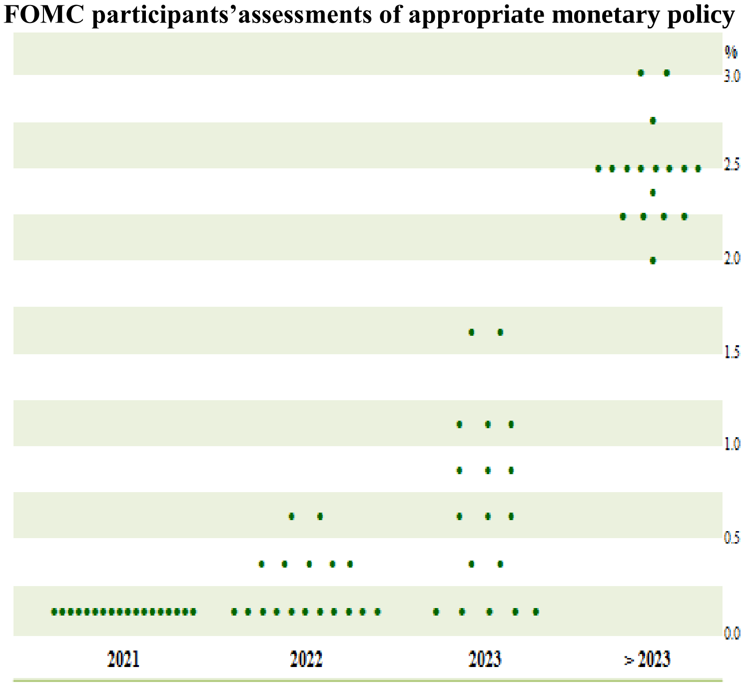
On June 17, after a 2-day meeting of the Federal Open Market Committee, the Fed announced its decision to keep the base interest rate at a near-zero margin to continue supporting the economic recovery. Notably, there were some changes publicly announced this time:

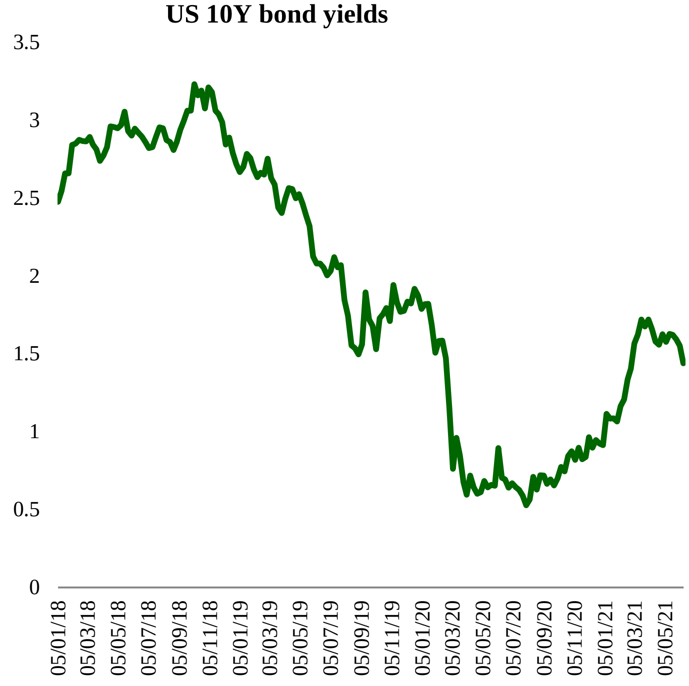
- First, Fed affirmed that inflation can still increase and settle high in the coming months. However, Fed still sees inflation trending to its 2% goal over the long run. At the same time, Fed raised its headline inflation expectation to 3.4% from 2.4%.
- Second, the labor market is showing signs of a better recovery than expected, and this trend shall remain. However, this threshold is still far from the pre-pandemic level.
- Officials raised their GDP expectations for this year to 7% from 6.5%
- Interest rates may get two hikes to 0.6% in 2023 instead of by the end of 2023 as stated in the previous meeting.
- Regarding the asset purchase program, Fed still maintains the bond-buying program of USD 120 billion per month and continues to have discussions about buying bonds in the coming meetings.

Thus, we observe a better US economic outlook in 2021 in this announcement in terms of both GDP and labor, asset repurchase programs are still being conducted regularly. At this time, we believe that the reactions followings this news is likely to be short-term expectations rather than a long-term impact on financial markets. This poses a question about the impact on Vietnam when Central banks worldwide put an end to easing phase.

FOMC participants' assessments of appropriate monetary policy



US 10Y bond yields

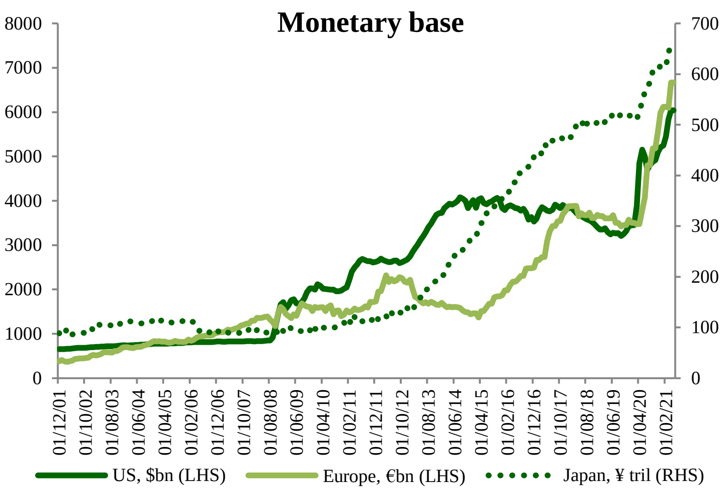


Source: Bloomberg, Fed

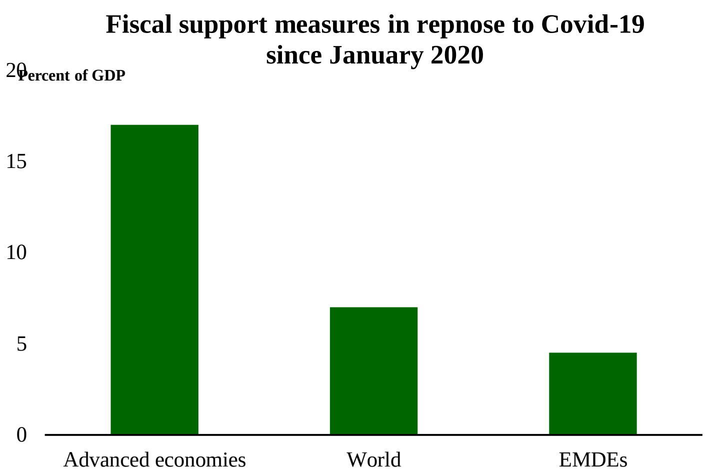
1. Worldwide context

In response to Covid-19, central banks have utilized unconventional loosening monetary policies. Consequently, in just a short time, the monetary base double. This results in an upward trend of asset channels, typically the higher equity valuation and low yields for fixed-income market.

The world economy is forecasted to enter a post-pandemic period in 2021. Hence, according to World Bank (WB), taking the economic structure of the economy into consideration, we observe that the construction industries, industrial production and retail sales (suffered a temporary halt of consumption demand due to the pandemic) has rebounded or got close to the pre-epidemic level while the service consumption level has yet to recover significantly.

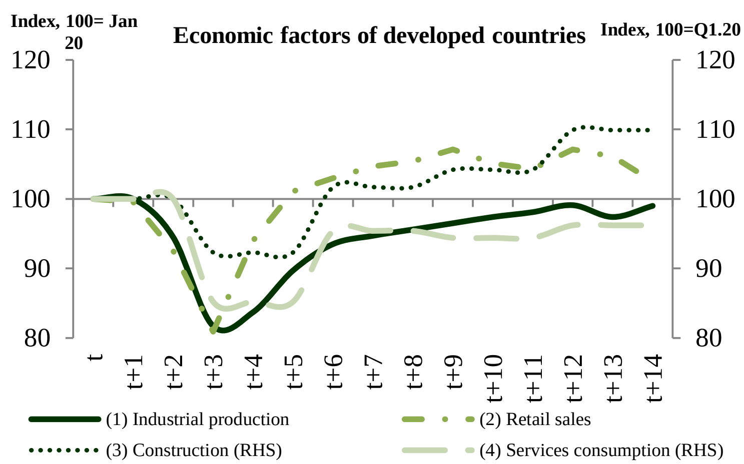


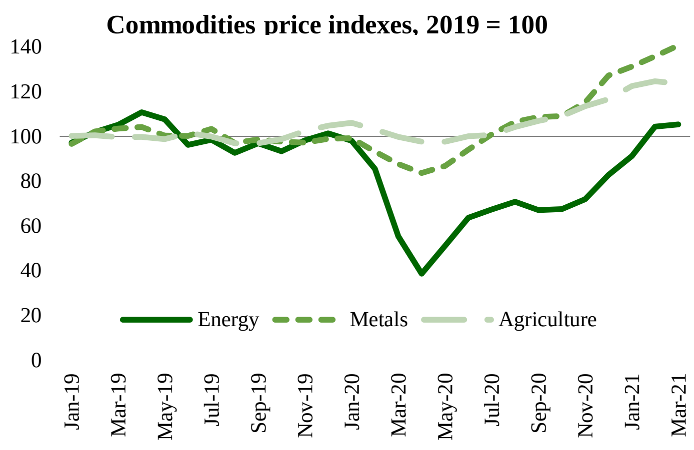
Source: Bloomberg, VCBS Research



Source: IMF, WB, VCBS Research

This leads to the phenomenon hike of headline inflation in many countries due to an increase in production inputs, notably crude oil with an increase of 40% over the same period last year. In Q1.2021, 80% of commodities price regain the pre-pandemic threshold regardless of Covid-19 impact. According to World Bank's latest report on commodities, oil prices are expected to average $56/bbl in 2021 (30% higher than the 2020 threshold) before rising to $60/bbl in 2022. Metal prices are forecast to rise nearly 30% in 2021 before dropping back in 2022. Agricultural prices are projected to rise nearly 14% in 2021 in some food commodities. **To sum up, upward trend dominate in commodity market in 2021.**





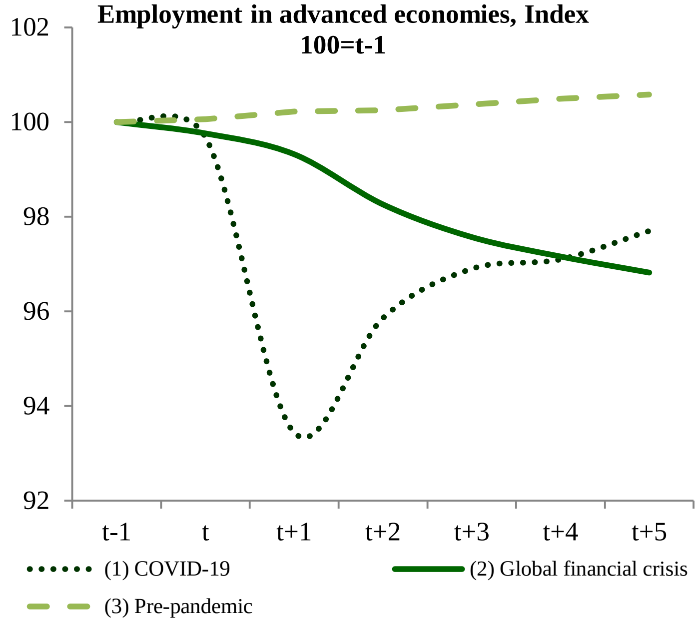
Source: USDA, WB, World Bureau of Metal Statistics

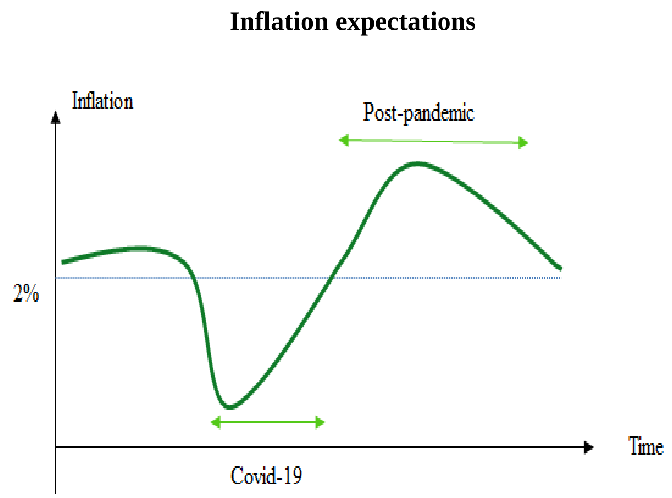
2. Reactions and comments of major central banks regard to higher inflation expectations.

Expansionary monetary policy shall be extended. Note that these days, central banks report better than expected growth prospects post-pandemic. Fed & ECB show consensus view that inflation has picked up lately on account of some idiosyncratic and temporary factors. Therefore, inflation target in medium term in still within reach. In detail, in August 2020, Fed announced the adjustment of monetary policy framework by re-framing the goal as an average inflation target (AIT) of 2% over the long-run. Meanwhile, ECB also target below but close to 2% over the medium term. **It refers a period of higher inflation above 2% following the pandemic period when inflation dropped significantly below 2%.**

At the present, there is no signal about changing monetary policy due to inflation heating up. Accordingly, VCBS believe that it is too early to call a super cycle in commodities price, which results in inflation pressure in medium and long-term.

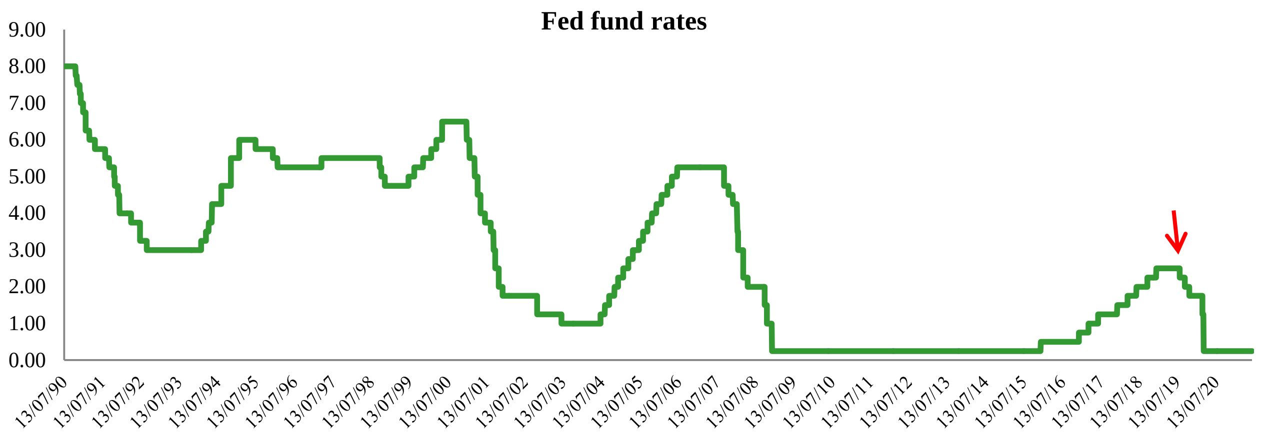
Taking the latest news from the Fed, although we see that there may be a tapering before previous expectations, the timing for this is scheduled in 2023. **Hence, we believe that it is still too early to call the fundamental changes to the financial markets as well as the capital flows. Accordingly, the effects these days are mainly short-term ones and therefore shall not last long.**





Source: Oxford Economics, WB, VCBS Research

We observe that it is hard to reverse unconventional loosened monetary policy as central banks face many difficulties to narrow the balance sheets. In 2015, Fed finally hiked interest rates after 10 year in procrastination. However, Fed had to cut interest rates again in September 2019 (when no Covid-19 cases were recorded). The ECB also quickly made a similar move to cut the deposit rate from -0.4% to a new record low: -0.5%, and restart the asset purchasing program. Efforts to reverse monetary policy will be difficult and unlikely to happen soon when the recovery of the labor market, especially the US and Europe, is still low. **To sum up, central banks will continue to maintain loosen monetary policy at least until 2022, and there are no concerns about inflation in the medium term.**



Source:: CEIC

In case the central banks begin to neutralize the loosened monetary policy, this is a positive signal when the world economy gradually recovers, minimizing the risk of global economic crisis. Looking into the past, even in the period when the Fed raised interest rates at the end of 2015, the negative and direct impacts on Vietnam are not clear. Specifically, interest rates on government bonds in the period 2015- up to now as well as interest rates in the economy have logged in a downward trend; exchange rate maintained a steady decrease of ~2%/year; FDI registered and disbursed inflows have maintained at a steady pace.

3. Expected effects on exchange rates, interest rates and operator response

From the perspective of a highly open economy, the top prioirity in the long term is to ensure macroeconomic stability and create attractiveness for international investment inflows. Accordingly, Vietnam may use resources, foreign inflows to boost production, raise income per capita and escape the middle-income trap. This mission has been successful over the years. With the assumption that Vietnam will contain the pandemic, maintain good macroeconomic indicators, investment capital flows may invest in Vietnam based on the country's risk level and potential growth of the economy. This is also the same assessments as credit rating agencies gave Vietnam,

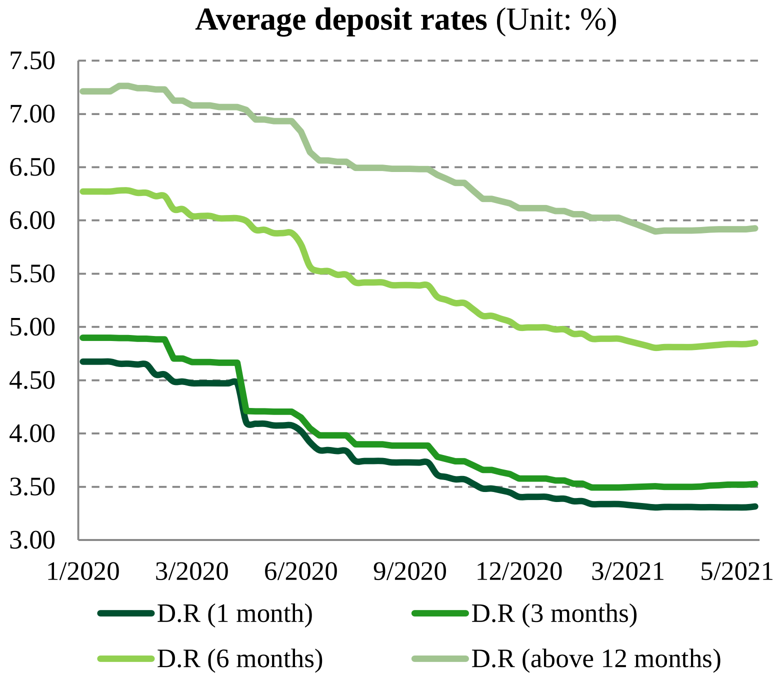
Thus, in the long term, when the monetary policies of the central banks gradually make the easing phase come to an end, Vietnam still has the conditions and resources to ensure macroeconomic stability. In particular, the trend is shifting investment flows from China (and other countries) to Vietnam. At the same time, FTAs are also a plus point in attracting investment flows.

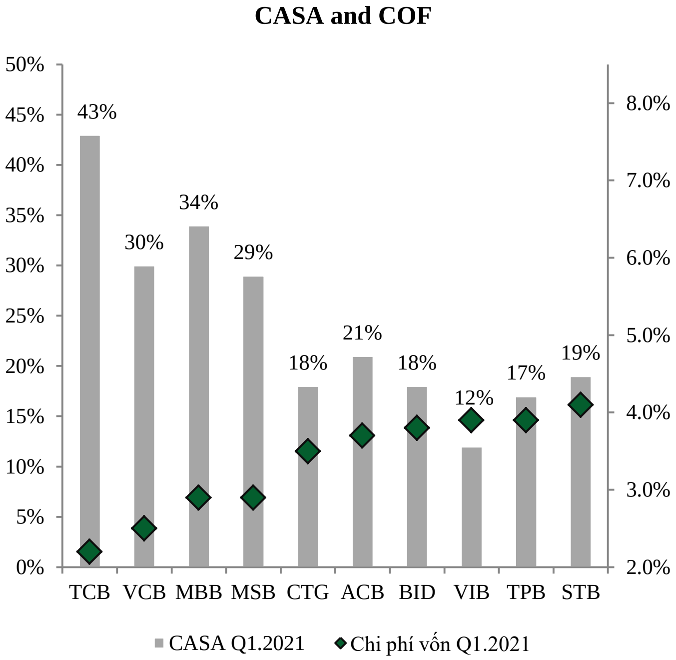
In the short term, compared with other central banks in the world, the State Bank of Vietnam (SBV) only lowers operating interest rates and has no plan to buy back assets such as bonds. Thus, this is considered a good point in terms of flexibility in monetary policy. Along with that, another plus point is that the flexible and appropriate management policies from time to time have shown their effectiveness in stabilizing macroeconomic indicators such as exchange rate, inflation, or interest rates in different sectors in recent years. However, some challenge for the SBV in 2021 comes from:

- Pressure from the large openness of the economy, import and export turnover tends to increase relative to the size of the economy given that raw material prices are high, creating pressure on the target. top priority on controlling inflation.
- Great pressure on harmonizing the interests of depositors and borrowers.
- The need to support capital flows into the economy to support businesses recovering after the pandemic, but minimizing capital inflows into asset channels or risky activities such as speculation and real estate business.

Basically, monetary policy interventions to control inflation by the Central Bank will not be effective when the cause comes from the increase in commodity prices. We observe that many world central banks have signaled to accept the scenario of increasing inflation during the recovery period and not being too rigid with the medium-term inflation target.

We have expectations on interest rates, exchange rates as below:





Source: Commercial banks

a. Interest rates

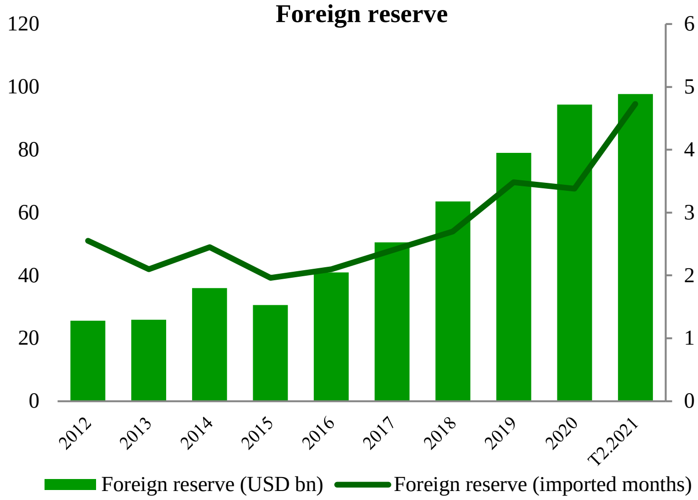
In May, upward pressure on deposit rates was recorded in certain banks. However, VCBS believes that upward pressure may not domain the whole system and these actions of certain banks in order to balance the interests of depositors, reduce the trend of diversification into other investment channels. In addition, it is expected to rebalance deposit growth while credit growth has increased faster in the first months of the year.

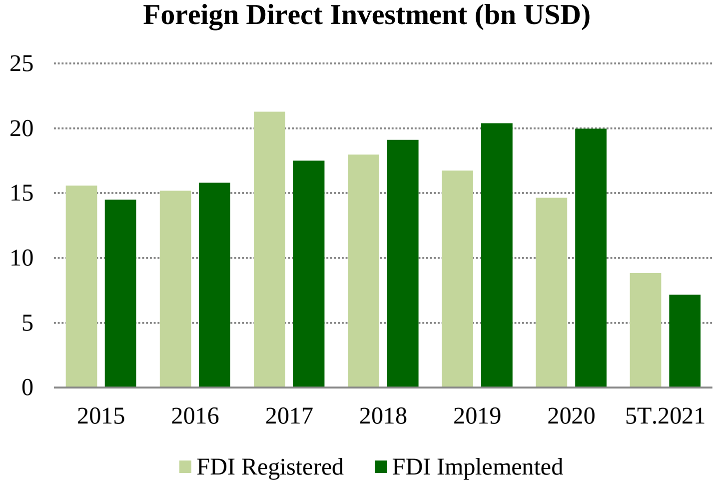
On the other hand, the direction is maintaining low lending rates to support businesses, and there is still room for further reduction when lending rates have not had a corresponding reduction in deposit rates.

To sum up, in the last months of the year, VCBS forecasts that deposit rates may sideway or increase slightly by 10-20 points while lending rates will have room to decrease further but the reduction will not spread across the system.

b. Exchange rates

The SBV has resources to stabilize the exchange rate as foreign reserves are gradually built up over the years along with the effectiveness of foreign currency forward contracts in 2021. The cautious intervention is a necessary factor and special priority when considering the risk that the US may return Vietnam to the list of currency manipulators as happened in 2020, although it was removed in April 2021. This risk will need to be watched more closely when in 5M.2021, according to data from CEIC, the US is Vietnam's largest export partner with a turnover of 37.4 billion USD, increasing by nearly 50% over the same period.





Source: CEIC, VCBS

In 2020, Vietnam has a record trade surplus of 19.94 billion USD. However, this trend comes from a decrease in the import of production materials. In 2021, when this trend reverses, especially in the context of high prices of goods and raw materials, the trade balance is deficit in 2021. There is a high probability that the State Bank may sell foreign currency to intervene the market. **Accordingly, VCBS maintains its forecast that in 2021 the exchange rate will fluctuate within ± 0.5%.**

4. Risks

- The world economy grew slowly and unsustainably leading to the global economic crisis.
- Vietnam suddenly encountered difficulties in pandemic control, leading to social isolation across the country.
- Commodity prices continued to increase rapidly and abnormally. There was no sign of adjustment in 6 months to 1 year, leading to difficulties in the supply of production materials and production interruptions.

In general, these are assumptions for the worst-case scenario and VCBS does not appreciate the possibility of this scenario.

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