

# ASIA PACIFIC ECONOMICS

## VIETNAM UPDATE

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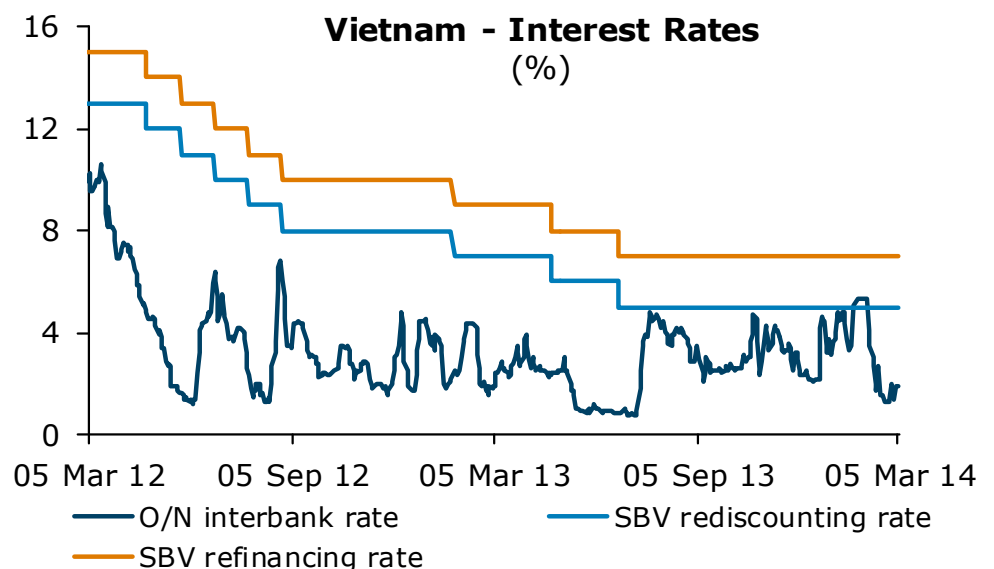
### VIETNAM: EXTERNAL-INTERNAL DICHOTOMY PERSISTS

**Vietnam continues to benefit from strong external demand, despite soft domestic consumption. In February, activity indicators still show a slow but steady improvement with the following features:**

- FDI is a steady buffer
- External trade posts a narrow ytd surplus
- Industrial production is boosted by FDI-related manufacturing
- VND is stable, enabling the central bank to add to its reserves
- Easing inflation points to weak consumer sentiment
- The lack of transparency in the banks' NPLs is still a challenge

We maintain our GDP growth forecast of 5.6% and 5.8% in 2014 and 2015 respectively on the back of slow but stable improvements. We downwardly revise our 2014 inflation forecast to average around 7.0-7.5%.

### SURGE IN LIQUIDITY PUSHES DOWN SHORT TERM RATES



Source: Bloomberg, ANZ

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**Vietnam's external position remains robust in February.** Foreign direct investments (FDI) continue to be the bulwark of the economy. As of 20 February, there have been 122 newly licensed projects year to date for a sum of USD830.9m in registered capital. Further, 41 existing projects received additional funding of USD708.8m, taking the total FDI capital infusion to USD1,539.7m. Realised FDI or implemented capital rose 6.67% ytd y/y to USD1,120m. The manufacturing sector remains the major recipient, posting USD625m ytd. Meanwhile, South Korean companies persist as the top source of FDIs, supporting our view that export-related production will remain strong in the medium term. The real estate sector, showing incipient signs of bottoming out, comes in second with USD156m.

**International trade posted a narrow ytd surplus of USD244m.** Initial estimates from the customs office reported an annual surge in exports and imports by 34.3% and 49.2% respectively, which reflect distortions from the celebrations of the Tet holidays in February. February trade balance reported a deficit of USD1,200m. This partially offset the revised trade surplus of USD1,444m in January, from an initial print of a narrow deficit of USD100m. Considering the continuous flow of FDI to the manufacturing sector, we expect both exports and imports to continue rising together and benefitting from the improvement in developed economies. With domestic demand remaining soft, imports for consumption should likewise be modest.

**Industrial production (IP) rose an average of 7.9% y/y over the January-February period.** Manufacturing production, which we estimate accounts for 70% of the IP index, remains solid. Despite muted domestic consumption, IP continues to benefit from FDI-related export production. Employment for industrial enterprises expanded 5.1% y/y in February, led by the 8.2% growth in FDI-related jobs. Employment generation in the FDI sector more than offset the contraction in the public sector.

**The sustained improvement in the external position keeps the VND stable.** In February, the USD/VND continued to trade within a thin range of 21,070-21,110, close to the central bank's official rate of 21,036. With the continuous flow of external funding, mostly from FDIs and external trade, the central bank continues to shore up its stock of FX reserves. However, in the absence of an official time series of FX reserves, various media outlets have reported contradictory statements on its actual level. On 18 February, Prime Minister Nguyen Tan Dung stated that FX reserves have risen to an all-time high of USD40bn. Meanwhile, the State Bank of Vietnam (SBV) Governor Nguyen Van Binh reported that the central bank has added USD2bn to its reserves taking the total to USD30bn. Despite the conflicting estimates, we maintain our view that Vietnam's stable external position has enabled the central bank to bolster its external buffers.

**Moderating inflation indicates soft domestic demand.** February inflation eased to 4.65% y/y, the lowest since December 2009. Despite the projected rise in consumer spending that usually accompanies the Tet celebrations, inflation was driven by gains in foods prices. This implies that the consumption was focussed on essentials and that consumer sentiment is still soft. However, retail sales are still improving with a year to date growth of 12.3% y/y. Domestic consumption remains constrained as reflected by the marginal contraction in credit by 1.6% ytd y/y. The central bank's 2014 credit growth target has been set at 12%-14%, compared to the 12% target in 2013.

**Considering the recent inflation trajectory, we downwardly revise our 2014 inflation forecast to average around 7.0-7.5%.**

**Robust external position gives the policymakers room to institute structural reforms.** In our view, the positive outlook on FDIs and external trade should offset the weakness in domestic demand while enabling the government to fine tune its policies regarding the state-owned enterprises (SOEs). The Prime Minister has stated that 432 SOEs will be privatised in the next two years. The government intends to sell companies where state control is not necessary. Regarding

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the SOEs where the government has complete ownership or controlling stakes, faster divestment of non-core businesses will be pursued. Inefficient SOEs have been weighing on Vietnam's growth prospects. SOEs account for only a third of the country's GDP, despite cornering almost 60% of total credit.

**On 18 February, Moody's maintained its negative outlook on the banking sector, despite stabilisation in the macro fundamentals.** While the credit watcher rates Vietnam's sovereign paper at B2 with a stable outlook, Moody's does not expect significant improvements in the capitalisation of Vietnamese banks. The ratings agency estimates non-performing loans (NPLs) to be at 15% of total assets, much higher than the 3.79% official estimate as of December 2013. Moody's included all credit, securities, interbank and receivable assets attributable to problematic counterparties in its NPL estimate. The report prompted a rejection from the SBV, saying that if Moody's assumptions were followed, NPLs would likely reach 9% only.

**Considering the persistent challenges from high NPLs, the central bank amended Circular No. 2 on debt classification and provisioning against risks.** Under the yet-to-be-implemented regulation (effective 1 June 2014), if a counterparty has a loan listed under the fifth grouping (worst loans group), all its loans with all banks will automatically fall into the fifth grouping. The amendment will allow banks to consider the loans of "bad counterparties as "good debt" so long as the counterparty continues to repay that debt with that particular bank. For example, Bank A can still consider a loan with a counterparty as good so long as the counterparty continues to service the debt, even if this same counterparty has defaulted on a loan with Bank B. **In our view, the amendment will likely mask the real risk of nonperforming loans in the banking sector, given that the banking system is highly interconnected.**

**Meanwhile, liquidity surged in February pushing down short-term interest rates.** Overnight interbank rates dropped to an average of 2.53% in February, after bottoming at 1.24%. This is compared to the average 4.34% in January. The central bank subsequently issued short term notes to drain excess liquidity, leading to a significant reduction in SBV note yields.

**Amid ample liquidity and low demand for credit, banks cut its deposit rates in February.** The SBV has also been encouraging banks to similarly cut its lending rates. According to an interview with SBV officials, average rates are similar to those seen in 2005-2006. As such, we reiterate our view that the SBV will likely keep its policy refinancing rate on hold at 7.00% in 2014. A disconnect between banks' lending rates and the policy rate persists and any changes in the policy rate will not likely spur credit growth.

**Low deposit rates are encouraging local investors to shift to the local stock exchange.** Anecdotal reports have mentioned an increase in local participation in the stock market. Since the start of the year, the local stock index has gained more than 14%. Also, foreign funds continue to flow into local stocks, attracting more than USD100m since the start of 2014. In our view, the stable external position of Vietnam is offsetting the softness in the domestic economy. **Although we see some improvement and stabilisation in domestic consumption, the favourable external environment would need to pick up the slack to keep the economy on a steady recovery path.**

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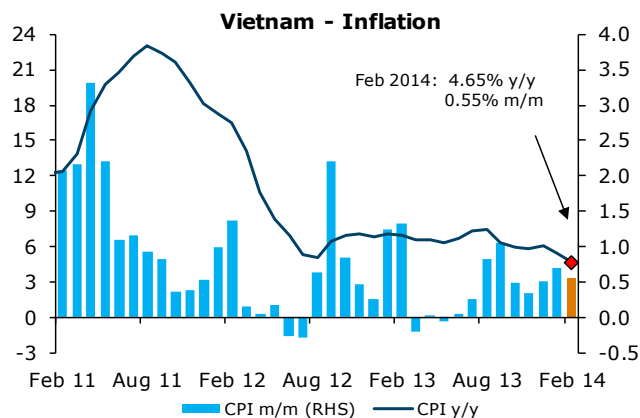
## VIETNAM INFLATION BY CATEGORY

Year on Year %	Sep-13	Oct-13	Nov-13	Dec-13	Jan-14	Feb-14
All Items	6.30	5.92	5.78	6.04	5.45	4.65
Food/foodstuffs	3.55	4.13	4.86	5.08	4.49	3.34
Food	-0.89	-0.36	0.88	1.98	3.18	3.50
Foodstuffs	4.32	5.11	5.92	6.02	4.77	2.89
Dining Out	5.56	5.54	5.51	5.27	4.98	4.72
Beverages/Tobacco	4.24	4.19	4.24	4.19	4.62	3.69
Textiles/Footwear/Hats	7.56	7.35	6.84	6.20	5.77	4.86
Housing/Construction Materials	4.00	3.39	3.27	5.49	6.19	5.04
Household Appliances	4.70	4.63	4.30	3.95	3.79	3.40
Medical Products/ Healthcare	32.39	25.09	19.04	18.97	10.96	10.37
Transport	3.58	2.78	2.40	2.60	3.83	3.67
Communication	-0.56	-0.57	-0.58	-0.57	-0.52	-0.51
Education	13.32	11.82	11.78	11.71	11.38	11.36
Culture/Sports/Entertainment	3.60	3.49	3.24	3.02	2.90	3.11
Others	6.36	5.85	5.60	5.02	4.91	4.37

Month on Month %	Sep-13	Oct-13	Nov-13	Dec-13	Jan-14	Feb-14
All Items	1.06	0.49	0.34	0.51	0.69	0.55
Food/foodstuffs	0.65	0.86	0.62	0.49	0.77	1.15
Food	0.41	0.91	1.29	1.22	1.33	0.68
Foodstuffs	0.87	1.04	0.56	0.38	0.75	1.16
Dining Out	0.19	0.25	0.17	0.17	0.32	1.60
Beverages/Tobacco	0.22	0.12	0.28	0.27	0.83	0.60
Textiles/Footwear/Hats	0.29	0.35	0.35	0.57	0.89	0.21
Housing/Construction Materials	0.91	0.50	0.41	2.31	1.02	-0.64
Household Appliances	0.23	0.24	0.24	0.25	0.39	0.22
Medical Products/ Healthcare	0.04	0.10	0.07	0.08	0.17	0.05
Transport	-0.24	-0.17	-0.34	-0.23	1.22	0.66
Communication	-0.01	-0.03	-0.02	-0.01	0.00	-0.02
Education	9.38	0.53	0.10	0.02	0.01	0.01
Culture/Sports/Entertainment	0.09	0.14	0.10	0.13	0.21	0.61
Others	1.33	0.23	0.18	0.16	0.63	0.55

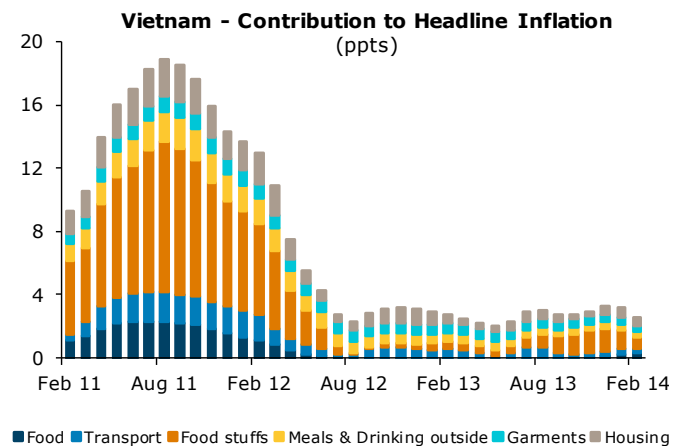
Sources: CEIC, Bloomberg, General Statistics Office, ANZ

FIGURE 1. Moderating inflation points to soft domestic demand



Sources: CEIC, Bloomberg, General Statistics Office, ANZ

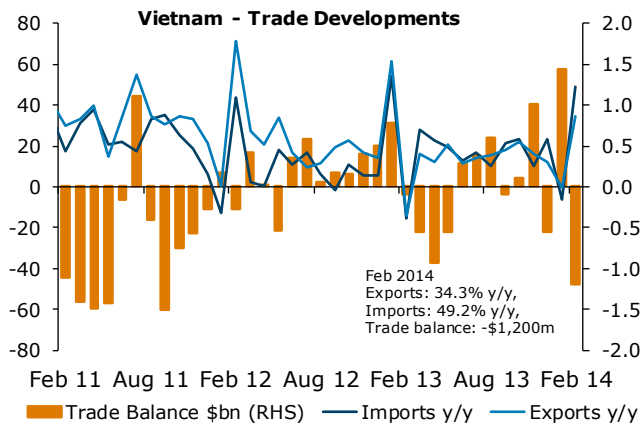
FIGURE 2. Food is still the main driver of inflation



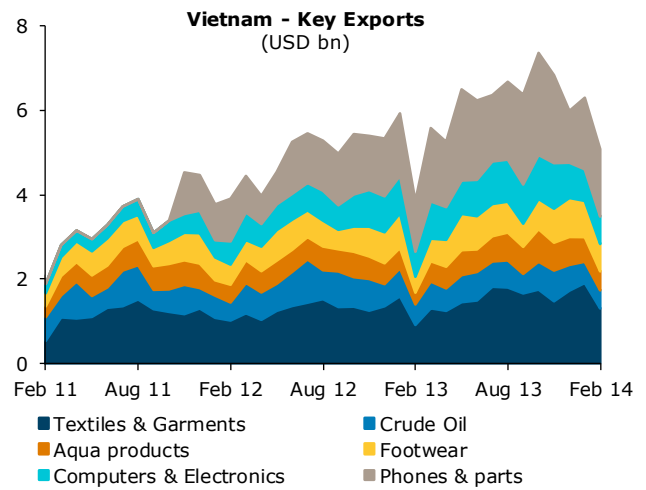
Legend: Food, Transport, Food stuffs, Meals &amp; Drinking outside, Garments, Housing

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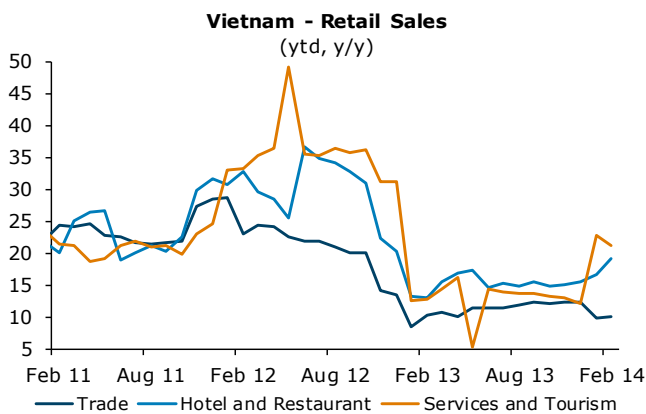
**FIGURE 3. Jan-Feb trade posts a narrow ytd trade surplus**



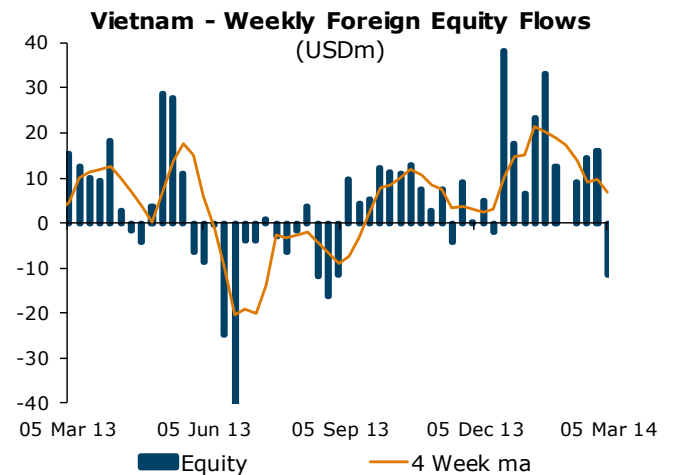
**FIGURE 4. Exports of phones & parts in 2014 is expected to benefit from recent FDI**



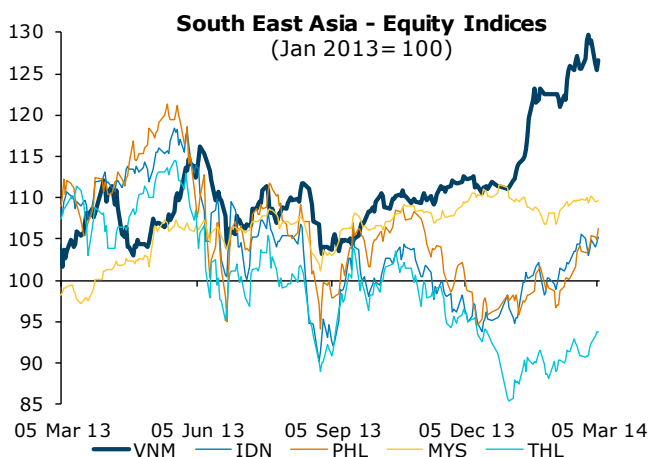
**FIGURE 5. Retail sales are on a steady path to improvement**



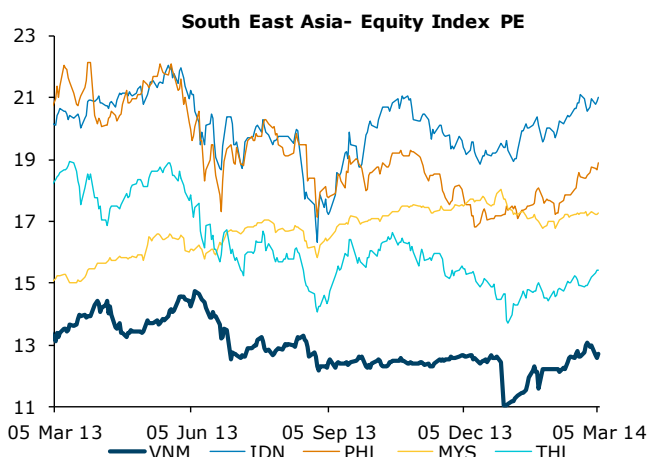
**FIGURE 6. Foreign equity continues to flow in**



**FIGURE 7. Vietnam's stock market holds up, despite weakness in the region**



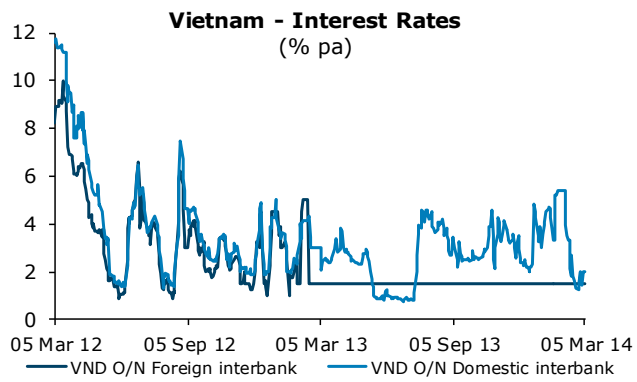
**FIGURE 8. Stock valuations are still relatively cheap**



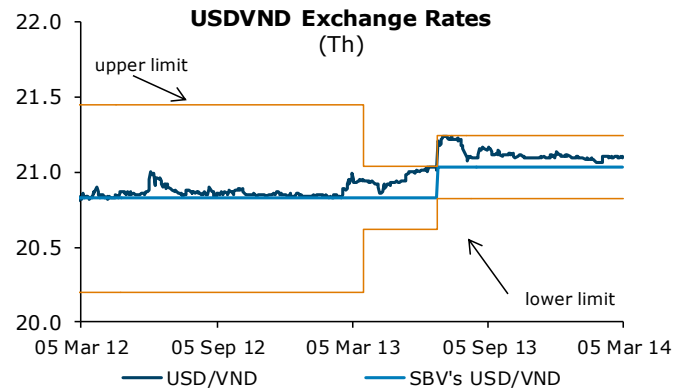
Sources: CEIC, Bloomberg, General Statistics Office, ANZ

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**FIGURE 9. Overnight rates declined following surge in liquidity after the Tet holidays**



**FIGURE 10. VND continues to trade well within trading bands**



Sources: CEIC, Bloomberg, General Statistics Office, ANZ

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