Thematic report: FOREIGN EXCHANGE MARKET & US-CHINA TRADE TENSIONS

Market's Strategy Team

Thematic report- Macroeconomic research

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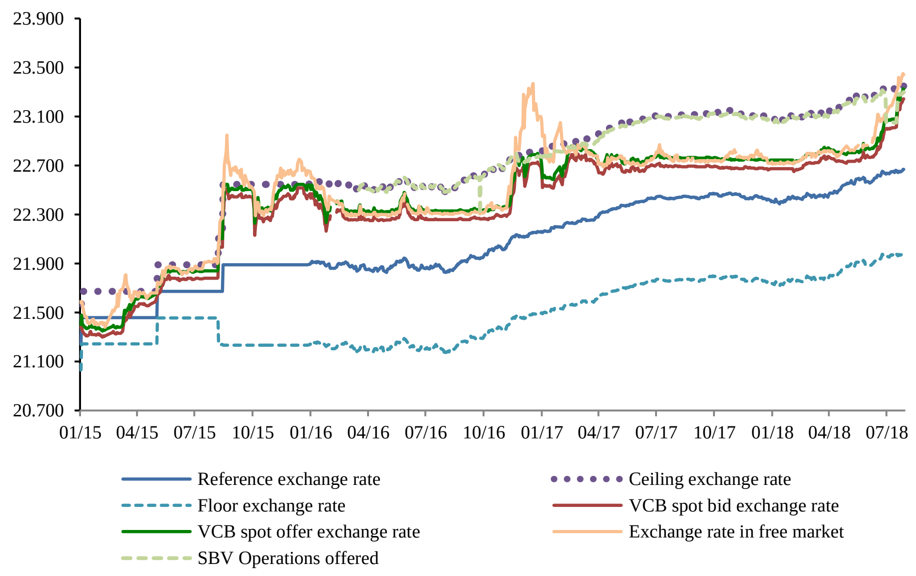
Highlights

At this time, the forecasts surrounding the US-China trade tensions and the impact on the Vietnamese market are almost exclusively conjectural when the main negotiations still not ready yet. However, there are two things that can be confirmed. First, trade war will bring damage to both sides in case it is ignited. In this case, we are inclined to the possibility that strong statements and moves recently aimed at seeking a deal. Secondly, it is clear that for the second largest economy in the world, in the face of the risk of a trade war, monetary policy are a key tool for Chinese operators. Specifically, in this period, loosen monetary policy continues to be a priority. Even there was rising concern that recent developments may lead to a currency war.

USD/VND Exchange rate



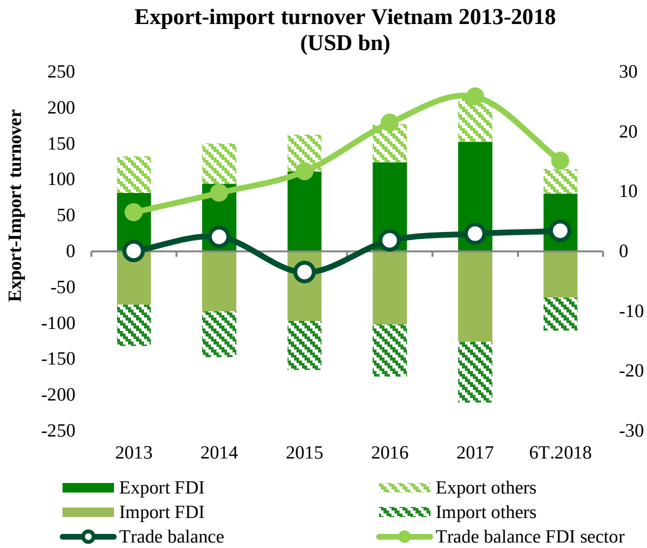
Source: Bloomberg, Fiinpro, VCBS compiled

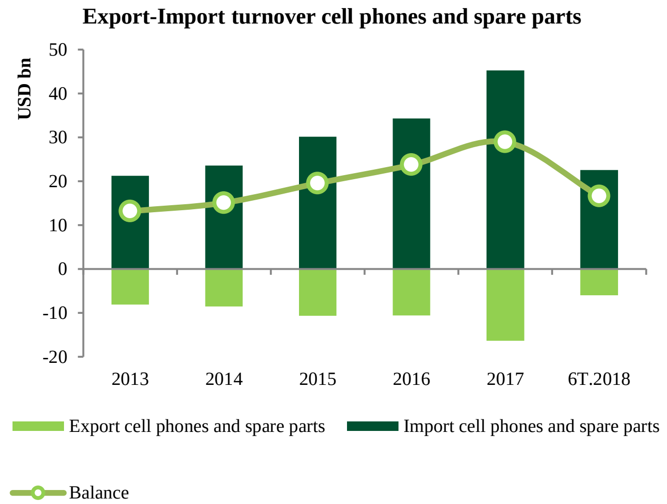
In the context that Vietnam is intensively integration with the international market and its close proximity to the second world economy, how will the impact on the Vietnamese economy is recognized?

As mentioned above, in this report, 2 assumptions we made will be (1) **After the negotiations are over, trade tensions will gradually ease with more harmonized benefits between nations and (2) The continuation of China's loose monetary policy will be the closest policy to Vietnam.** As a result, we aim to forecast the management and behavior of the SBV in order to stabilize the macro economy, avoiding undue impacts from the world market.

1. The impact of trade war on domestic import and export is not a core issue at this stage:

From the perspective of the Vietnamese economy, in recent years, the largest contribution to export-import activities are FDI enterprises. Specifically, in the first seven months, the FDI sector (including crude oil) accounted for 70.8% of total export turnover. Notably, these enterprises, especially large enterprises such as Samsung and LG, are importing raw materials and components and exporting finished products as enterprises mainly carry out assembly in Vietnam. Due to the special characteristics of both export-import activities, the exchange rate will not be the top concern of these enterprises. Instead, government incentives for investment climate, business procedures, tax policies, and new labor costs are major concerns.





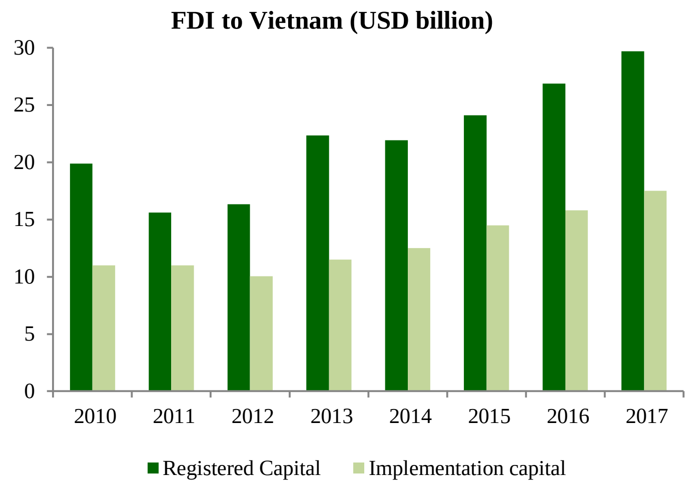
Source: Fiinpro, VCBS tổng hợp

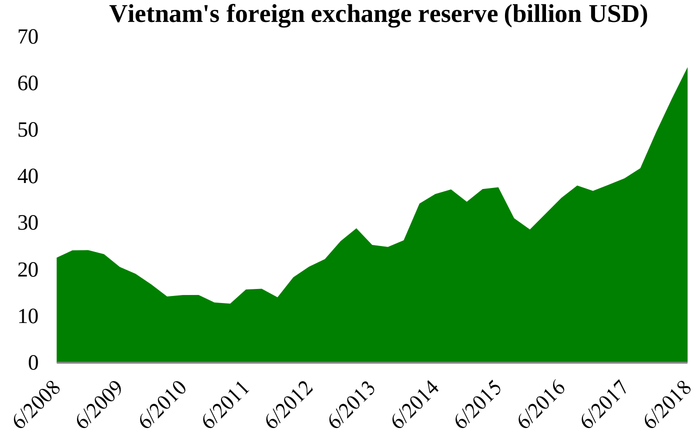
For domestic export-import businesses, since the middle of June, due to continuous exchange rate fluctuations, certain difficulties have been recorded. However, many businesses have taken the initiative to reduce the negative impact. Specifically, the signing of foreign currency forward contracts with commercial banks; dealing with export credit via deferred payment letter of credit (UPAS L / C). We think that from the point of view of import-export business, it is important to project the devaluation of VND against USD for business plan.

2. Vietnam has strongly benefited from direct and indirect investment flows in the last three years:

In recent years, attracting large amounts of direct and indirect investment has created more room for executives to maintain economic stability. First, (1) the supply of foreign currency is sufficiently large and abundant for the State Bank to increase its foreign exchange reserves in line with the double digit growth in import and export activities in 2017 (+20, 95%); June 6, 2018 (+ 13.3%). By the end of June 2018, foreign exchange reserves reached USD 63.5 billion, equivalent to 12-15 weeks of imports.

This resource indirectly supports liquidity in the banking system. Since then, commercial banks have abundant to increase credit, accelerate the process of solving bad debt.

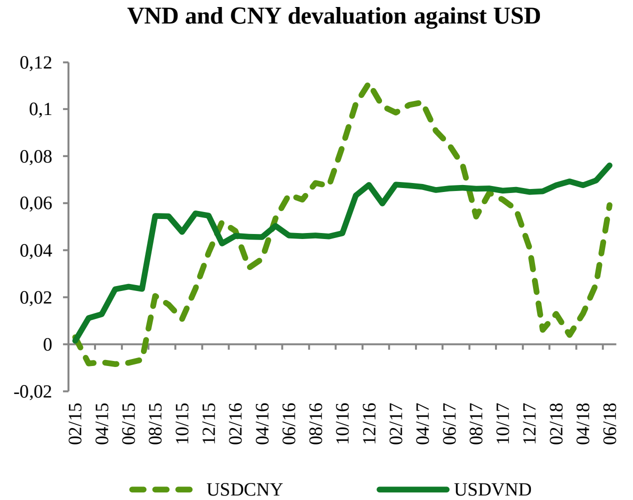


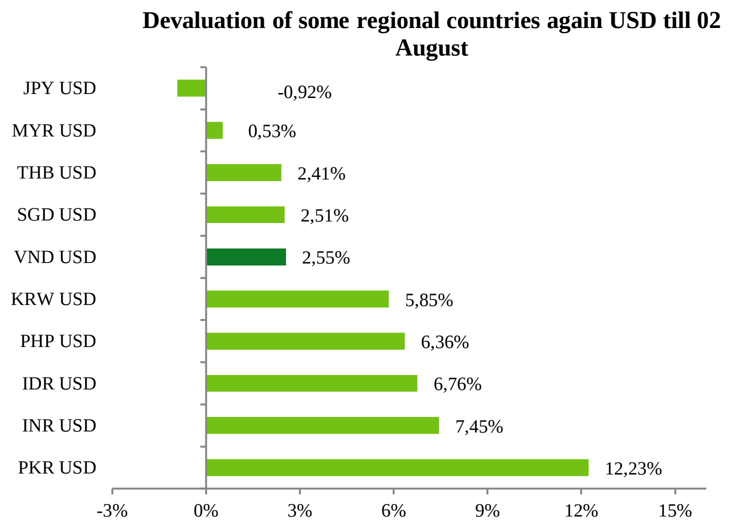


Source: CEIC, VCBS compiled

Finally, contribution from foreign direct investment (FDI), particularly large FDI enterprises such as Samsung, LG, or Formosa, is an important component contributing to the overall economic growth, helping Manufacturing subsector becomes the growth driver.

From this perspective, government policy priorities in the coming years will continue to improve the business environment, ensure the stability of macroeconomic data and maintain relative attractiveness of Vietnam in Foreign's views. In particular, the objectives related to macroeconomic indicators include (1) ensuring that inflation is controlled, which not exceed the government's annual commitment targets; (2) keeping the domestic currency depreciated at a relatively reasonable rate compared to other countries in the region. And so far, the State Bank has played their role as regulator for the exchange rate when it comes to clear policy direction and regulatory measures based on the market's performance and is not Follow the unpredictable developments in the world market.





Source: Bloomberg, VCBS compiled

3. China's loosen monetary policy from another view can have positive effects on Vietnamese economy

2016-2017 - The key moment in the Chinese government's 13th Five-Year Plan (2016-2020) shifts the model of an economy based on investment and exports to a mainly consumer-based paradigm domestic and service sectors. This time, China has made considerable choices with the flow of FDI inflows into the country. This, coupled with rising labor costs, makes FDI inflows into China more likely to shift and seek new destinations with similar labor cost and selectivity not too strict. Vietnam is considered one of the most ideal destinations for this flow of capital.

Source: Bloomberg, VCBS compiled

At the same time, since 2015, PBOC has continued to maintain its monetary policy easing in recent years to limit the effect of the strong greenback after the FED started to tighten monetary policy. The investment demand of domestic capital inflows of the world's second largest economy increased. **This, also makes the country has policies to attract strongly foreign investment flows like Vietnam to benefit.**

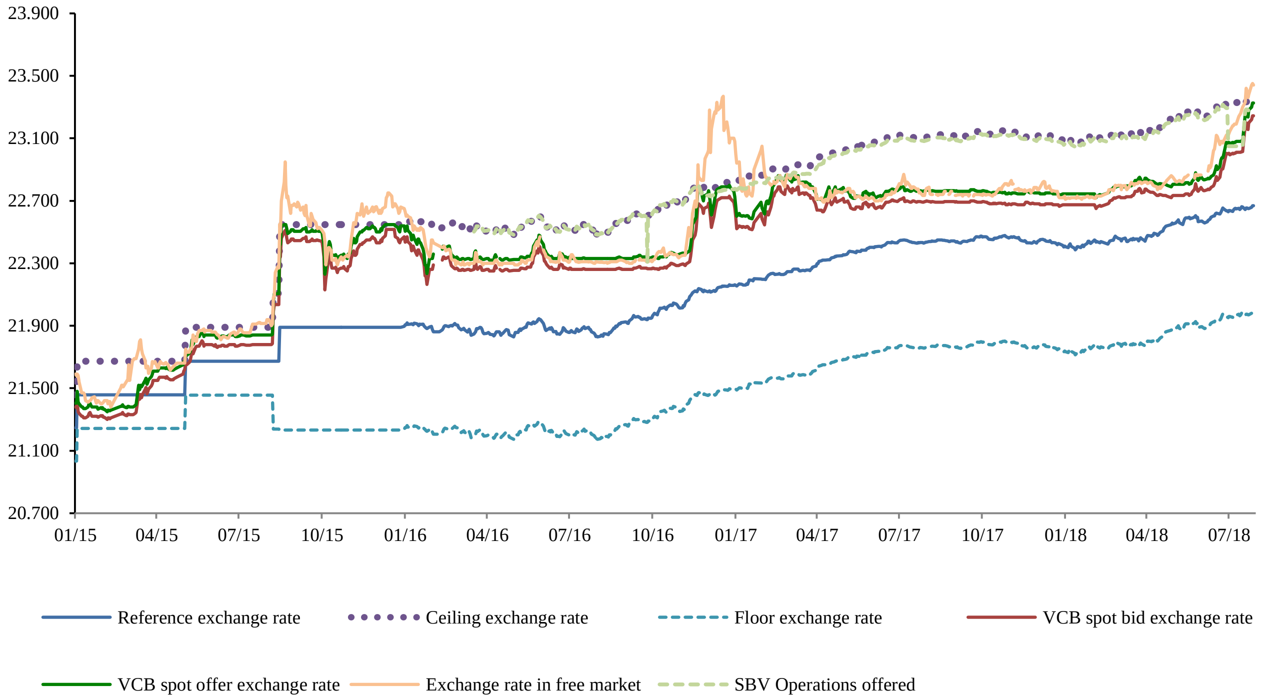
4. Potential risks are difficult to forecast and should be monitored closely

As mentioned above, the above analysis is based on two initial assumptions, when these two assumptions change the all variables will change in different directions.

It should be added that the above analysis is more probable in the absence of random events resonating. In our opinion, such an event occurred in June when the market continuously witnessed the escalation of the exchange rate on the free market, stemming from the lack of foreign supply. Temporary cash inflows due to the change of partner in this service are not only in the Vietnamese market but also in many other countries in the world.

With this fact, despite the fact that the market-based regulation was timed out by the SBV, the exchange rate in the free market is still not expected to escape the short-term upward pressure. This phenomenon together with the relatively stable foreign exchange market in two consecutive years, has created speculative psychology to significantly differentiate prices in the market. This partly explains the large amount of foreign currency up to USD 2.12 billion was sold by the State Bank at a "low price" 23,050 was absorbed by commercial banks in the week from 16 – 20 July in Real demand for production, import and export activities is considered as non-mutable.

USD/VND Exchange rate



Source: Bloomberg, Fiinpro, VCBS compiled

5. In another view, some bright spots may support the exchange rate in the last 6 months:

Beside the potential risks, we also see that some factors may be able to bring certain advantages in achieving the target related to the reasonable discount of VND. (1) Foreign exchange reserves reached USD 63.5 billion in the first half of the year - equivalent to 12-15 weeks of imports; (2) At the same time (i) realized FDI continued to grow well in the first seven months of the year, recording an 8.8% increase over the same period; (ii) The trade balance surplus is maintained. Even in July, the trade surplus reached over USD 3 billion compared with a surplus of USD 2.71 billion recorded in June; (iii) Remittances are expected to continue to grow (2017 overseas remittances are expected to reach USD 13.8 billion, up 16% over 2016).

Meanwhile, on the world market, the FED decided to raise interest rates for the second time in a year in a meeting of monetary policy in June, announcing that it would raise interest rates four times this year. Accordingly, expectations of the Fed will raise interest rates four times this year this part has partly reflected in the market performance.

With all of the above factors, we continue to maintain our views. Although the pressure on the exchange rate in the short term is likely to continue, we think that with the existing resources and a clear message on the direction of the government, the SBV will be able to keep the exchange rate down. around 2% -2.5% for 2018 - significantly lower than other countries in the region. Meanwhile, at times of stress, exchange rates at commercial banks may trade at the ceiling level within the 3% band that has been regulated against the central rate.

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