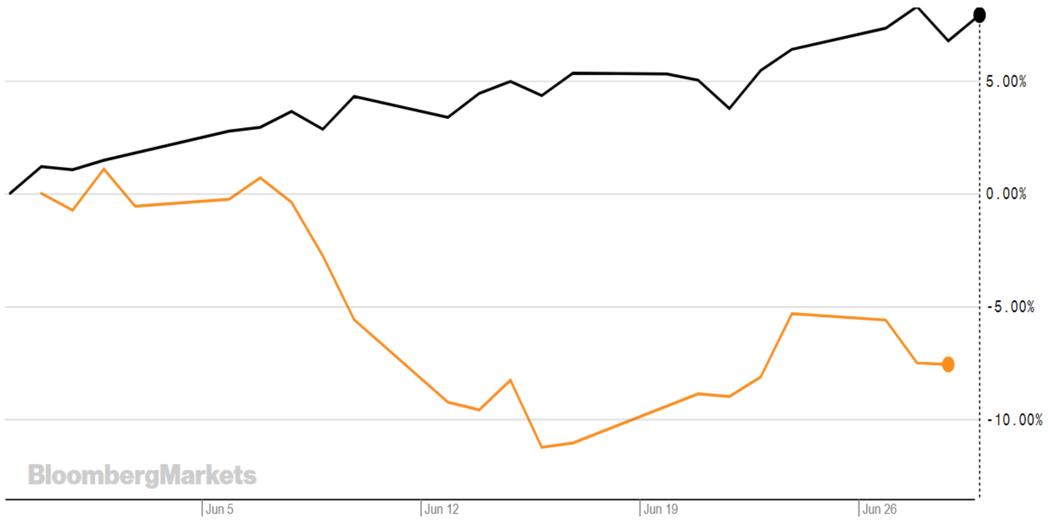
The same as regards inflation also applies to Europe. Eurozone headline HICP inflation and core inflation rose from 7.4% y/y and 3.5% y/y, respectively, in April to 8.1% and 3.8% in May, the highest inflation prints since the establishment of the euro at the beginning of 1999 (Figure 8).

**Figure 8: Eurozone inflation, y/y, %**



Meanwhile we observe a slight reduction in correlation among equity markets globally lately. For example, Shanghai A shares have massively outperformed the S&P 500 in June (Figure 9). This could continue for a while as investors adjust their portfolios to the current reality.

**Figure 9: Shanghai A shares (black line) versus S&P 500, one month return**




*<u>Bottom line:</u>*

*Economic uncertainty may have peaked in the first half of 2022 but could still contribute to volatility and <u>affect market performance</u> for the remainder of the year.*

# VIETNAM ECONOMY

- Highlights of economic growth in Q2/2022
- Outlook for inflation, interest rates and exchange rates in 2H2022

## Highlights of economic growth in Q2/2022

Economic growth in the second quarter of 2022 reached 7.7% over the same period, of which the agricultural sector increased by 3.0%, industry and construction increased by 8.9% and services increased by 8.6%. While the industrial production sector recovered as expected, the service sector showed better resilience in the second quarter. Specifically, the industrial production sector increased by 11.5% over the same period, higher than the growth of 7.8% in the first quarter. Meanwhile, the wholesale and retail sectors' growth accelerated from approximately 3.0% in the first quarter to 8.3% in the second quarter, and the accommodation and food services' growth changed from a negative growth of 1.8% in Q1 to positive growth of 25.9% in Q2.

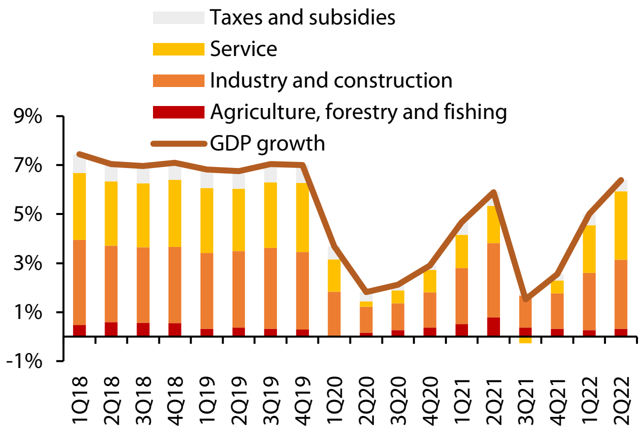
**Figure 10: Vietnam's GDP by economic activity**

| | 3Q21 | 4Q21 | 1Q22 | 2Q22 | 3Q21 | 4Q21 | 1Q22 | 2Q22 |
|---|---|---|---|---|---|---|---|---|
| | % yoy | | | | % pt contribution to GDP | | | |
| **Real GDP** | **(6.0)** | **5.2** | **5.1** | **7.7** | **(6.0)** | **5.2** | **5.1** | **7.7** |
| Agriculture | 1.2 | 3.2 | 2.4 | 3.0 | 0.2 | 0.3 | 0.3 | 0.3 |
| Mining | (9.1) | (2.7) | 1.2 | 3.4 | (0.3) | (0.1) | 0.0 | 0.1 |
| **Manufacturing** | **(4.1)** | **8.0** | **7.8** | **11.5** | **(1.0)** | **1.9** | **1.9** | **2.9** |
| Construction | (10.1) | 2.1 | 2.6 | 4.0 | (0.7) | 0.2 | 0.1 | 0.2 |
| **Wholesale & Retail Sales** | **(17.1)** | **4.9** | **3.0** | **8.3** | **(1.3)** | **0.4** | **0.3** | **0.7** |
| Transportation & Storage | (19.6) | 0.9 | 7.1 | 9.4 | (0.9) | 0.0 | 0.4 | 0.5 |
| **Accommodation & Food** | **(54.1)** | **(15.3)** | **(1.8)** | **25.9** | **(0.6)** | **(0.3)** | **(0.0)** | **0.5** |
| Financial services | 7.9 | 11.2 | 9.8 | 9.2 | 0.4 | 0.6 | 0.5 | 0.5 |
| Real estate | (9.7) | 0.7 | 1.8 | 6.1 | (0.3) | 0.0 | 0.1 | 0.2 |
| Other | 0.4 | 8.3 | 4.9 | 6.7 | (1.6) | 2.1 | 1.5 | 1.8 |

*Source: GSO, Rong Viet Securities*

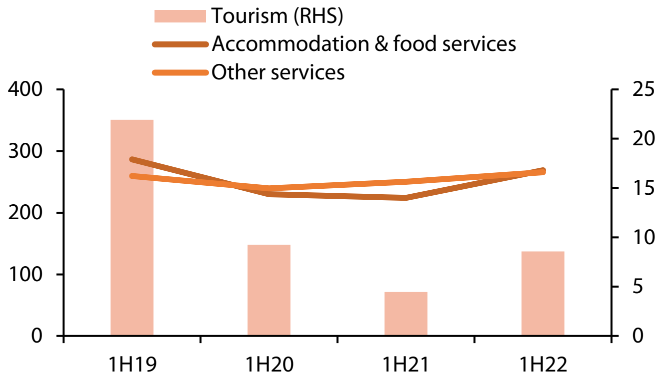
Prominent growth sectors in the manufacturing sector were textiles and garments (+26.8% in Q2 vs. 20.1% in Q1), drugs, pharmaceutical chemicals (+24.6% in Q2 vs. 10, 0% in Q1), electronics (+14.7% in Q2 vs. 7.6% in Q1), beverages (+15.1% in Q2 vs. 5.6% in Q1) and wood (10. 3% in Q2 vs. 0.6% in Q1). In addition, in terms of output, seafood, beer, and urea production showed improved growth compared to the previous quarter. For the service sector, positive growth sectors were food retail (+13.7% in 1H vs. 11.0% in Q1), accommodation and catering services (+20.9% in 1H vs. 1.2% in Q1) and tourism (+94.4% in 1H vs. 1.9% in Q1). Compared to the pre-epidemic levels, retail sales of accommodation, catering and tourism services are still 6.2% and 60.9% lower compared to the levels recorded in the first half of 2019. However, retail sales of these two sectors in June alone showed signs of a recovery, with a decrease of 2.5% and 36.3% respectively compared to June 2019. The tourism sector has not returned to pre-pandemic levels mainly because the number of international visitors is still low: only 7.1% of international arrivals to Vietnam in 1H19. Although the number of international visitors had a strong acceleration in June, it only reached 20% compared to the level recorded in June 2019. Domestic tourism demand is the driving force for the recovery with the number of domestic tourists in the first half of the year reaching 60.8 million (1.4 times higher than the same period in 2019).

**Figure 11: GDP growth breakdown**




*Source: GSO, Rong Viet Securities*

**Figure 12: Retail sales of services hit hard by the pandemic (trillion VND)**




*Source: GSO, Rong Viet Securities*

Looking to the second half of the year, we see that the bounce of economic growth in Q2 will create a premise for optimism about growth prospects in the second half of 2022 on the basis of 1) the industrial production sector is still the main driver of growth; 2) the economy's consumption recovered better than expected and 3) the low base level of the second half of 2021. With economic growth in the second half of 2022 forecasted at more than 8.0%, we revise our forecast GDP growth this year from 6.5% to 7.5%. Some challenges that may restrain growth in the second half of the year include: 1) the negative picture of the world economy may negatively affect export growth and industrial production; 2) rising prices affect domestic demand; 3) some industry groups may not be as positive as the first half of the year such as finance, construction and real estate and 4) risk of Covid-19 resurgence.

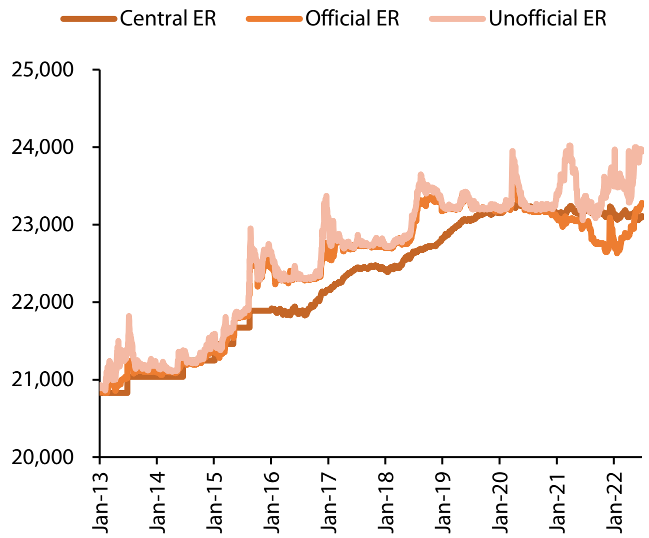
## Outlook for inflation, interest rates and exchange rates in the second half of 2022

The persistently high inflation is the factor that makes the growth picture of the world 2022-23 become less positive. In early June, the World Bank revised its forecast for global economic growth for 2022 from 4.1% to 2.9%. Global economic growth in 2023 is forecasted at around 3.0%, of which growth slows down in developed economies (USA, EU, Japan) but improves in emerging and developing markets. In a less optimistic forecast, the IMF revised down US growth in 2022 and 2023 to 2.9% and 1.7%, respectively in the context of the Fed raising interest rates quickly and sharply to control inflation. The Fed in its June meeting forecasted that US GDP will grow only 1.7% in 2022-23, lower than the 2.8% forecast for 2022 and 2.2% for 2023 at its meeting in March. Projecting the picture closer, the GDPNow growth gauge of the Atlanta Fed branch shows that US economic growth in the second quarter of 2022 is estimated to decrease by 2.1%. If this forecast is correct, the US economy will fall into a technical recession (GDP fell for 2 consecutive quarters because the US economy recorded negative growth of 1.5% in the first quarter). This has led some analysts to forecast that the Fed's rate hike cycle may have to slow down or even lower rates as soon as this year. However, this scenario is probably still not reflected in investors' expectations.

As for Vietnam's developments, the dong continued to depreciate against the USD in June by 0.4% after having depreciated by about 1.0% in May. From the beginning of the year until now, the dong has depreciated by about 2.0% and is still one of the least depreciated currencies in the Asia-Pacific region. In order to curb the dong's depreciation, the SBV has sold about USD12-13 billion so far this year, equivalent to more than 11% of the peak foreign exchange reserves at the end of January. At the same time, in Jun 2022, the SBV restarted the channel to attract money through bill issuance. From June 21 to July 1, the total amount of net withdrawal through the SBV bill issue channel reached VND107.6 trillion. The latest auction interest rates for 7-day and 14-day tenors were 0.65% and 0.9%, respectively, significantly lower than the corresponding term rates in the interbank market. Despite the continuous net withdrawal of VND through the foreign currency selling channel and the open market, the positive difference between USD and VND interest rates in the interbank market continues to expand, showing that the demand for holding USD in the system has not cooled down. In the short term, the SBV will continue to use two tools, namely foreign exchange reserves and money withdrawal in the open market, to affect the liquidity of VND in the system, thereby curbing pressure on the exchange rate.

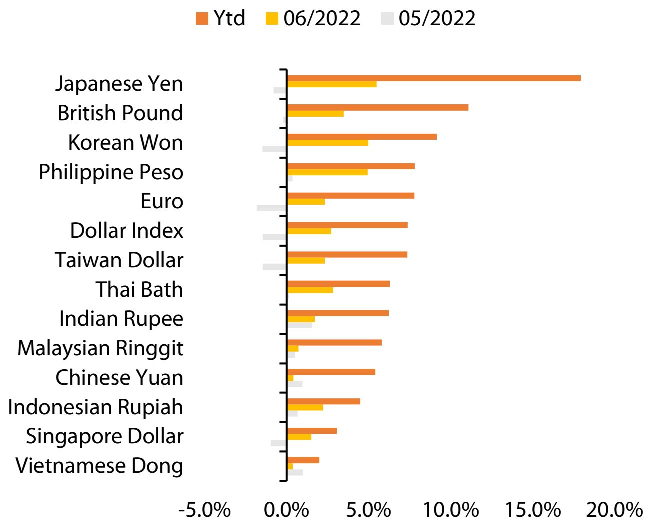
Looking to the second half of the year, USDVND exchange rate movements will depend heavily on the movements of two counterbalancing risks: 1) global inflation continues to remain at a higher level than expected and 2) recession risks in the US and world economies. If the scenario leans towards recession, exchange rate pressure may cool down and vice versa. If both of these happen, we believe that the dong's depreciation pressure will also cool down as we expect that major central banks will not be able to raise interest rates sharply when the economy falls into recession. Therefore, we still maintain the view that the dong may depreciate by 2.0-2.5% in 2022. In the short term, as the gap between USD-VND interest rates was still high while other factors such as trade balance, USD inflows are not quite supportive, the USDVND exchange rate depreciation could be higher than our end-year exchange rate forecast.

**Figure 13: USDVND exchange rate**




*Source: Bloomberg, Fiinpro, Rong Viet Securities*

**Figure 14: Most currencies depreciated against USD in 1H22**

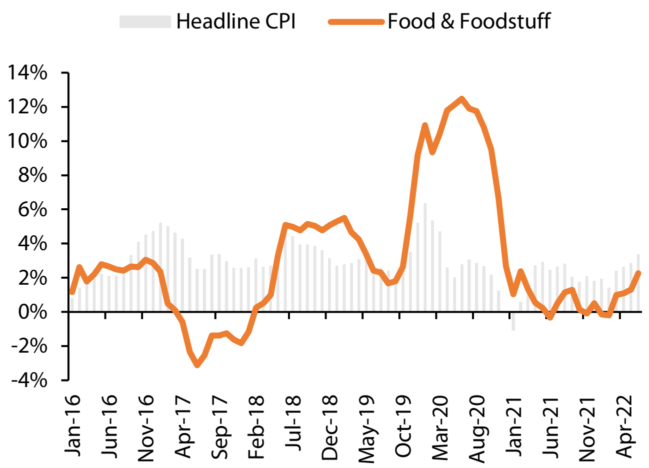



*Source: Bloomberg, Rong Viet Securities*

As for the interest rate tool, we argue that inflation will be the decisive factor for the prospect of hiking interest rates by the SBV. In Jun 2022, the consumer price index rose 0.7% mom, well above our expectations. However, the 6-month average inflation is still within expectations at 2.4%. Inflation accelerated strongly in Jun, in addition to the increase in the traffic price index due to gasoline prices, the impact of high gasoline prices and input factors began to transmit through the acceleration of the food price index, increasing 0.8% mom. This is also the highest monthly increase since the end of 2019, not calculating the impact of price increases during the Tet holidays on this commodity group. The recovery of domestic tourism is also reflected in the consumer price index through the increase in prices of food services or the price of passenger air transport.

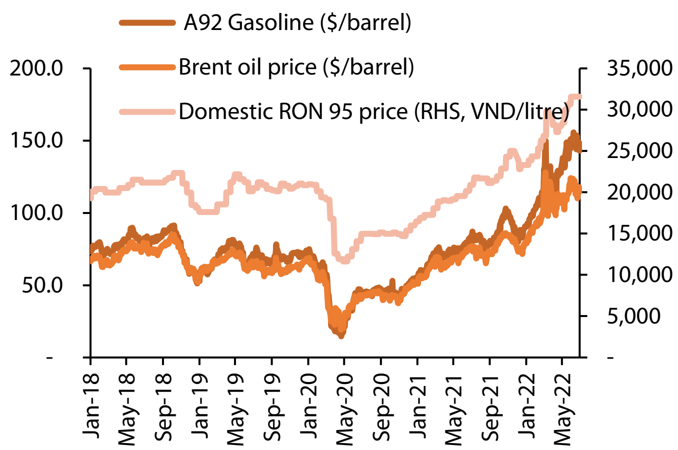
As mentioned in previous reports, inflation in the second half of the year will depend heavily on the price index of food and housing and construction materials. Currently, we are seeing mixed impulses from these two price indexes, with the food price index continuing to rise while the housing and building materials price index fell slightly. In addition, the oil price scenario also affects inflation expectations for the whole year. With a state budget surplus of approximately VND 20 trillion in the first 6 months of the year, the Government will have room to reduce taxes on petroleum products in order to limit the increase in domestic gasoline prices, first of all, environmental protection tax since August. If the oil price remains in the range of $120-130/barrel from now until the end of the year, the inflation rate for the whole year is forecast at 4.5%, 50 basis points higher than the ceiling deposit interest rate for 1-6 months term. Currently, the SBV is still shouldering the burden of maintaining low-interest rates to support the economy's recovery in the post-Covid-19 period. With current inflation and exchange rate pressures, we think the SBV will need more time to observe before deciding to raise the regulatory interest rates. In the base scenario, we expect an increase in the regulatory rate to be done in early 2023 with an increase of 50 basis points. In a more cautious scenario, the SBV could raise interest rates sooner than expected in Q42022 if oil prices break $130/barrel and remain at this level long enough to push domestic inflation higher than we expected.

**Figure 15: Headline CPI and Food Price Index**



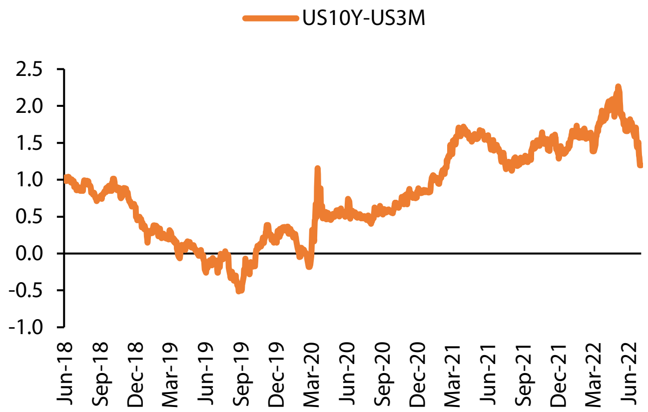

*Source: GSO, Rong Viet Securities*

**Figure 16: Domestic vs. global petrol prices**



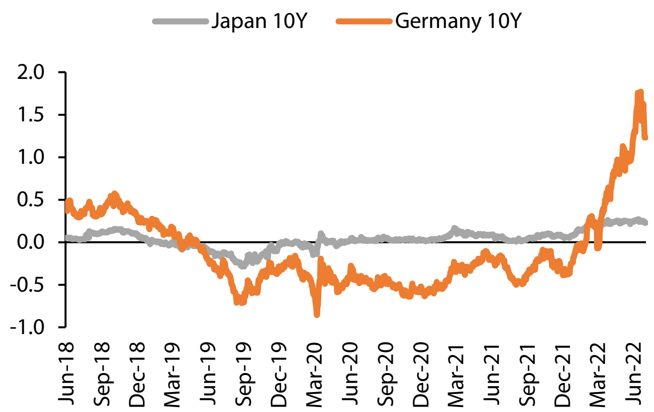

*Source: Bloomberg, MoF, PLX, Rong Viet Securities*

**US G-Bond yields gap (%/year)**



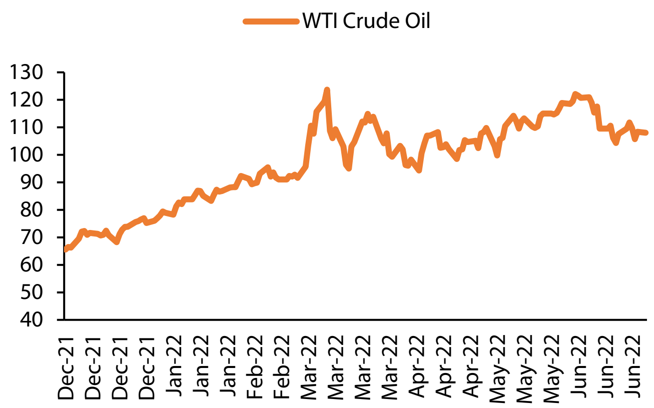

*Source: Bloomberg, Rong Viet Securities*

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



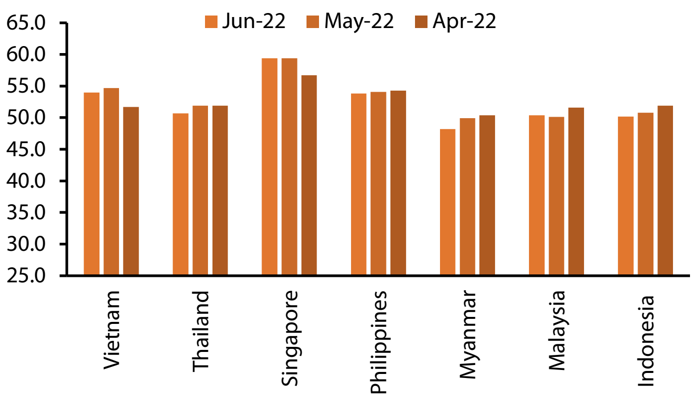

*Source: Bloomberg, Rong Viet Securities*

**WTI crude oil price (USD/barrel)**



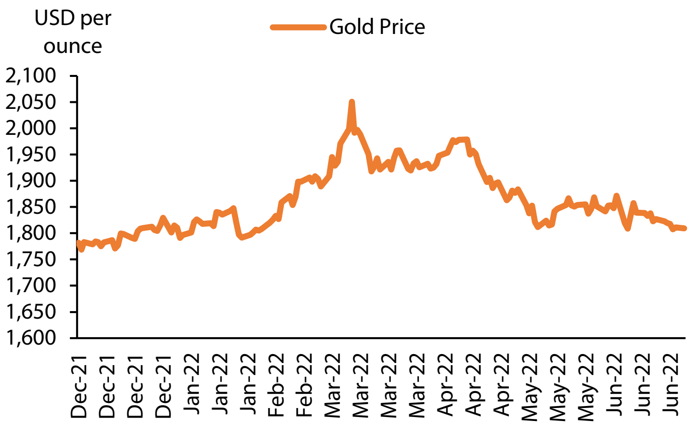

*Source: Bloomberg, Rong Viet Securities*

**ASEAN's PMI**



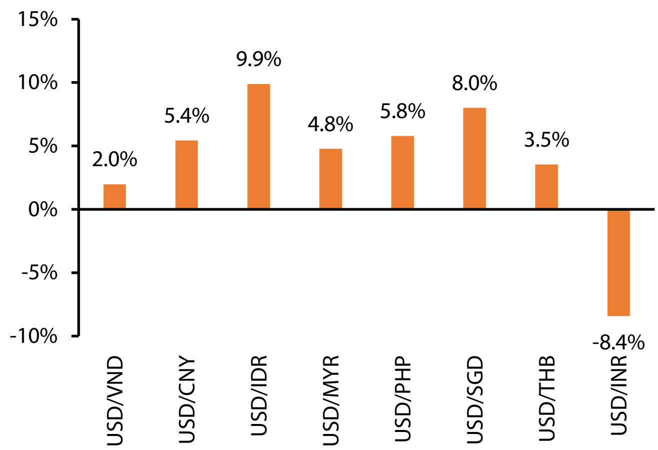

*Source: Markit Economics, Rong Viet Securities*

**Gold prices (US$/ounce)**




*Source: Bloomberg, Rong Viet Securities*

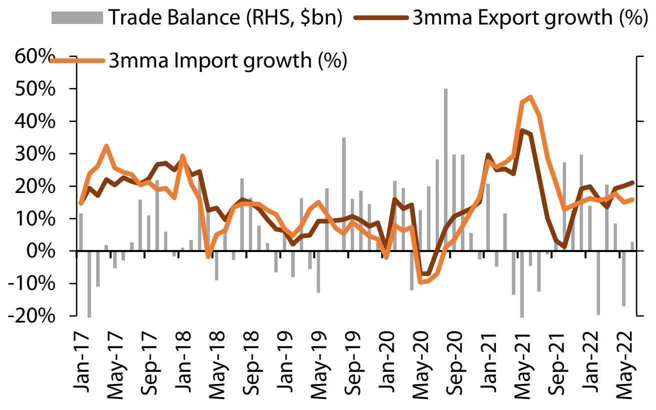
**FX rates (%, YTD)**




*Source: Bloomberg, Rong Viet Securities*

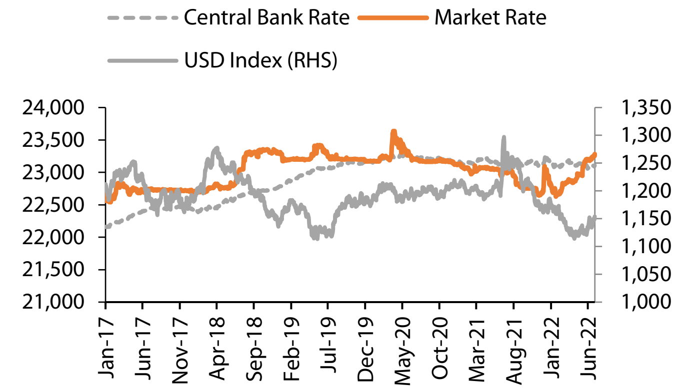
# VIETNAM ECONOMIC INDICATORS IN JUNE 2022

### Trade balance



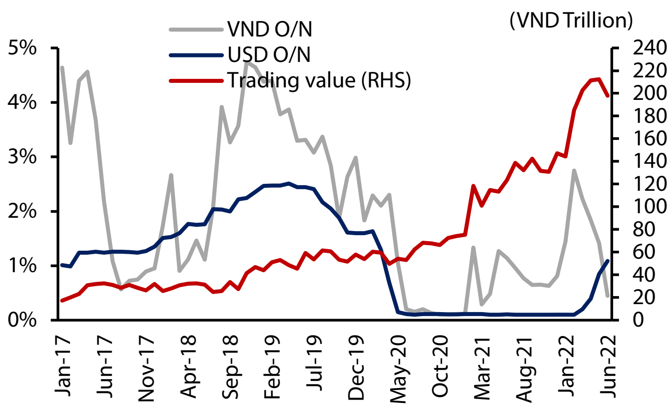

*Source: GSO, Rong Viet Securities*

### USDVND exchange rate



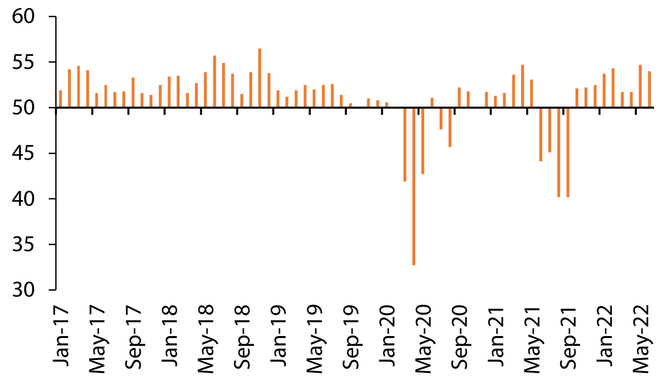

*Source: SBV, Bloomberg, Rong Viet Securities*

### Interbank interest rate (%/year)



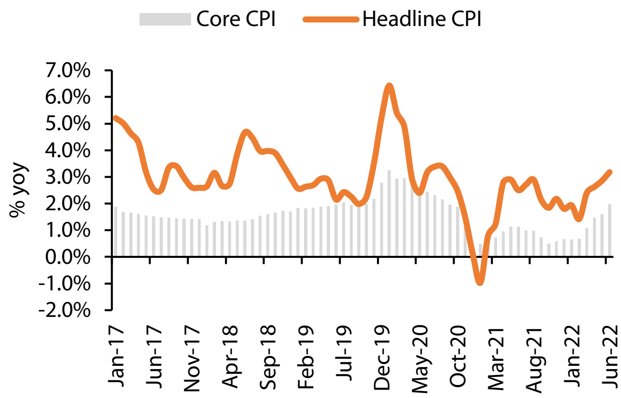

*Source: SBV, Rong Viet Securities*

### Vietnam PMI



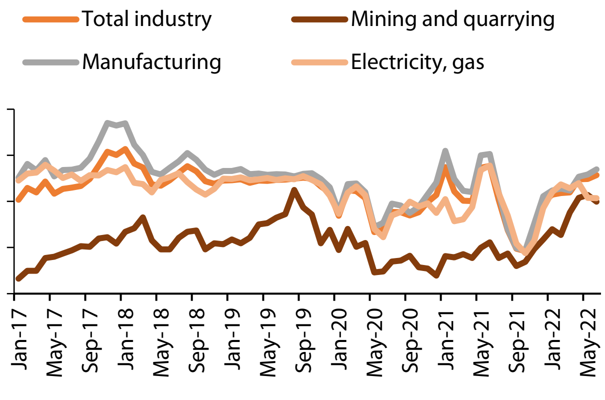

*Source: IHS Markit, Rong Viet Securities*

### Vietnam CPI




*Source: GSO, Rong Viet Securities*

### 3-month MA Industrial Production Indices




*Source: GSO, Rong Viet Securities*

# ANALYSIS & INVESTMENT ADVISORY DEPARTMENT


**Lam Nguyen**
***Head of Research***
lam.ntp@vdsc.com.vn
+ 84 28 6299 2006 (1313)
- Market Strategy
- Industrial Park

**Vu Tran**
***Senior Manager***
vu.thx@vdsc.com.vn
+ 84 28 6299 2006 (1512)
- O&G
- Fertilizer

**Tam Pham**
***Manager***
tam.ptt@vdsc.com.vn
+ 84 28 6299 2006 (1530)
- Bank
- Insurance

**Tung Do**
***Manager***
tung.dt@vdsc.com.vn
+ 84 28 6299 2006 (1521)
- Retails
- Aviation
- Logistics
- Market Strategy

**An Nguyen**
***Senior Analyst***
an.ntn@vdsc.com.vn
+ 84 28 6299 2006 (1541)
- Food & Beverage
- Automotive & Spare parts

**Anh Tran**
***Senior Analyst***
anh.tk@vdsc.com.vn
+ 84 28 6299 2006 (1544)
- Market Strategy
- Residential RE
- Construction

**Loan Nguyen**
***Analyst***
loan.nh@vdsc.com.vn
+ 84 28 6299 2006 (1531)
- Textile
- Fishery
- F&B

**Thanh Nguyen**
***Analyst***
thanh.nn@vdsc.com.vn
+ 84 28 6299 2006 (1535)
- Bank
- Insurance
- Securities

**Thao Nguyen**
***Analyst***
thao.nn@vdsc.com.vn
+ 84 28 6299 2006 (1524)
- Utilities
- Sea ports
- Logistics

**Ha Tran**
***Assistant***
ha.ttn@vdsc.com.vn
+ 84 28 6299 2006 (1526)

**Hung Le**
***Analyst***
hung.ltq@vdsc.com.vn
+ 84 28 6299 2006 (1546)
- Industrial RE
- Market Strategy

**Bernard Lapointe**
***Senior Consultant***
bernard.lapointe@vdsc.com.vn
+ 84 28 6299 2006

**Ha My Tran**
***Senior Consultant***
my.tth@vdsc.com.vn
+ 84 28 6299 2006
- Macroeconomics

**Quan Cao**
***Analyst***
quan.cn@vdsc.com.vn
+ 84 28 6299 2006 (2223)
- Technology

**Trang Tran**
***Assistant***
trang.tnt@vdsc.com.vn
+ 84 28 6299 2006 (1522)

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**HEAD OFFICE**

141 Nguyen Du Street, Ben Thanh Ward,
District 1, Ho Chi Minh City

T +84 28 6299 2006
F +84 28 6299 7986
E info@vdsc.com.vn
W www.vdsc.com.vn

**HANOI BRANCH**

10th Floor, Eurowindow Building, 2 Ton That Tung,
Trung Tu Ward, Dong Da District, Hanoi

T +84 24 6288 2006
F +84 24 6288 2008
E info@vdsc.com.vn
W www.vdsc.com.vn

**NHA TRANG BRANCH**

7th Floor, 76 Quang Trung, Loc Tho Ward,
Nha Trang City, Khanh Hoa

T +84 258 3820 006
F +84 258 3820 008
E info@vdsc.com.vn
W www.vdsc.com.vn

**CAN THO BRANCH**

95-97-99 Vo Van Tan Street,
Ninh Kieu District, Can Tho City

T +84 292 381 7578
F +84 292 381 8387
E info@vdsc.com.vn
W www.vdsc.com.vn