7th September 2023

Macro Report

ECONOMIC GROWTH TO IMPROVE AT SLOW PACE

- *Economic growth in Q3/2023 is estimated to reach 4.5%*
- *Inflation increased again but remained under control*
- *The SBV will not further reduce regulatory interest rates*

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VIETNAM ECONOMY

- Economic growth in Q3/2023 is estimated to reach 4.5%
- Inflation increased again but remained under control
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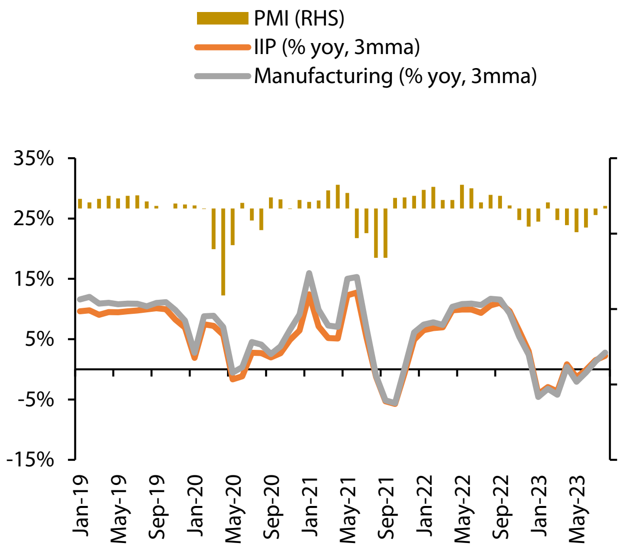
Economic growth in Q3/2023 is estimated to reach 4.5%

The manufacturing sector activities were more positive than the previous quarter, as new orders, export orders, and output improved for the first time after a long period of decline, according to S&P Global. With improved demand, purchasing activities have increased significantly since September 2022, with purchased inventory rising for the second consecutive month. The recovery is still relatively slow, as shown by a continuous employment reduction lasting six months or an increase in finished goods inventories for the second consecutive month. The improving trend in manufacturing activities in Vietnam is similar to three other countries in the ASEAN region: Indonesia, Myanmar, and Singapore, in contrast to the decline in Thailand, Malaysia, and the Philippines. In addition, the improvement of the ASEAN region was slow when the region's PMI slightly increased to 51 points in August, compared to 50.8 points in July.

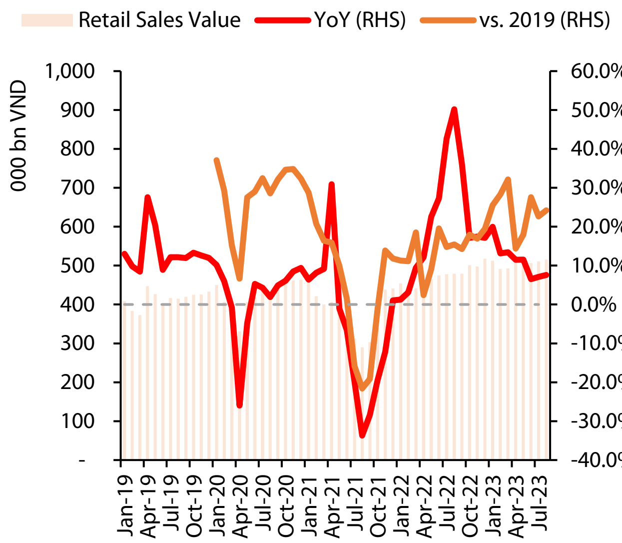
The industrial production index in August continued to record higher growth than the previous month, increasing by 2.87% over July and 2.62% over the same period, respectively. Encouragingly, the growth of the manufacturing and processing industry increased higher than the overall growth rate, 4.5% over July and 3.5% over the same period, respectively. Industries with high growth month-on-month are manufacturing machinery, equipment, motor vehicles, electronic products, and computers. Meanwhile, industries with high growth over the same period include food and beverage processing, chemical production, rubber, metal and beds, cabinets, tables, and chairs. Key export industries such as textiles, seafood, electronics, and wood have yet to recover in production index and output over the same period. However, import data shows that the electronics manufacturing sector may improve in the coming months as the demand for imported raw materials to produce these items has accelerated in the past three months. The latest estimate of the GSO shows that imports of this product group increased by 9.4% over the previous month and decreased by only 2.1% over the same period.

Figure 1: Vietnam's manufacturing actitvities



Source: GSO, RongViet Securities

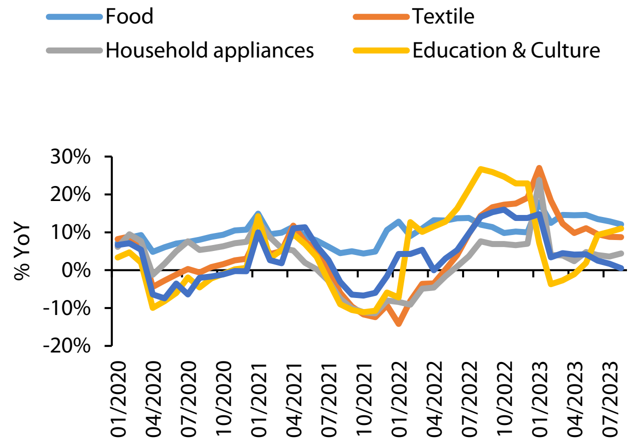
Figure 2: Retail sales growth



Source: GSO, RongViet Securities

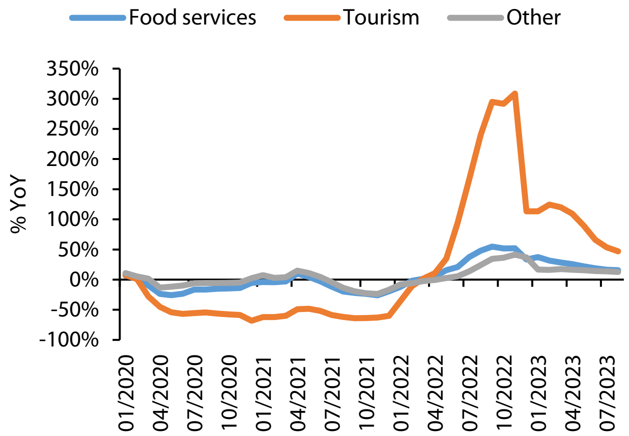
The trend in the retail sector is in line with our expectations when the growth rate of this sector gradually decreased in the third quarter. The positive point is that the decline pace has slowed down thanks to the effects of expansionary fiscal and monetary policies. Growth in retail sales of goods and services in the first half of the year was 10.9%, which decreased to 10.0% in the first eight months of 2023. In August alone, retail sales of goods increased by 7.5%. Meanwhile, the growth of the tourism-related services group was 11.4%, higher than the increase in June & July. The point to note is that the growth of other service groups is relatively low, only increasing by 4.2% over the same period in August. Usually, the quiet growth of this group is often associated with a weakening of aggregate demand, which is an important signal to watch over in the upcoming months.

Figure 3: Retail sales of goods



Source: GSO, RongViet Securities

Figure 4: Retail sales of services



Source: GSO, RongViet Securities

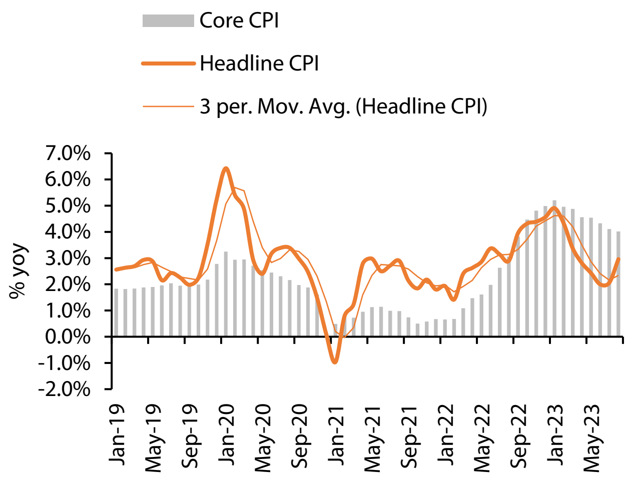
Overall, industrial production was better than in the first half of the year, while retail growth slowed moderately. Based on the industrial output and retail activities trend in the last two months, we estimate that economic growth in Q3 could reach 4.5%, higher than the 4.1% increase in Q2. Cumulatively, for the first three quarters of the year, economic growth is estimated at 4.0%. Risks in the forecast will tilt to the upside if economic activities in September are more favorable than expected.

Inflation increased again but remained under control

Inflation in August was the highest increase in 18 months, up 0.88% over the previous month. The main reason is the sharp increase in food and gasoline prices, increasing by 3.28% and 3.85%, respectively, contributing 0.49 percentage points to the overall price increase. In addition to the two commodity groups affected by external factors (increased rice prices and oil prices), domestic inflationary pressure also comes from the rise in the price of housing, construction materials, and education groups, which increased by 0.85% and 0.96% compared to the previous month, respectively. While the price increase of the education group is typical at the beginning of a new school year and will continue in September, the housing and construction materials group has increased continuously for four months due to the increase in housing rental and electricity prices. In the first eight months of the year, the housing and construction materials price index increased by 6.7% over the same period. While general inflation increased sharply, core inflation tended to cool down but remained high. Core inflation in August increased by 0.32% over the previous month and 4.02% over the same period. Average headline and core inflation in the first eight months of the year were 3.1% and 4.6%, respectively.

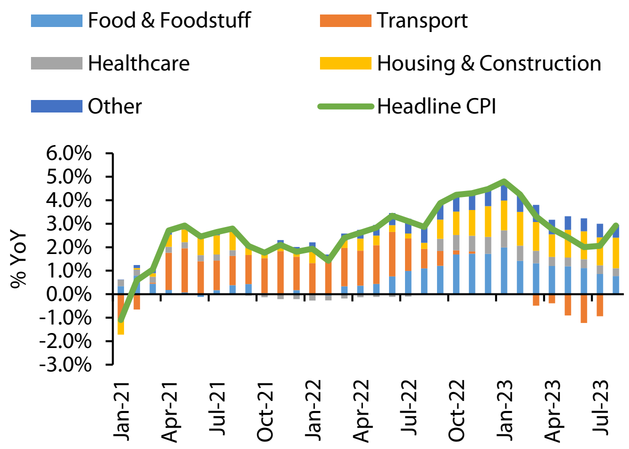
Last summer saw a sharp increase in crude oil prices. In the first days of September, Brent oil prices reached $90/barrel, 6% higher than at the end of July and 13% higher than at the beginning of the year. The average Brent oil price from the beginning of the year until now is $80.9/barrel, close to our assumptions for forecasting inflation for 2023. However, if crude oil prices exceed the $90/barrel threshold or increase sharply to $100/barrel, domestic inflation will rise higher than forecast. Meanwhile, food price inflation pressure has spread to Vietnam, even though Vietnam has abundant rice supplies. The need for food gathering is increasing, pushing the price of export rice and domestic prices. Although food prices only account for less than 4% of the CPI basket. However, rising rice prices will push the food & foodstuffs price index (accounting for 33.6% of the CPI basket).

Figure 5: Headline and core CPI



Source: GSO, RongViet Securities

Figure 6: Inflation breakdown



Source: GSO, RongViet Securities

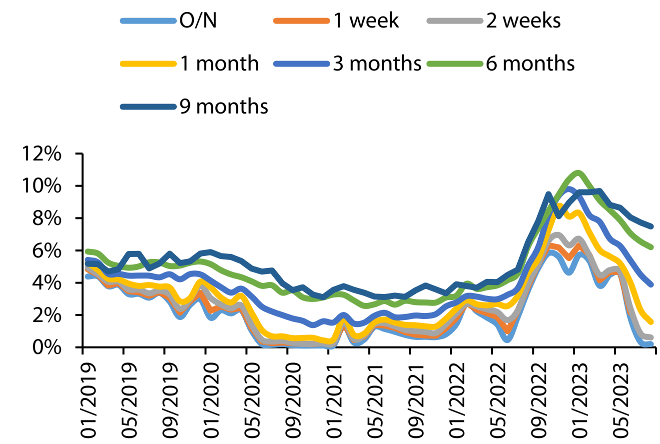
Regarding the reasons for the increase in oil and rice prices, it can be seen that the main factor driving the recent price increase is supply. In the crude oil market, the extension of production cuts by OPEC+ and Russia is the driving force in China's crude oil demand continuously increasing and currently at the highest level in 2 years despite concerns about economic growth prospects. In general, the rice and grain markets were led by expectations of the adverse effects of the El Nino phenomenon, along with India's ban on rice exports and Russia's withdrawal from the Black Sea grain deal. These factors will hardly change in the short term, leading to more pressure on global and Vietnam's inflation in the last quarter of the year. In the current context, we still believe that the inflation control target 2023 at 4.5% is still feasible. In addition, the rebound in inflation in the last months of the year will partly affect the prospect of continued reduction of the SBV's regulatory interest rates, along with several other factors that we will discuss in the next section.

The SBV will not further reduce regulatory interest rates

Deposit interest rates continued to decline sharply in August in the context of slow credit growth. In August, deposit interest rates for terms of state-owned banks decreased by 30-50 basis points, while private banks decreased by more than 50-100 basis points. Since the beginning of the year, deposit interest rates have decreased by 150-250 basis points, depending on the term, and thus have fallen deeper than the reduction in regulatory interest rates of the SBV. At the same time, credit growth was relatively low in the first two months of Q3, after declining in July, credit recovered in August. As of August 24, 23, credit is estimated to increase by 5.03%. Compared to the beginning of the year, the credit scale in the past two months increased by only about VND40 trillion. Although credit is usually weak in the early third quarter, this year's developments show that credit demand is still fragile. The sharp drop of interest rates in August will trigger a further decrease in lending rates, helping improve credit growth in the coming months.

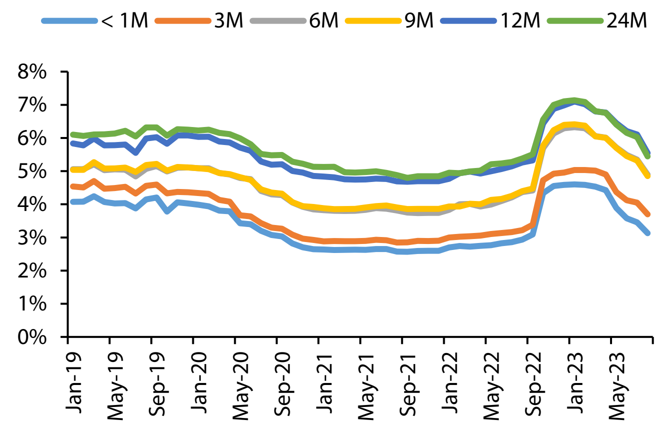
Currently, the system's deposit interest rates for most terms have decreased to the level as of September 2022, except the deposit rates for 3-month and 6-month terms are still higher than 30 basis points compared to September 2022. However, compared to the record low-interest rate during the Covid-19 period, the current interest rate level is still about 30-100 basis points higher. Meanwhile, interest rates in the interbank market remained at record lows throughout August. As mentioned in the Macro Outlook for the second half of 2023, September was one of the peak months of maturity pressure of corporate bonds, especially bonds of real estate companies, with a maturity size of about VND27 trillion. However, according to our observations, real estate businesses' capital mobilization activities through the bond channel significantly recovered in August, and issuers are still relatively active in negotiating debt and interest repayment terms. Accordingly, the issue of corporate bonds maturing may not create much liquidity pressure on the system in September. In addition, although credit demand in September continued to recover, Circular 06's amendments to loosen lending conditions will create a premise to help stabilize system liquidity. In a nutshell, with deposit interest rates falling sharply in August, credit recovering in the context of system liquidity not being under too much pressure in September, and inflation rising again, we believe that it will not be necessary for the SBV further to reduce regulatory interest rates in Q3/2023. Our view has changed compared to the most recent update report, and the current base scenario is that the regulatory interest rate level will remain the same until the end of this year.

Figure 7: Interbank rates



Source: SBV, RongViet Securities

Figure 8: Deposit rates



Source: RongViet Securities, 4 SOBs + 4JCBs + 4 Foreign banks

Global bond yields

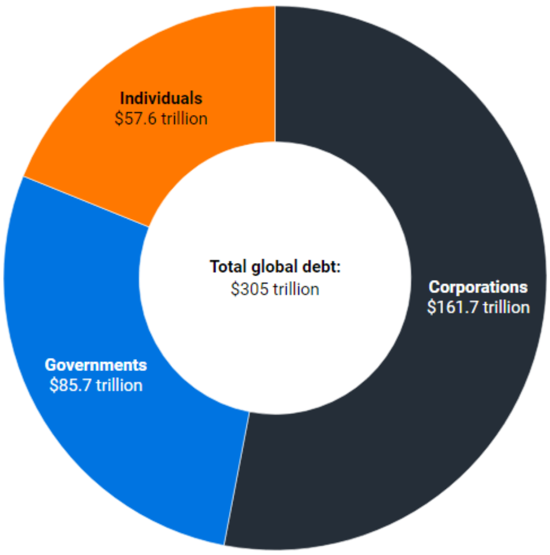
- Why are gov't bond yields going up in certain regions but not in others?
- Are investors becoming risk averse regarding certain bonds?
- Hum… maybe there is a supply/ demand issue.

There is an increasing realization among bond traders that the rock-bottom yields of recent years may now be gone for good. The surprising resilience of the US economy, ballooning debt and deficits as well as concerns about higher-for-longer rates are driving US Treasuries yields back to the highest levels in more than a decade. Not just in the US. European yields are also moving up.

Maybe markets are realizing that government debt in general is at unsustainable levels.

Global debt currently stands at USD 305 trillion (Figure 9), USD 45 trillion higher than before the COVID-19 pandemic, according to the Institute of International Finance (IIF). Global debt is the total amount of money owed by corporations, governments and individuals around the world. Of the USD 305 trillion of debt, corporations account for USD 161.7 trillion (53 percent), governments owe USD 85.7 trillion (28 percent) and individuals comprise USD 57.6 trillion (19 percent).

Figure 9: Global debt in USD



Source: IIF

The US government is the single largest debtor at USD 30 trillion (Table 1). However China's government debt has risen dramatically in the past ten years from USD 3 trillion to 14 trillion now. At the other end of the spectrum some countries like Japan and Germany have managed to reduce their government debt.

Table 1: Government debt in USD

	Government	Debt trillions ($)	2013-2023 (trillions)
1	US	$30.11	16.34 – 30.11
2	China	$14.00	3.10 – 14.00
3	Japan	$10.17	11.87 – 10.17
4	France	$3.14	2.74 – 3.14
5	Italy	$2.87	2.69 – 2.87
6	India	$2.70	1.22 – 2.70
7	UK	$2.70	2.44 – 2.70
8	Germany	$2.62	3.05 – 2.62
9	Canada	$1.81	1.59 – 1.81
10	Brazil	$1.63	1.45 – 1.63

Source: IIF

In general, government bond yields go up as debt rises. This is the natural way for market to send a signal to debtors that it will be more expensive to borrow money to finance their activities.

In the US 10 year bond yields have moved up from around 0.5% in early 2020 to 4.1% now (Figure 10). Even though so-called experts are calling for a GDP/ growth slowdown, it has not stopped yields to rise. From a pure economics perspective it appears counterintuitive.

Figure 10: US 10 year bond yields

But maybe not as we know that the US government debt to GDP is now 123%.

Figure 11: Euro area 10-yr bond yields

Japan, the world's third largest economy, has the highest debt-to-GDP ratio at 239 percent. Tokyo's high debt-to-GDP ratio can be partly attributed to its ageing population and social welfare costs. And lately bond yields have come up (Figure 12), which will eventually affect the central government's ability to finance this debt.

Figure 12: Japan 10-yr bond yields

China's cyclical soft patch keeps deepening. Data from a wide range of indicators, including credit growth, investment in capital markets and properties, industrial production, retail sales, construction, exports, and manufacturing and agricultural product prices reveal an overall loss of economic momentum.

China's banks extended RMB 345 billion in new loans in July, the least since November 2009. Meantime, consumer inflation fell for the first time in over two years, producer inflation fell for the tenth month, while exports dropped 14% year-on-year in July, and imports contracted 12%, falling at their steepest pace since February 2020.

This is all obviously negative for bond yields (Figure 13).

Figure 13. China 10-yr bond yields

But them in some economies, for example Brazil and Vietnam, government bond yields have been coming down (Figures 14 & 15).

Figure 14: Brazil 10-yr bond yields

Figure 15: Vietnam 10-yr bond yields

Why the discrepency?

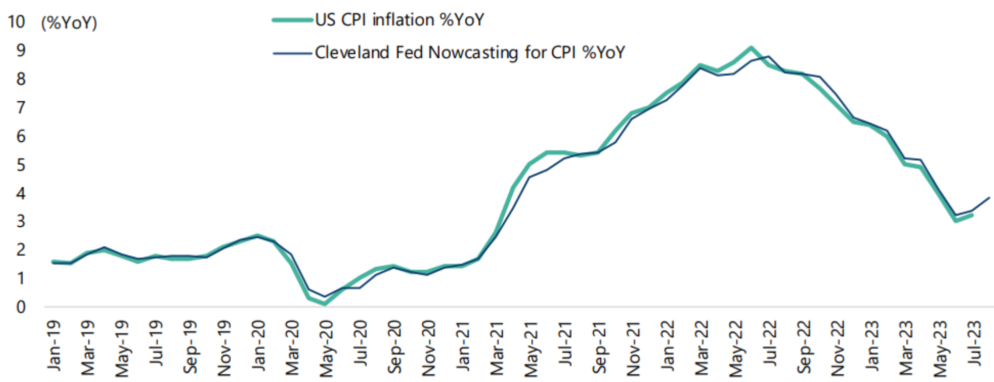
This writer can only guess but for global fixed income investors it is easier to sell in very liquid markets – like the US, Europe and Japan- than in much less liquid places like EM. Hence this pushes yields up in liquid markets while not impacting EM yields that much. It is called asymmetry and/or vanishing yield cushion.

US rates, BRICS, oil.

The Jackson Hole August central bank meeting has been navigated successfully by financial markets. If higher for longer has been the prevailing mantra of the moment – the higher for longer mantra- Jerome Powell delivered the message markets were hoping for. That is that the Fed will "proceed carefully" before making any further interest rate moves. This has confirmed the base case of many market participants that markets have seen the last Fed rate hike in this cycle. Still, there are always risks to navigate. This writer believes that there is one more hike coming.

The base effect is not positive for the US August CPI report to be announced on 13 September. US CPI was up only 0.2% m/m in August 2022. So if the CPI rose by a moderate 0.2% m/m again in August 2023, the headline CPI inflation will be flat at 3.2% y/y in August. But more interesting, the Cleveland Fed's Nowcasting model currently forecasts August CPI to rise by 0.79% m/m and 3.82% y/y (Figure 16).

Figure 16: US CPI inflation and Cleveland Fed Nowcasting forecast model

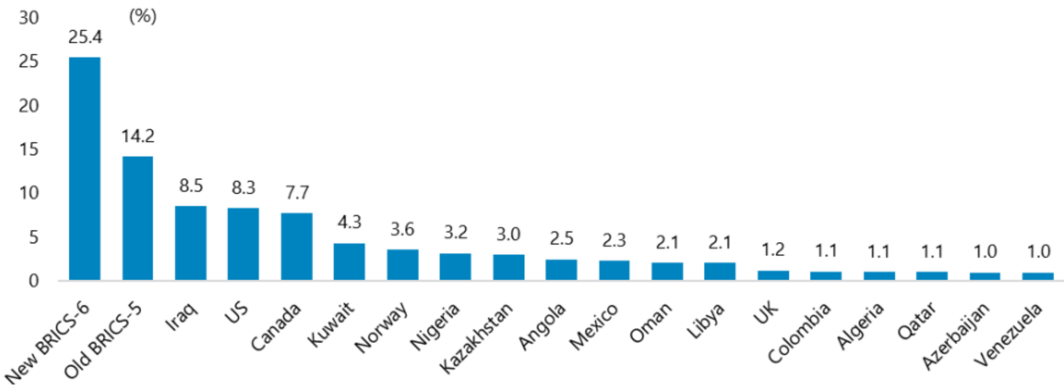


Source: Federal Reserve Bank of Cleveland

Meanwhile, there is also the issue of the oil price. The chief outcome of last week's meeting of the BRICS countries in Johannesburg was the announcement that Saudi Arabia and the UAE, among other countries, have been invited to join the grouping. South African President Cyril Ramaphosa announced last Thursday that the BRICS members have decided to invite Argentina, Egypt, Ethiopia, Iran, Saudi Arabia, and the United Arab Emirates to become full members of BRICS, effective from January 2024. Saudi Foreign Minister Prince Faisal bin Farhan has said that the kingdom will study the details and take "the appropriate decision" and that BRICS was "a beneficial and important channel" to strengthen economic cooperation. UAE President Mohamed Bin Zayed also praised the group's decision to include his country in BRICS.

Such an outcome would mean that the **BRICS grouping would control 40% of world oil exports** at a time when the overwhelming probability is that US shale oil production has peaked. This is, potentially, a huge development. The current BRICS members accounted for 14.2% of world total crude oil exports in 2022, while the newly invited BRICS members accounted for a further 25.4% of the total (Figure 17). Within the new BRICS countries, Saudi, UAE, and Iran accounted for 16.9%, 6.2%, and 2.1%, respectively, of world crude oil exports.

Figure 17: Share of global crude oil exports, %



Source: OPEC

This would have a significant impact on the balance of power of who dictates the marginal price of crude oil.

The oil price remains highly relevant for the US Fed because of its potential to disrupt inflation expectations. The WTI crude oil price has risen by 20% from a recent low reached in late June (Figure 18), while the US five-year five-year forward inflation expectations rate rose from 2.23% in late June to 2.53% in early August, the highest level since April 2022. The correlation between crude oil price and the five-year five-year forward inflation expectations rate has been 0.88 since 2011. So higher crude oil prices do have an impact on inflation expectations.

Figure 18: WTI crude oil price, USD/bbl

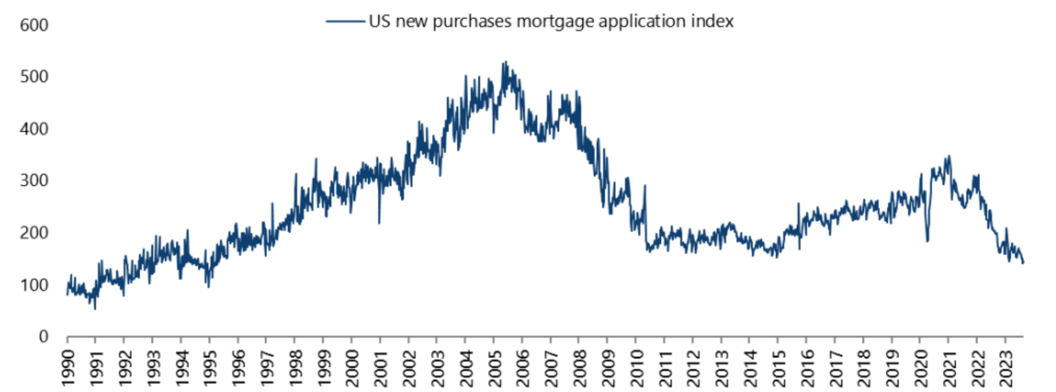
Which brings us to housing affordability in the US. The ten-year Treasury bond yield is now around 20 basis points below its recent peak of 4.36% reached in early August (Figure 19). This will come as a relief to the housing market where the average 30-year fixed-rate mortgage rate recently reached 7.31%, the highest level since December 2000, according to the Mortgage Bankers Association (Figure 20). Mortgage applications for home purchases have also recently fallen to the lowest level since April 1995. The new purchase mortgage applications index declined by 30% y/y to 142 in the week ended August 18th, the lowest level since April 1995, though it rose by 2% to 145 in the week ended August 25th (Figure 21).

Figure 19: US ten-year Treasury yield, %

Figure 20: US 30-year fixed mortgage rate, %

Source: Mortgage Bankers Association (MBA), Bloomberg

Figure 21: US new purchase mortgage application index



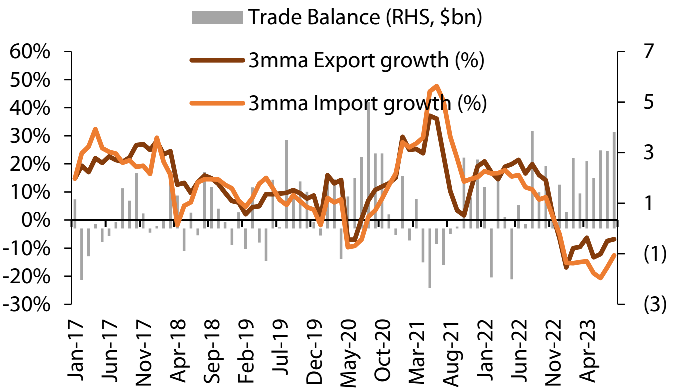
Source: Mortgage Bankers Association (MBA), Bloomberg

Bottom line:

- Bond market participants are looking for the US Fed to end the tightening cycle soon.
- US mortgage market is still in a 'limbo' as mortgage rates have gone up so much and buyers are uncertain about asset values.

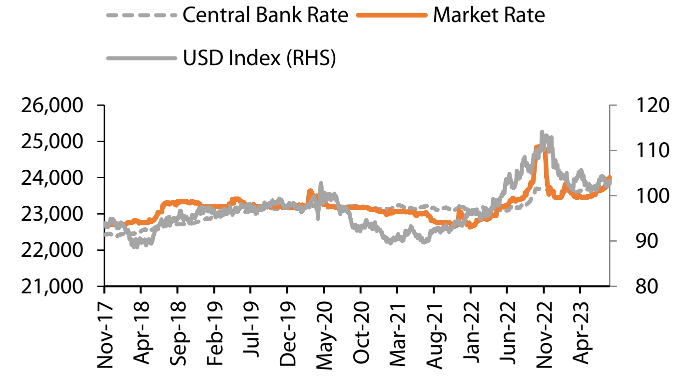
VIETNAM ECONOMIC INDICATORS IN AUG 2023

Trade balance



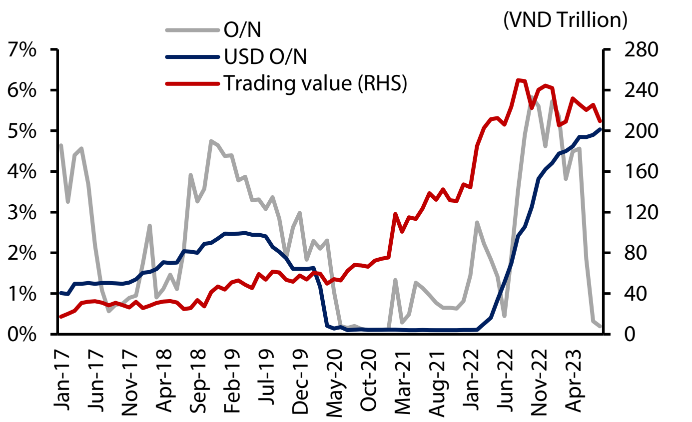
Source: GSO, Rong Viet Securities

USDVND exchange rate



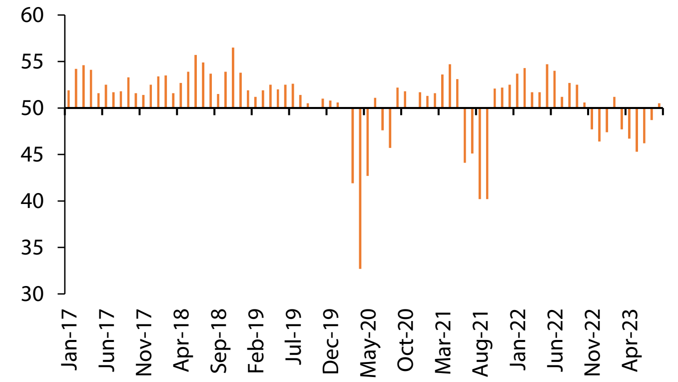
Source: SBV, Bloomberg, Rong Viet Securities

Interbank interest rate (%/year)



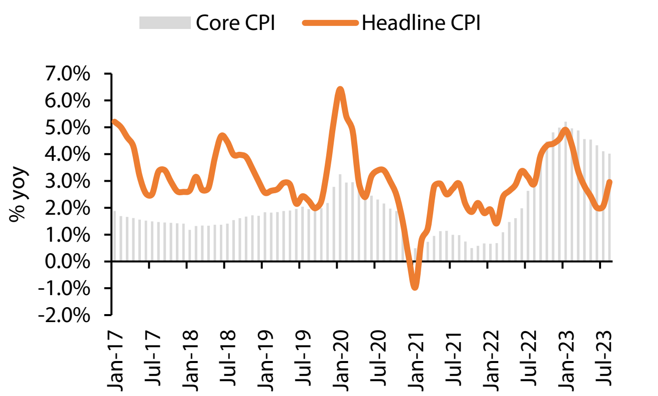
Source: SBV, Rong Viet Securities

Vietnam PMI



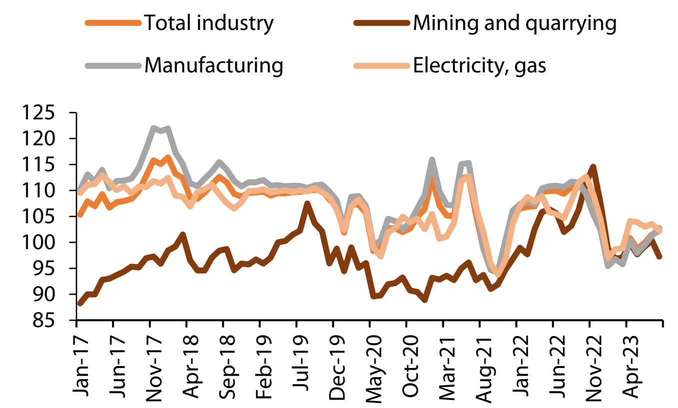
Source: S&P Global, Rong Viet Securities

Vietnam CPI



Source: GSO, Rong Viet Securities

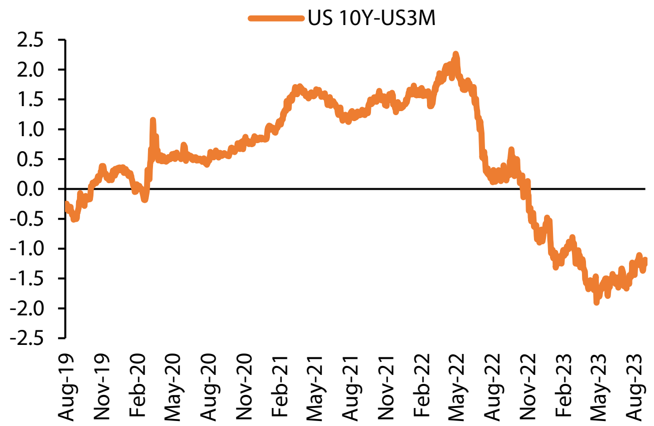
3-month MA Industrial Production Indices



Source: GSO, Rong Viet Securities

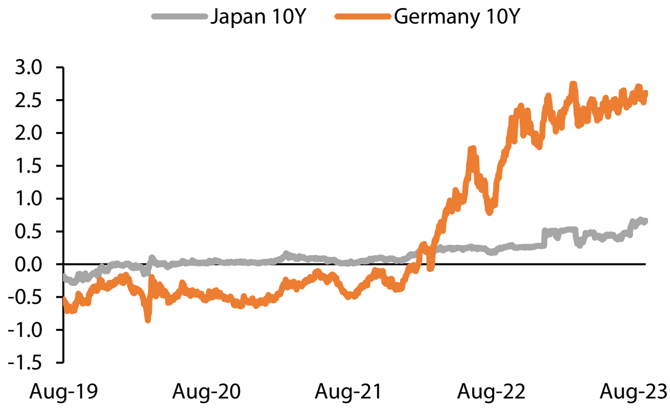
GLOBAL ECONOMIC INDICATORS IN AUGUST

US G-Bond yields gap (%/year)



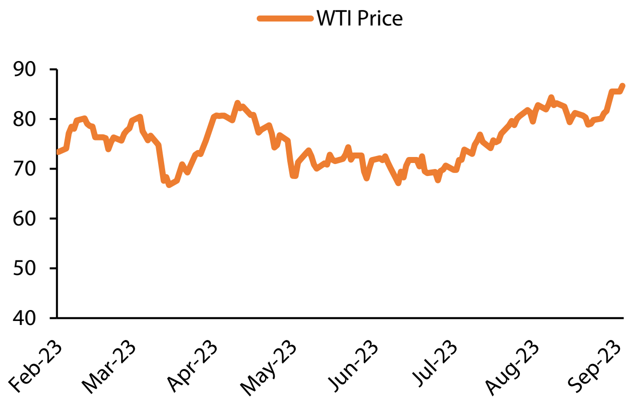
Source: Bloomberg, Rong Viet Securities

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



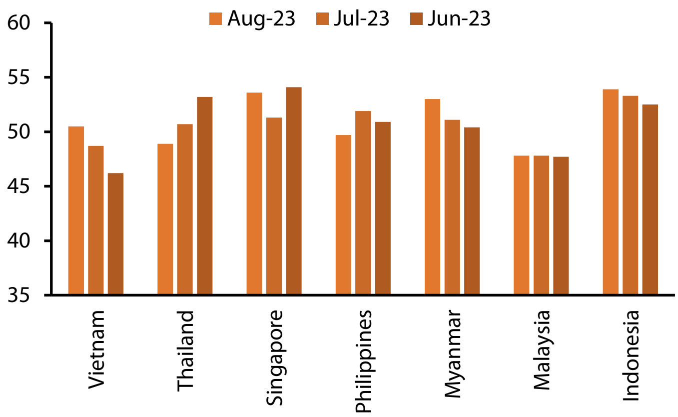
Source: Bloomberg, Rong Viet Securities

WTI crude oil price (USD/barrel)



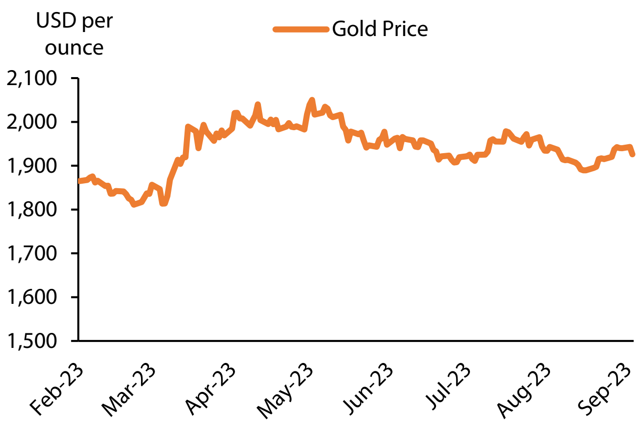
Source: Bloomberg, Rong Viet Securities

ASEAN's PMI



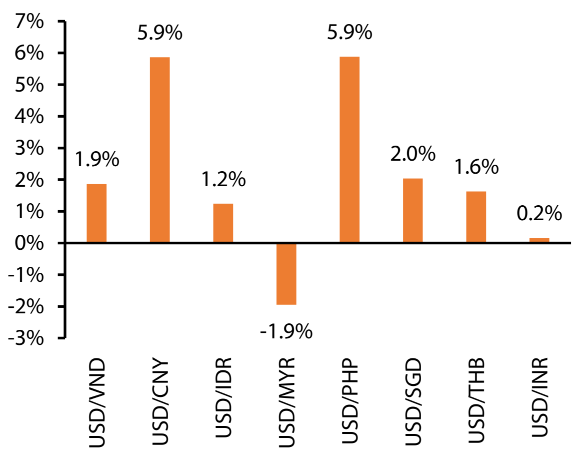
Source: Markit Economics, Rong Viet Securities

Gold prices (US$/ounce)



Source: Bloomberg, Rong Viet Securities

FX rates (%, YTD)



Source: Bloomberg, Rong Viet Securities

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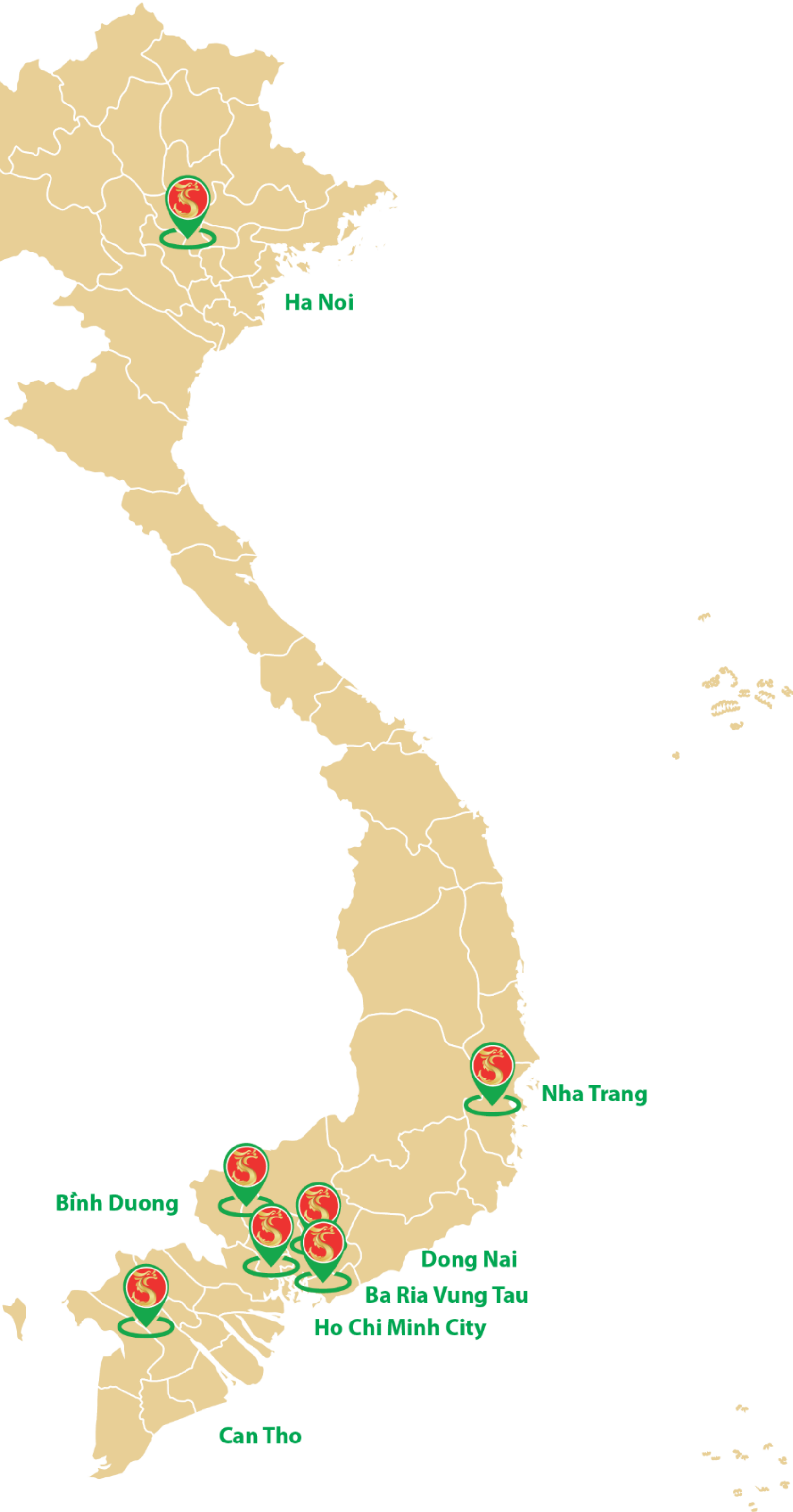

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