6th September 2022

Special Report

CAUTIOUS OPTIMISM

- *The third quarter will be a prosperous quarter for the manufacturing sector. Industrial production growth is estimated at 13.5% yoy, higher than the growth rate of 10.8% in the previous quarter.*
- *Weakening imports, especially raw materials for the production of electronics, signals a slowdown in the growth of industrial production in the fourth quarter.*
- *In Aug, the SBV continued to use the OMO tool to reduce pressure on the exchange rate, in return for higher stabilization costs.*
- *The Fed's messages delivered at the Jackson Hole Conference at the end of Aug raised the expectation of a 75bps rate hike ahead of the Sep meeting.*
- *If looking beyond predicting short-term events, we think a 125bps hike from now to the end of the year is appropriate, the fluctuation lies in the speed of increases, either (75-25-25) bps or (50-50-25) bps.*

Bernard Lapointe

bernard.lapointe@vdsc.com.vn

Ha My Tran

my.tth@vdsc.com.vn

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GLOBAL ECONOMY

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Jackson Hole meeting: August 2022

- The US FED Chairman, Jerome Powell, was very clear: economic 'pain' from higher rates.
- Global central bankers delivered a hawkish message.
- Balancing reactivity and predictability.

This year's conference of central bankers, economists and fund managers was held in person for the first time since 2019.

For those waiting in anticipation of a sudden central bank reversal on interest rate hikes or full capitulation and a return to stimulus, you might be holding your breath a while longer.

A host of central banking heads from around the world delivered a unified message of hawkish intent on August 27 at the Kansas City Fed's annual retreat in the Grand Teton National Park in Wyoming. The heads of the Bank of England, the Bank of Canada, Swiss National Bank, Bank of Japan, Bank of Korea and several European Central Bank policy makers delivered remarks that sought to unequivocally commit to raising interest rates until inflation meaningfully slows.

This followed a 10 minutes speech by Fed Chairman Jerome Powell the day before indirectly specifying that another rate hike of 75 basis points in September is highly probable. Powell referenced previous attempts by the FED to bring down inflation and said history has taught the central bank that not acting quickly on prices will likely only mean a bigger hit to the labor market in the long run. Reversing course too quickly would also backfire, implicitly playing down investors' expectations that the central bank might soon start to pause or reverse course after a series of steep interest-rate increases.

Some of his remarks are well published but we focus on one: "The Federal Open Market Committee's overarching focus right now is to bring inflation back down to our 2 percent goal. Price stability is the responsibility of the Federal Reserve and serves as the bedrock of our economy. Without price stability, the economy does not work for anyone. In particular, without price stability, we will not achieve a sustained period of strong labor market conditions that benefit all. The burdens of high inflation fall heaviest on those who are least able to bear them."

The US bond market did not react well to those comments with 2-year yields moving back up to the highest level since the middle of June (Figure 1).

Figure 1. US 2-year treasury yield

The continued hawkish tone of central bankers flies in the face of previous predictions by many economists that rate hikes and balance sheet cuts would be short lived and that bankers would seek to avoid market turmoil at all costs. This has not been the case. Considerable attention has been on the US Federal Reserve but other central bank policy makers including those at the ECB are also calling for 75 bps rate hikes in September.

The rate hike conundrum is widely understood among alternative economists but rarely discussed in the mainstream. Central banks have engaged in a non-stop program of QE, stimulus measures and near zero interest rates for well over a decade since the credit crash of 2008. Now, stock and bond markets and many other elements of the global economy are addicted to easy money derived from central bank fiat money. Without the printer and digital money creation running non-stop, there is no lifeline for massively indebted corporations, nor will there be cheap overnight loans to support corporate stock buybacks.

These policies have kept many nations and stock markets on financial life support for years, but they have also created the detrimental price inflation the public is now suffering under today. Thus, a Catch-22 scenario has been engineered. If central banks cut off the easy money and raise interest rates, many corporations will lose their lifeline, stock buybacks will plunge, markets will fall and unemployment will rise. On the other hand if central banks continue with stimulus and low rates, inflation will only climb higher.

So far it would seem that central bankers are choosing market instability and job losses over more inflation and they have given no indication they plan to reverse course for months to come.

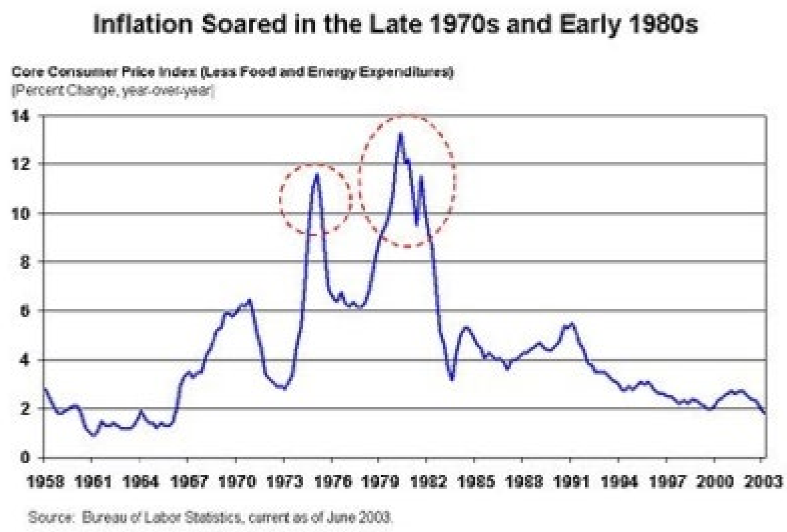
One of the theme discussed at the meeting was how expectations of inflation actually affect inflation. From the Bank of France, Mr. Villeroy De Galhau, did ask three somehow simple questions on this subject:

- What is the pass-through of inflation expectations to inflation?
- What horizon of expectations matter most?
- What role does past inflation plays beyond expectations?

There are no easy answers to any of those questions. Economists have struggled for years to find the right balance between tackling expectations and securing a smooth growth environment.

In 1979, Paul Volcker, then Chairman of the FED, did pronounce the same words when US inflation was running at above 10% (Figure 2). He took action by raising rates substantially.

Figure 2. US inflation – 1958-2003



The 'Great Inflation' was the defining macroeconomic period of the second half of the twentieth century. Lasting from 1965 to 1982, it led economists to rethink the policies of the FED and other central banks.

The US administration under President Nixon introduced measures to fight rising prices over three phases between 1971 and 1974. Those controls only temporarily slowed the rise in prices while exacerbating shortages, particularly for food and energy. The Ford administration later fared no better in its efforts. After declaring inflation "enemy number one," President Ford in 1974 introduced the Whip Inflation Now (WIN) program, which consisted of voluntary measures to encourage more thrift. It was a failure.

Bottom line:

This year Jackson Hole meeting was a reminder that central bankers have now realized that inflation does not disappear overnight. We are in a period of rising interest rates in general, globally. Except in some countries like China and Japan.

The Euro

- **The economic slowdown in Europe and the weakness of the Euro could have an impact on many Vietnamese companies that have a high exposure to that region.**
- Second time this summer that the European currency falls below one (1.0) versus the USD.
- Russia's Gazprom is still being paid for its gas shipments to the EU in Euros.

The Euro, for the second times in a few weeks (Figure 3) fell below one (1.0) versus the US Dollar. This time the drop seems more serious than in July. The USD has gained 2.4% versus the Euro in a few trading sessions before stabilizing ahead of central bankers meeting in Jackson Hole (organized by the Kansas City Fed) August 25-27.

Figure 3. EUR/USD

Note: As of August 24

After it started officially trading in early 2002[1], the Euro briefly dipped below 0.9 versus the USD before rallying to almost 1.6 in 2008 (Figure 4).

[1] After a decade of preparations, the euro was launched on 1 January 1999. For the first three years it was an 'invisible' currency, only used for accounting purposes and electronic payments. Coins and banknotes were launched on 1 January 2002 and in 12 EU countries the biggest cash changeover in history took place.

Figure 4. EUR/USD, last 20 years

The more than 11% year-to-date (as of August 24th) decline is comparable to losses seen in 2015, when the European Central Bank unleashed a massive stimulus program- the Euro went from 1.4 to1.1 to the USD.

The backdrop of ongoing conflict from the Russian invasion of Ukraine, a hesitant ECB and a hawkish US Federal Reserve continue to harm demand for EUR/USD. On the other hand the US Dollar has been steadily stronger across the board, benefitting from its 'safe-haven' status. This is a concept that this writer has been struggling to understand for a long time…

Russia's Gazprom is still being paid for its gas shipments to the EU in Euros, according to our sources. However Gazprom probably exchanges these Euros very quickly in various non-Euro currencies, such as USD, Brazilian Real, Mexican Peso etc.. This is one of the reason why the Euro is so weak. Apparently Gazprom trades these Euros within two days so they do not face sanction from the European Union. It is murky. The Brazilian Real has appreciated versus the USD since early July (Figure 5). Somebody has been buying.

Figure 5. Brazilian Real (USD/BRL) versus USD

It has not helped the Euro that the seasonally adjusted Eurozone PMI Composite Output Index dropped to 49.2 in August, from 49.9 in July. The index signals a second successive reduction in business activity across the eurozone following a 16-month period of growth. Although still only slight, the latest decline was sharper than that seen in July.

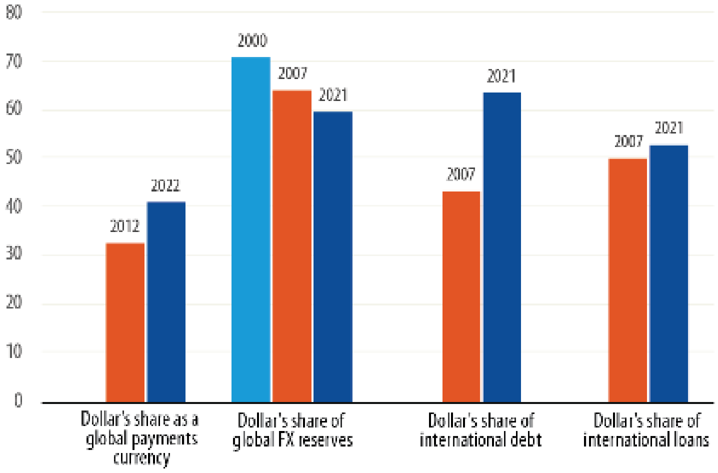
Hence this begs the question: will we see a more hawkish ECB? The market prices a 50bp rate hike at the September 8th ECB meeting. Could the ECB starts to discuss prospects of more aggressive rate increases if it wants to support the Euro? According to Bundesbank Chief Joachim Nagel, "Given high inflation, further interest-rate hikes must follow. The past few months have shown that we have to decide on monetary policy from meeting to meeting." A growing number of policymakers on the ECB governing council are increasingly supportive of an outsized rate hike of 50 basis points in the September meeting.

The ECB faces the conundrum of trying to address inflation fears while at the same time trying to avoid driving the eurozone economy into recession.

Bottom line:

The international monetary system may be at the threshold of significant change from a combination of economic, geopolitical, and technological forces. However it is an open question whether these forces will knock the US Dollar off its pedestal as the dominant international currency (Figure 4), which it has been for much of the post–World War II period.

Figure 6: Dollar dominance



Sources: Bank for International Settlements; European Central Bank; International Monetary Fund; and SWIFT.
Note: Data are from the end of 2021, except for payments, which are from March 2022. FX = foreign exchange.

VIETNAM ECONOMY

- Manufacturing activities recovered as expected
- Retail and inflation are bright spots
- The exchange rate continues to be under pressure

Manufacturing activities recovered as expected

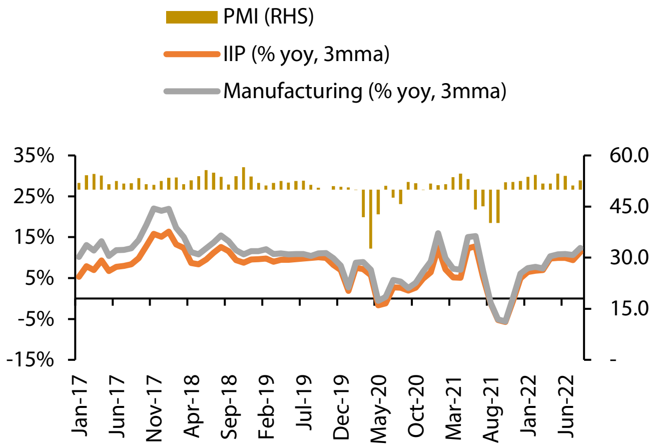
According to GSO's official data, industrial production growth in Jul continued to be adjusted down from an increase of 11.2% to 9.5%, of which, the growth of manufacturing and processing activities was also revised down from 13.1% to 11.1%. However, industrial production growth in Aug recorded a strong increase (+15.6% yoy), mainly due to the low base effect. Industries that contributed to the strong increase of the IIP in the past month include Food (+22.8%) & Beverage (+101.5%), Footwear (+57.0%) & Textiles (+28.2%), Machinery & Equipment (+69.5%), Timber (+45.5%), and Pharmaceuticals (+21.5%). Compared to the previous month, the industrial sector still grew by 2.9% compared to Jul's adjusted figures, the month-on-month increase in the industrial sector was supported by the Electronics industry (+12.0% mom).

According to GSO estimates, export turnover grew strongly in Aug, up 22.1% over the same period and 9.1% over the previous month. Similar to the development of industrial production growth, the high yoy increase in exports was led by the low base of the Fisheries (+51.3%), Textile (+42.4%), Handbags (+201.9%) & Footwear (+186.5%), Wood (+65.0%). On the other hand, electronics only increased by 4.1% yoy. However, the month-on-month increase in exports was led by Electronics (+22.9% mom). In general, if not taking into account the low base effect due to the impact of the widespread lockdown last year, the growth momentum of the industrial sector is being maintained thanks to the production of electronic products. This group is also the main pillar for export growth. However, the growth momentum of key export items such as Textiles, Fisheries and Timber slowed down significantly compared to previous months.

Vietnam's PMI in Aug reached 52.7 points, higher than 51.2 points in Jul, an indicator that the health of the manufacturing industry is still improving. The components in the PMI basket including new orders (30%), output (25%), employment (20%), delivery time (15%), and purchased inventory (10%) recorded a significant improvement compared to the previous month. In which, employment, output and new orders improved compared to Jul. Purchasing activities and delivery times shortened, but inventories of raw materials and finished products all decreased. Factors promoting the expansion of the manufacturing industry's activities include: 1) Increasing number of customers; 2) Rising demand; 3) Competitive prices and 4) Reduced input costs. The positivity of the manufacturing sector in Vietnam is in line with the picture of business conditions of ASEAN manufacturers but contrasts with the outlook of the global manufacturing sector. In Aug, ASEAN's overall PMI reached 52.8 points, slightly up from 52.2 in Jul, recording the 11th consecutive month of growth. In contrast, the global PMI fell to a 26-month low, reaching 50.3 points in Aug and lower than 51.1 points in Jul.

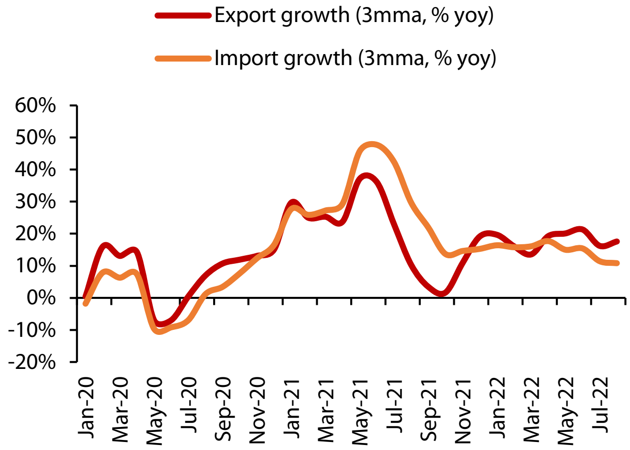
Bottom line, the third quarter will be a prosperous quarter for the manufacturing sector. Industrial production growth is estimated at 13.5% yoy, higher than the growth rate of 10.8% in the previous quarter. According to S&P Global, customer demand in ASEAN countries remains high, however, there is a rising risk of falling demand in the coming months as inflation persists and central banks continue to raise interest rates. Vietnam is also not immune to this risk, although PMI continues to improve. We note that Vietnam's imports are weakening rapidly. According to GSO estimates, imports in Aug only increased by 12.4% yoy and 1.4% mom, much lower than the growth of exports. In which, the import of raw materials for the electronics industry decreased by 1.8% yoy and 0.4% mom. Official data from the General Department of Customs shows that in Jul, imports increased by only 4.2% yoy but decreased by 5.3% mom. Weakening imports, especially raw materials for the production of electronics, which are the key pillar of industrial production and export growth in the third quarter, signal a slowdown in the growth of industrial production in the fourth quarter.

Figure 7: Manufacturing growth



Source: GSO, RongViet Securities

Figure 8: Trade growth



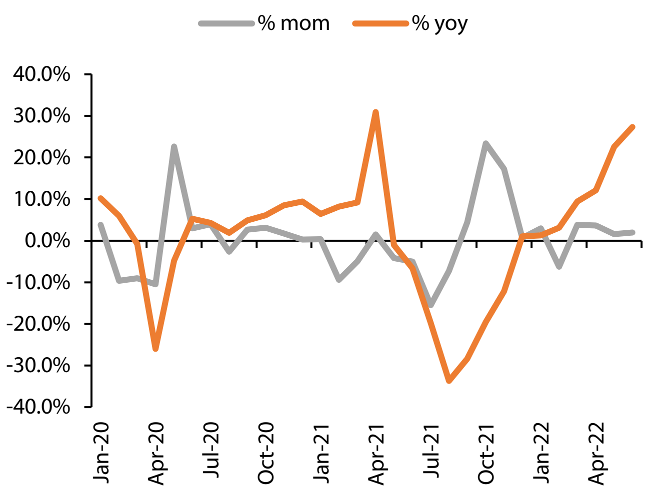
Source: GSO, RongViet Securities

Retail and inflation are bright spots

The low base effect is also supporting the retail goods and services sectors. The growth of retail sales of goods and services in Aug reached 50.2% yoy, higher than the 42.6% increase in the previous month. In which, retail sales of goods increased by 31.9% and services increased by 238.8% yoy. However, compared to the previous month, retail sales of goods and services increased by only 0.6%, of which retail sales of goods increased by 0.8% and retail sales of services remained unchanged. This shows that the recovery momentum of the service sectors, negatively affected by Covid-19 has leveled off as the summer ends. With the current recovery momentum, the retail goods and services sector could record an increase of more than 58.0% yoy in Q3, significantly higher than the 19.5% increase in Q2. Retail, accommodation and food services, transportation and warehousing, and entertainment account for about 40% of GDP. While the industrial sector is in line with our expectations, the sharp recovery in the third quarter of the above service industries could be the catalyst to boost Q3 GDP higher than our forecast of 10.4%.

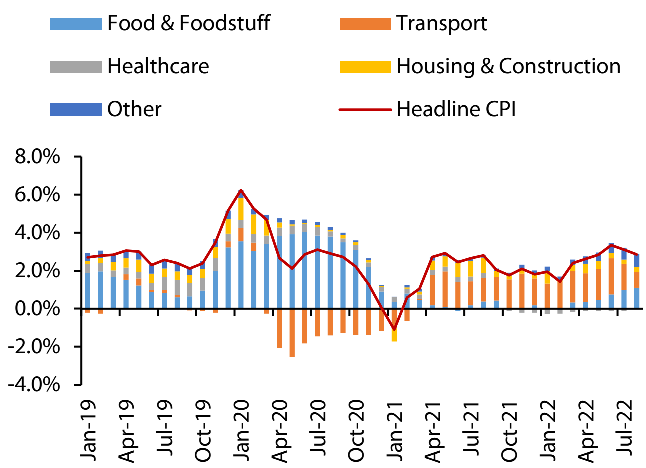
Besides the optimism about the recovery of the retail and service sectors, we see that the average oil price from the beginning of the third quarter to now is only at $100/barrel, significantly lower than the assumption of $120/barrel for the inflation scenario we provided earlier. Inflation in Aug has cooled down thanks to lower petrol prices, but because prices of other commodity groups are still in an uptrend, headline inflation only decreased slightly compared to the previous month, from 3.1% to 2.9%. Meanwhile, core inflation is accelerating, from 2.6% in Jul to 3.1% in Aug. The slowdown in oil prices will partly offset the increase in other items prices. The positive point is that the average inflation for the whole year will probably only approach but not exceed the Government's target of 4.0%.

Figure 9: Retail sales growth



Source: GSO, RongViet Securities

Figure 10: Inflation by component



Source: GSO, RongViet Securities

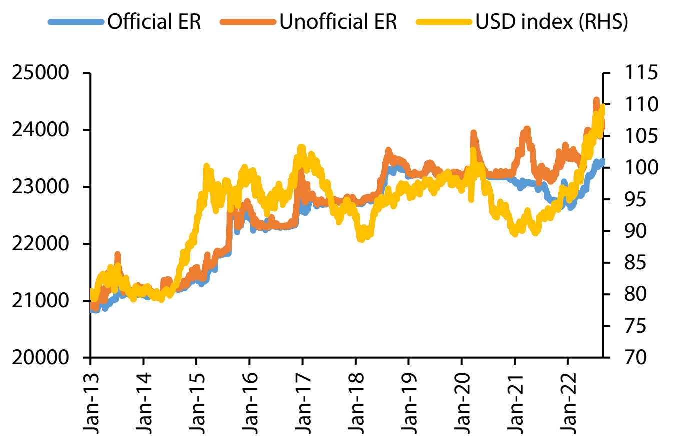
The exchange rate continues to be under pressure

In Aug, the USD/VND exchange rate on the interbank market increased by approximately 0.5% to 23,451 (as of 31 Aug), slightly higher than the peak set on 20 Jul. This development was associated with the USD index continuing to increase by 2.6% and the yuan recording a strong depreciation of 2.2% during the month. In Aug, the regulation of money supply through the open market continued to be used by the State Bank to reduce pressure on the exchange rate. By the end of the month, the overnight lending rate for VND reached above 4% and the difference in VND and USD interest rates was at 2 percentage points, in return for higher stabilization costs, interest rates of 14-day SBV bills increased from 2.6%/year at the beginning of the month to 4.0%/year. At the same time, the SBV also sold a relatively large amount of foreign currency in Aug, showing that the demand for USD in the system was still high despite a higher trade surplus.

As we mentioned in the Macro section in the 2H22 Industry Outlook Report released in mid-Aug 2022, the strength of internal factors to support exchange rate stability will be tested in the last months of the year. Although our expectation is that the Fed's rate hike at the Sep 2022 meeting will be an important milestone, the Fed's messages delivered at the Jackson Hole Conference at the end of Aug raised the expectation of a 75bps rate hike. The probability of a 75bps rate hike increased from 64% before the Jackson Hole Conference to 75%. Interestingly, after the release of US employment data in Aug with the rising unemployment rate, decreasing the number of new jobs, and sustained high wage inflation, the probability of a 75bps rate hike dropped to only 58%.

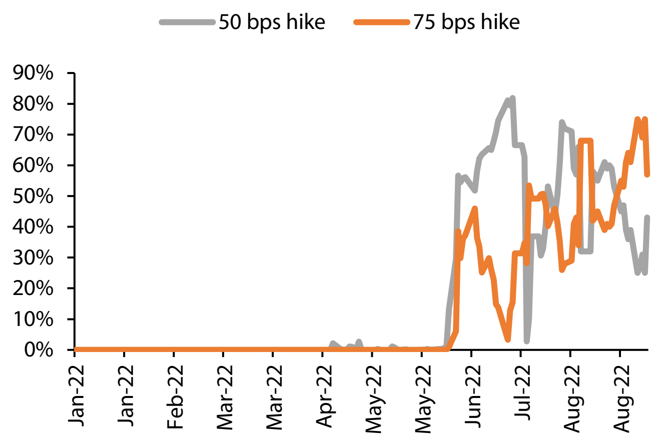
From now to 21 Sep, US Aug inflation data (released on 13 Sep) will affect the Fed's outlook for raising interest rates. Aug inflation is likely to move in line with expectations, ie slightly down from the 8.5% increase in Jul. If looking beyond predicting short-term events, we think a 125bps hike from now to the end of the year is appropriate, the fluctuation lies in the speed of increases, either (75-25-25) bps or (50-50-25) bps. Therefore, we expect the pressure on the exchange rate to ease after the Sep meeting if there is no unexpected rise in inflation.

Figure 11: Exchange rate movement



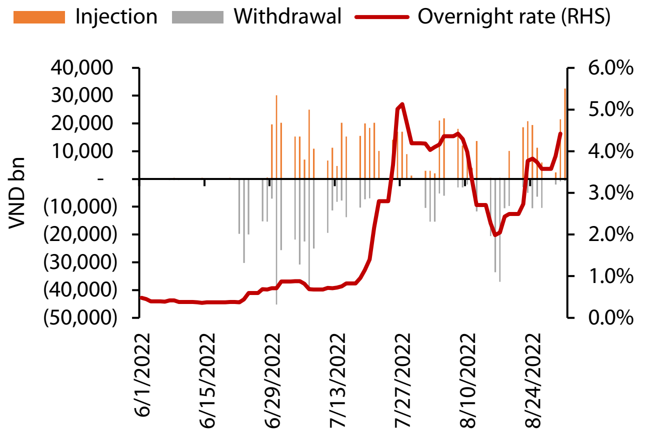
Source: Bloomberg, Fiinpro, RongViet Securities

Figure 12: Probability of Fed rate hike in Sep meeting



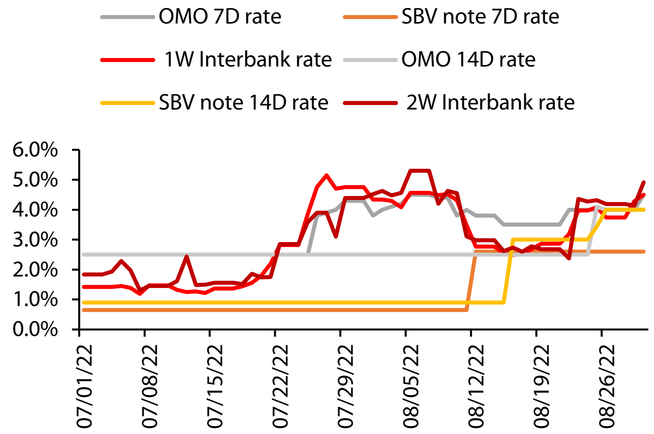
Source: CME Fed Watch, RongViet Securities

Figure 13: SBV net withdrawal/injection in the OMO market and O/N interbank rate



Source: SBV, RongViet Securities

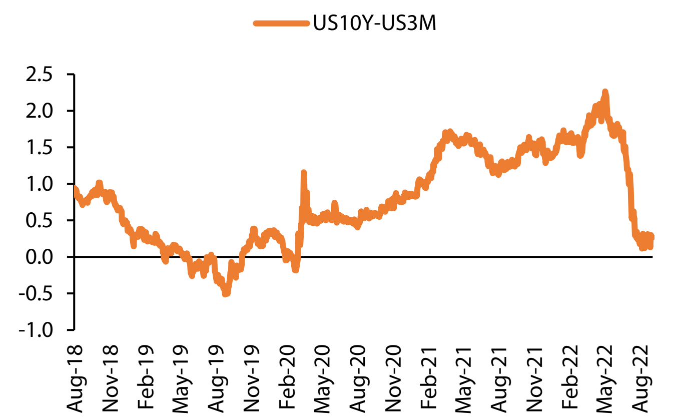
Figure 14: Interest rate in the OMO market



Source: SBV, RongViet Securities

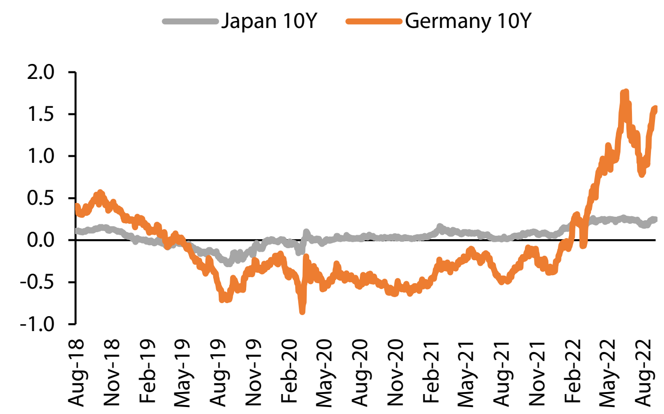
GLOBAL ECONOMIC INDICATORS IN AUGUST

US G-Bond yields gap (%/year)



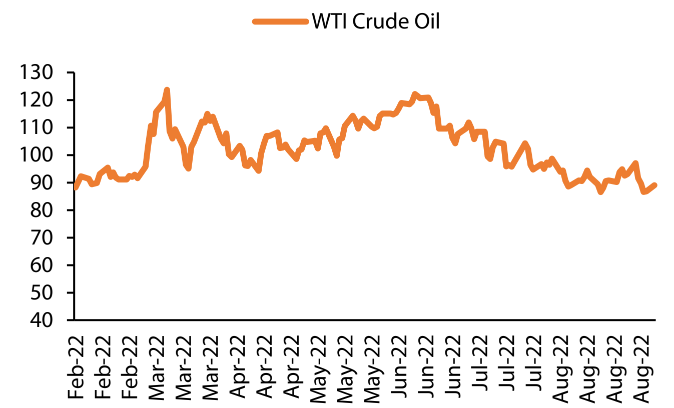
Source: Bloomberg, Rong Viet Securities

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



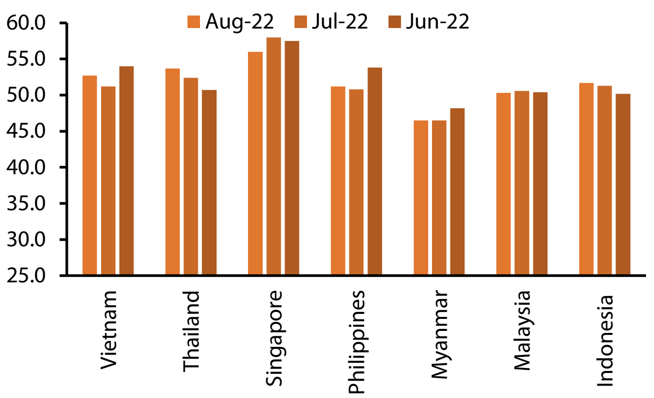
Source: Bloomberg, Rong Viet Securities

WTI crude oil price (USD/barrel)



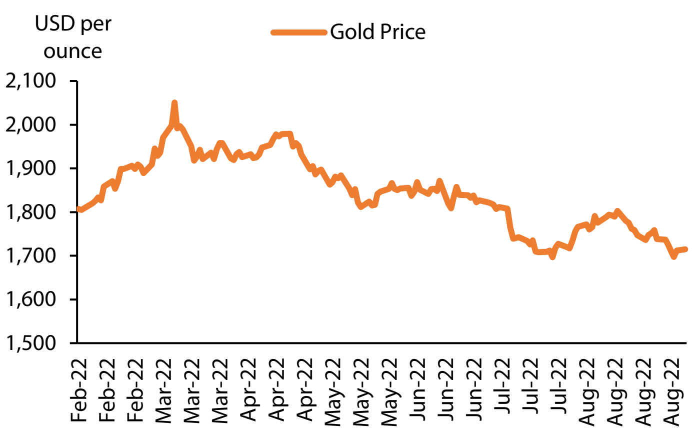
Source: Bloomberg, Rong Viet Securities

ASEAN's PMI



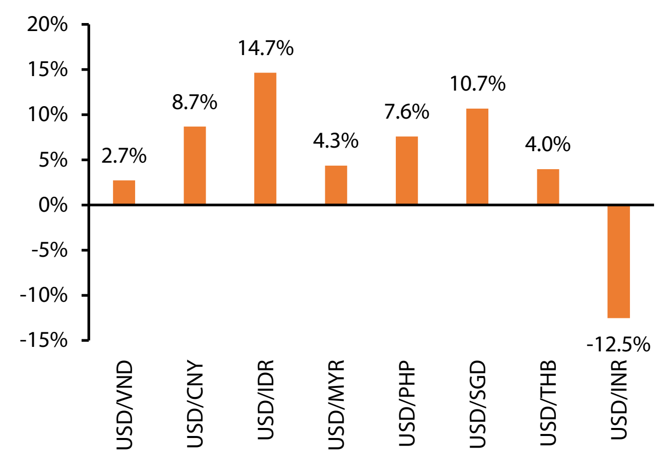
Source: Markit Economics, Rong Viet Securities

Gold prices (US$/ounce)



Source: Bloomberg, Rong Viet Securities

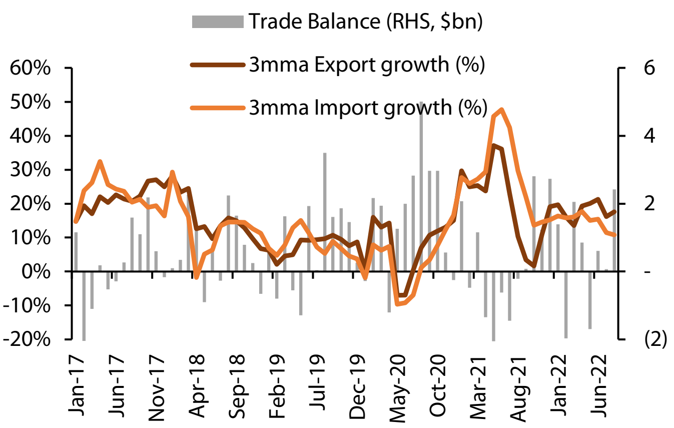
FX rates (%, YTD)



Source: Bloomberg, Rong Viet Securities

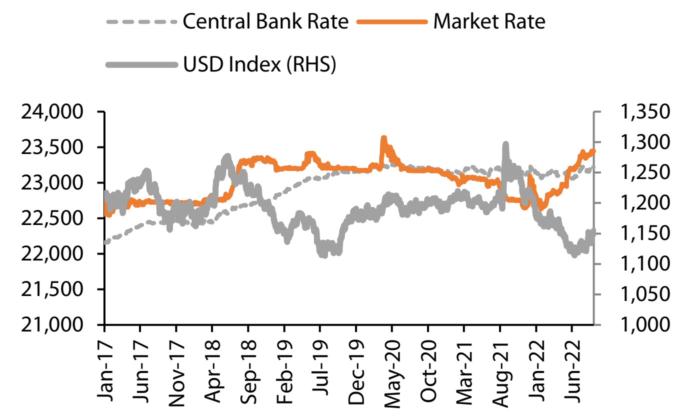
VIETNAM ECONOMIC INDICATORS IN AUG 2022

Trade balance



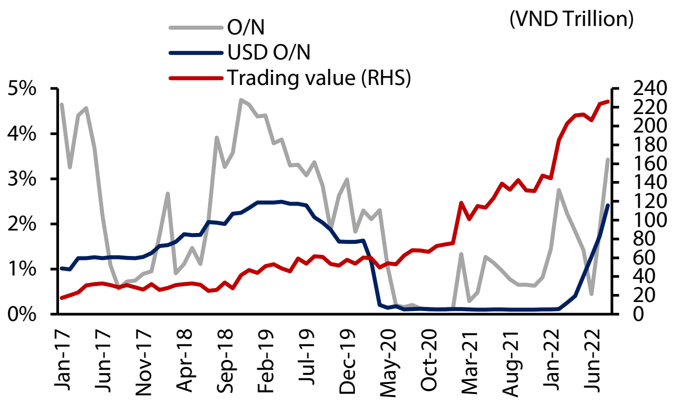
Source: GSO, Rong Viet Securities

USDVND exchange rate



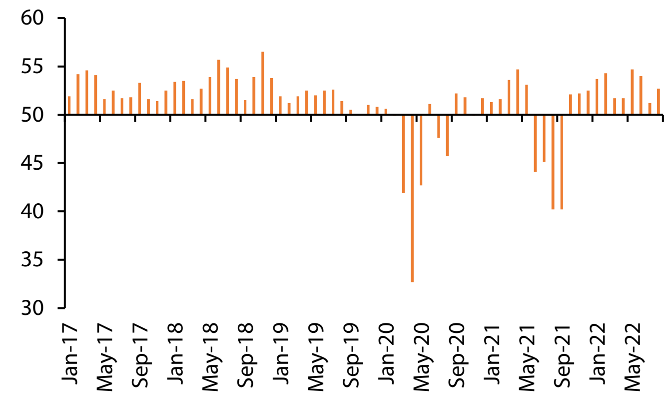
Source: SBV, Bloomberg, Rong Viet Securities

Interbank interest rate (%/year)



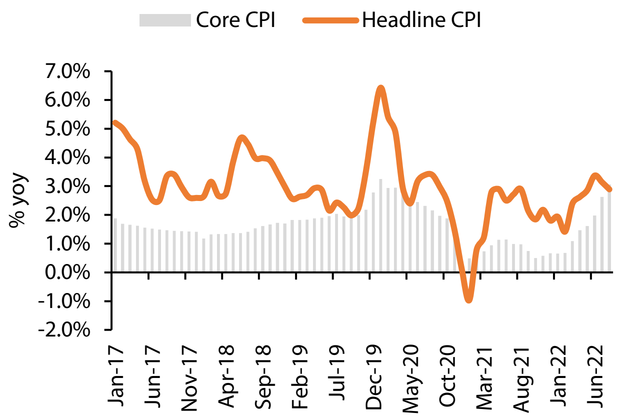
Source: SBV, Rong Viet Securities

Vietnam PMI



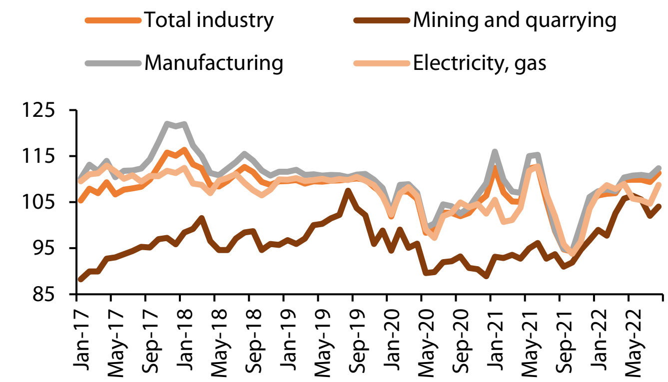
Source: IHS Markit, Rong Viet Securities

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