true friend KIS Viet Nam Securities Corporation

Economy
Quarterly

27 Jul 2023

Economic Forecast

Vietnam's economy: gaining momentum

Inflation expected to rise in 3Q23

We anticipate that the Consumer Price Index (CPI) will rise by 2.82% in the third quarter of 2023 when compared to the corresponding period of 2022. Moreover, we have revised our forecast of average CPI from 4.3% in the last forecast to 3.45% due to subdued domestic demand resulting from economic challenges. Furthermore, the vigilant oversight by the regulatory authority and positive developments in the international market contributed as supplementary elements driving inflation towards the target of below 4.5%.

Decelerating retail sales

Despite the government's efforts to stimulate consumer spending through VAT cuts and base salary increases in 2H23, the retail sales' main driver – international tourism demand is not as bright as expected. This is expected to be the decelerating retail sales revenue in 3Q23, standing at 7.80% YoY from 8.66% YoY in the last quarter.

The export performance to improve

We predict the decline in export value to be softer at 7.12% YoY in 3Q23 but the improvement needs more time to be material. Our concerns related to the slowdown in U.S. consumption and its consequence on Vietnam's export activities persist for 3Q23 although the global tendency of the interest rate hike has eased.

KIS leading economic index

	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23F	Corr.[1]
GDP %YoY	7.8	13.7	5.9	3.3	4.1	6.0	-0.07
FDI %YoY	9.7	32.9	7.9	-2.2	1.0	-0.5	-0.03
Retail sales %YoY	19.9	40.4	17.3	13.2	8.7	7.8	-0.23
Export %YoY	21.3	16.0	-6.5	-10.4	-11.5	-7.1	0.20
CPI %YoY	3.4	3.9	4.6	3.4	2.0	2.8	-0.13
Credit %YoY	16.8	16.9	14.2	10.5	8.5	10.0	0.01
USDVND %qoq	1.9	2.5	-1.0	-0.7	0.5	1.0	-0.42
U.S. GDP % YoY	1.8	1.9	0.9	1.8	2.3[2]	1.5[2]	N/A
China GDP % YoY	0.4	3.9	2.9	4.5	6.3	4.6[2]	N/A

Source: SBV, GSO, Bloomberg, KIS
[1] Correlation to VNINDEX's quarterly return; [2] Bloomberg estimates
Green = acceleration; yellow = deceleration; red = contraction.

Contents

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I. Economic activities to accelerate

We expect real GDP to accelerate in 3Q23 with a growth rate of 6.00% YoY due to the improvement in external demand and productive public spending. The deceleration in domestic consumption would prevent the economy from an impressive pickup. However, supports from the state budget, such as VAT reduction and the increase in base salary for state workers, suggest a proactive fiscal tendency to limit the slowdown in domestic consumption. Furthermore, the government seems to pay more attention to fulfilling the progress of key infrastructure projects as planned, encouraging economic acceleration.

Figure 1. Vietnam's real GDP growth forecast

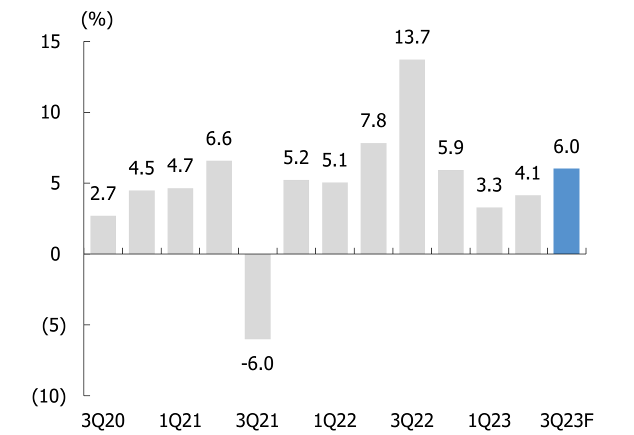
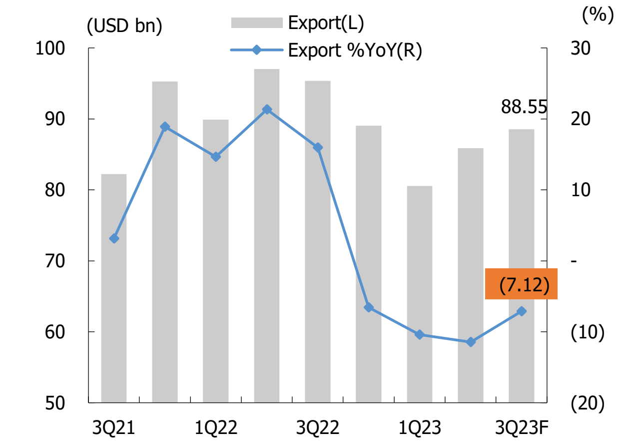


Figure 2. Vietnam's export growth forecast



Source: Bloomberg, KIS

II. The export performance to improve

We predict the decline in export value to be softer at 7.12% YoY in 3Q23 but the improvement needs more time to be material. Our concerns related to the slowdown in U.S. consumption and its consequence on Vietnam's export activities persist for 3Q23 although the global tendency of the interest rate hike has eased. It seems that the fed fund rate will increase two more times with a total amount of 50bps for two remaining quarters, leaving the target range of the fed fund rate reaching 5.50%-5.75%, before occurring any adjustments in the beginning of 2024. Under the phenomenon of increasing interest rates, consumption and investment decisions, including building up inventories, will be costly.

Figure 3. Effective fed fund rate trajectory

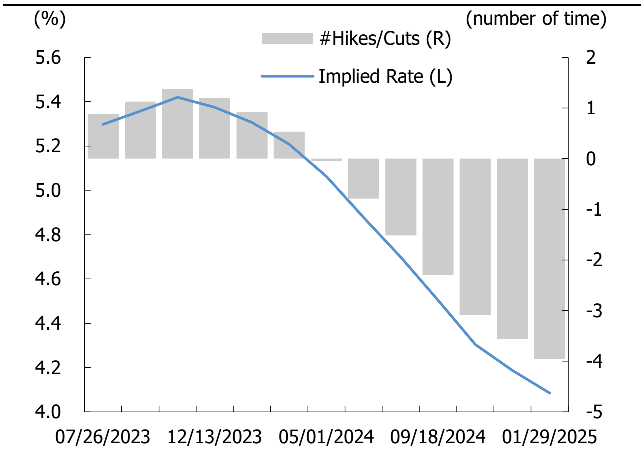
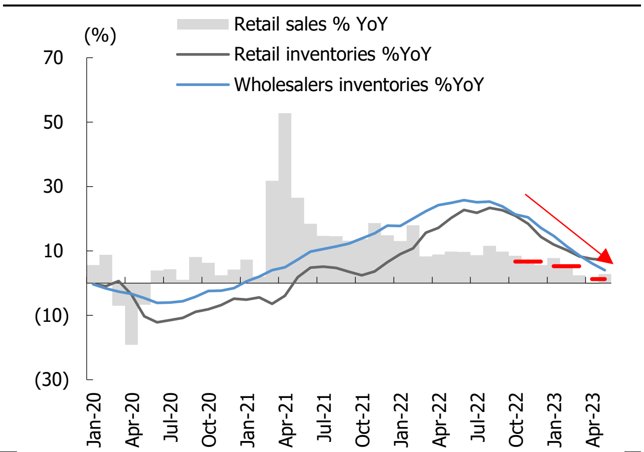


Figure 4. U.S. sales and inventories



Source: Bloomberg, KIS

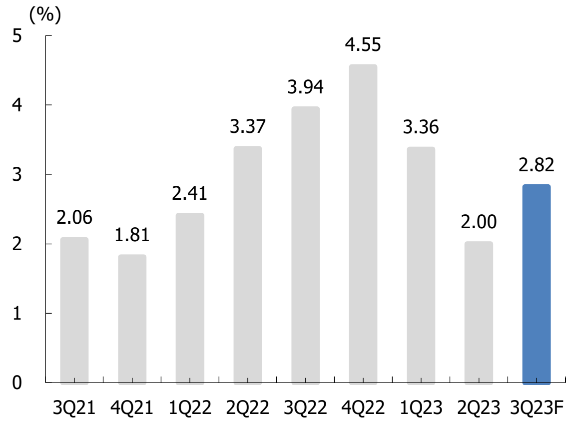
Regarding the current situation, the growth rate of U.S. retail sales kept sliding from around 10% in 2022-mid to 2.80% YoY in May. Sales in 3Q23 seem to slow partly due to the seasonality and the minimal improvement in consumer confidence. Therefore, reducing the excessive inventories will further be the focus of retailers. Related wholesalers and their suppliers in manufacturing hubs, including Vietnam, are more likely to receive fewer new orders, at least at the beginning of 3Q23. Hence, we forecast the production and sales of export-oriented enterprises in Vietnam to experience trivial improvement. For the Euro area, the situation is quite similar, even the ECB's monetary policies are expected to be more hawkish than colleagues under the serious inflation persistency, implying that the improvement for Vietnam's export to the region will take more time to be material.

In the opposite direction, despite its depressed performance in terms of the market assessment, the recovery momentum of China's domestic consumption tends to extend in 3Q23 and partly mitigates the downturn in Vietnam's export activities. Retail sales in China grew by 12.7% YoY, coupled with muted inflation. The current situation implies that supply and demand curves have expanded equivalently after Zerocovid-19. Therefore, we expect that the revenue of Vietnam's goods sold to China could remain its growth momentum for the next quarter.

III. Inflation expected to rise in 3Q23

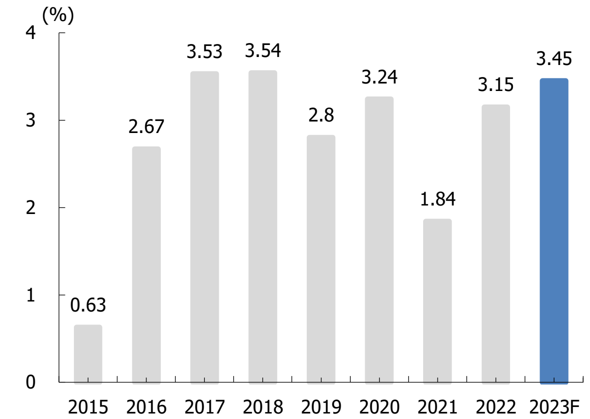
We anticipate that the Consumer Price Index (CPI) will rise by 2.82% in the third quarter of 2023 when compared to the corresponding period of 2022. Moreover, we have revised our forecast of average CPI from 4.3% in the last forecast to 3.45% due to subdued domestic demand resulting from economic challenges. Furthermore, the vigilant oversight by the regulatory authority and positive developments in the international market contributed as supplementary elements driving inflation towards the target of below 4.5%.

Figure 5. Quarterly CPI



Source: GSO, KIS

Figure 6. Average CPI by year

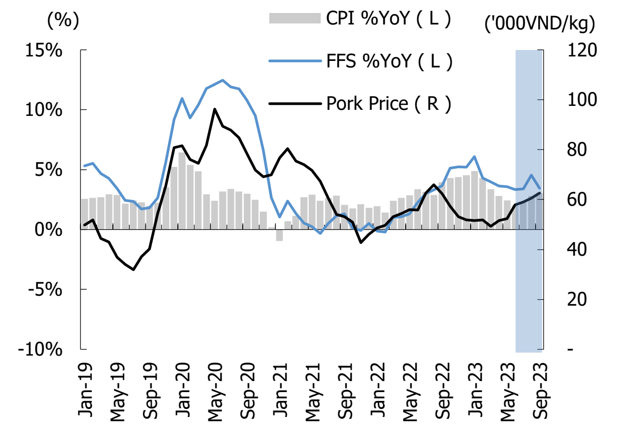


Source: GSO, KIS

According to KIS's forecast, the FFS index (food and foodstuff), which carries the highest weight in the CPI's basket (33.56%) is expected to keep rising in the third quarter of 2023, despite the fact that this period is typically characterized by reduced activity levels and is not linked to holidays. As aforementioned in previous report, the increase in prices of live hogs can be attributed to the occurrence of African swine fever in certain areas, starting in March 2023, resulting in a localized decrease in production. Additionally, there has been a sharp decline in household pig output, while large-scale pig farming operations, both domestic and foreign, hold a significant share. These entities may proactively raise prices in order to mitigate their losses.

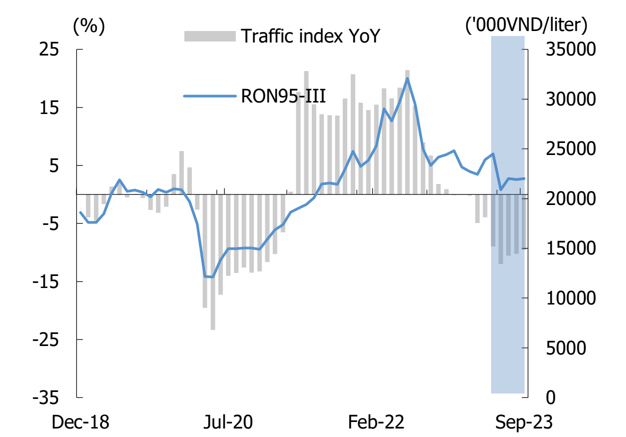
However, the rise in pork prices will be constrained by the current low purchasing power in the market and the financial difficulties faced by consumers, leading them to choose more affordable food options instead of pork. Furthermore, the decrease in exports of seafood and aquatic products this year, coupled with the upcoming flood season in the Mekong Delta and some consumers' adoption of vegetarian diets during the Vu Lan season, act as factors that impede a significant increase in pork prices.

Figure 7. Domestic pork price



Source: channuoivietnam, KIS

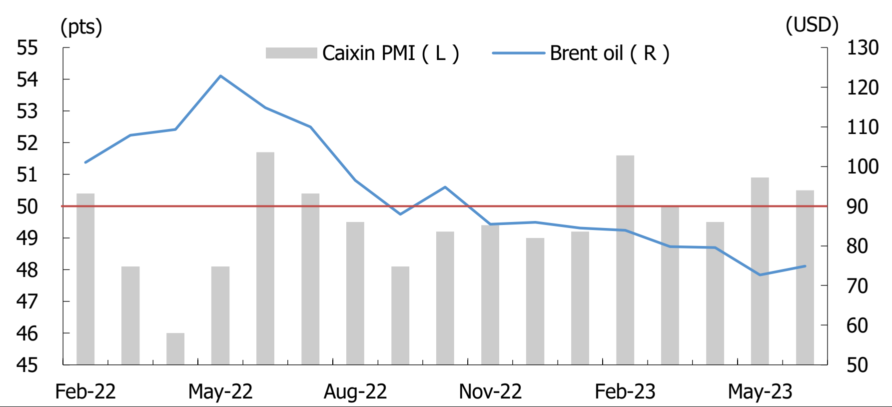
Table 1. Domestic gasoline and Brent oil



Source: MoIT, Bloomberg, KIS

KIS foresees that oil prices will cease to be a significant factor affecting the traffic index as well as the inflation in the second half of 2023. As per the latest update from the Energy Information Administration (EIA), the forecast for oil prices has recently been revised downward from USD 85 per barrel to approximately USD79.50 per barrel by the end of 2023. Moreover, the anticipated economic rebound of China (the foremost global oil importer), which had been eagerly awaited after the easing of COVID-19 restrictions, seems to be faltering, thus contributing to the pessimistic outlook for oil prices.

Figure 8. China Caixin PMI and Brent oil price



Source: Bloomberg, KIS

Additionally, in the third quarter, when students return to school, there will be a substantial increase in the education index. This can be attributed primarily to the rising expenses related to school fees, stationery, and study materials.

In addition, the National Assembly adopted Resolution 69/2022/QH15 on State budget estimates for 2023, which increases the base salary for private employees and public employees by 20.8% from 2H23. This will have an impact on inflation in the upcoming quarter.

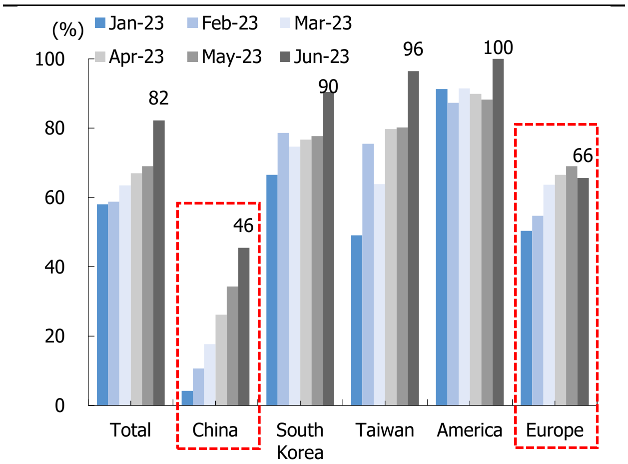
IV. Decelerating retail sales

Despite the government's efforts to stimulate consumer spending through VAT cuts and base salary increases in 2H23, the retail sales' main driver – international tourism demand is not as bright as expected. This is expected to be the decelerating retail sales revenue in 3Q23, standing at 7.80% YoY from 8.66% YoY in the last quarter.

Week tourism demand from China and Europe

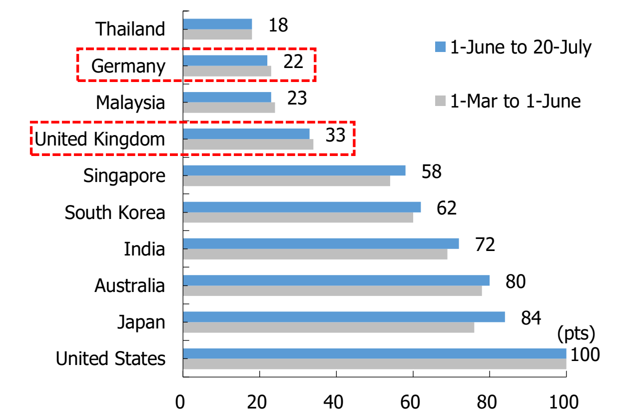
The inbound tourists to Vietnam from all nationalities recovered to 82% of the 2019 level by June, attributable to the solid growth of retail sales in 1H23. Among the five largest tourism providers, China and Europe recovered much weaker than the average, marking 46% and 66%, and shows no significant rebound in 3Q23 (Figure 9). Google Insights data also confirms no demand improvement of international tourism to Vietnam from major EU countries such as Germany and the UK (Figure 10). Moreover, a survey by Dragon Trail International revealed that a significant majority of Chinese travelers still have no plans for outbound travel, with 84% of respondents (Figure 11). Vietnam is not among the top 10 destinations for Chinese visitors, while Thailand remains the most desirable travel destination for 31.8% of respondents. Furthermore, the current international tourism demand remained flatter compared to domestic demand (Figure 12). As a result, we anticipate that international tourism inbound in 3Q23 will not be as strong as initially expected, primarily due to the underperformance of key tourism sources like China and Europe, contributing to the deceleration of travel-related revenue.

Figure 9. International arrivals by country of origin as % of 2019 levels



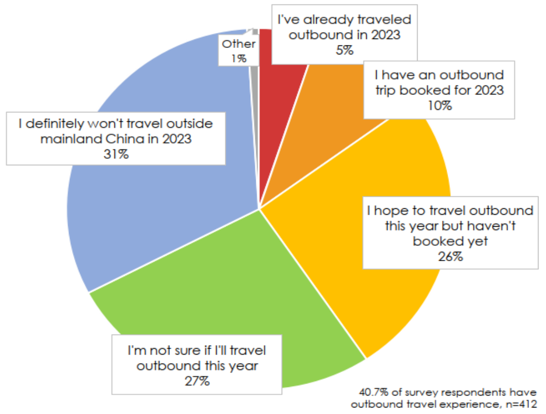
Source: GSO, KIS

Figure 10. International tourism demand to VN by country



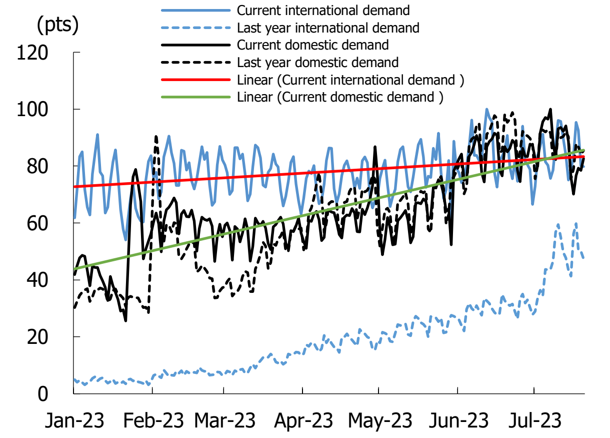
Source: Google Insights, KIS
Note: data as of 20th July 2023

Figure 11. China mainland's 2023 outbound travel plan



Source: Dragon Trail International, KIS
Note: surveyed data as of April 2023

Figure 12. International arrivals by country of origin as % of 2019 levels

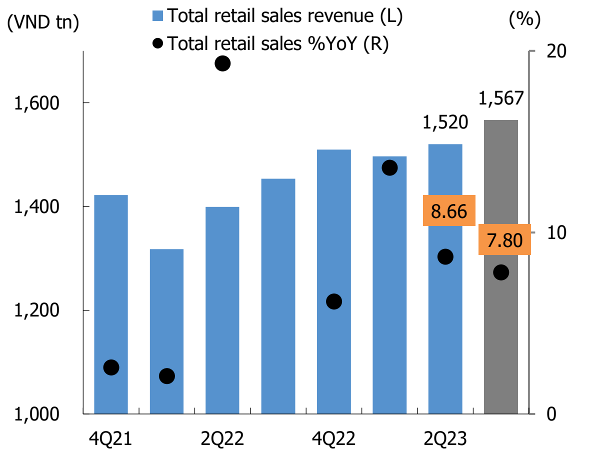


Source: Google Insights, KIS
Note: data as of 20th July 2023

Weakening consumer sentiment outweighs government's stimulus

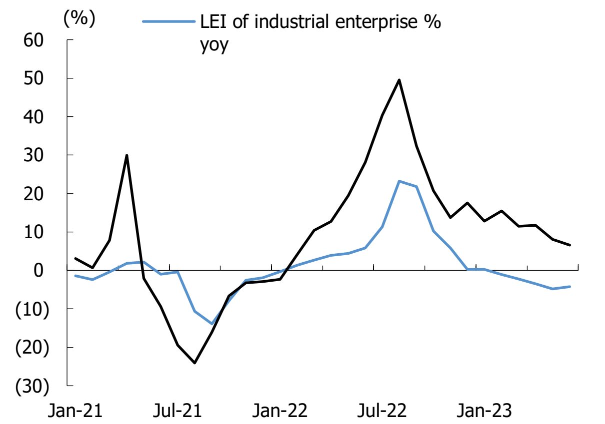
The continuous contraction in the labor employed index (LEI) of industrial enterprises over the past five months is expected to negatively impact total retail sales, as it correlates strongly at 80.57%. This decline in the LEI results in lower disposable income for workers. This trend is expected to continue as weak manufacturing activities persist (PMI underwater for consecutive four months). However, there are some positive factors to consider. The implementation of a 2% VAT cut and a 20% increase in the base salary for 4.70M state workers (KIS estimate), both effective in 2H23, could boost retail sales revenue by VND12.00tn and VND10.00bn for 3Q23. Despite these encouraging measures, the overall outlook remains unfavorable, and we anticipate that 3Q23 retail sales will decelerate to 7.80% YoY or 3.05% QoQ.

Figure 13. Quarterly performance of total retail sales



Source: GSO, KIS

Figure 14. Industrial labor employed index (LEI) vs total retail sales

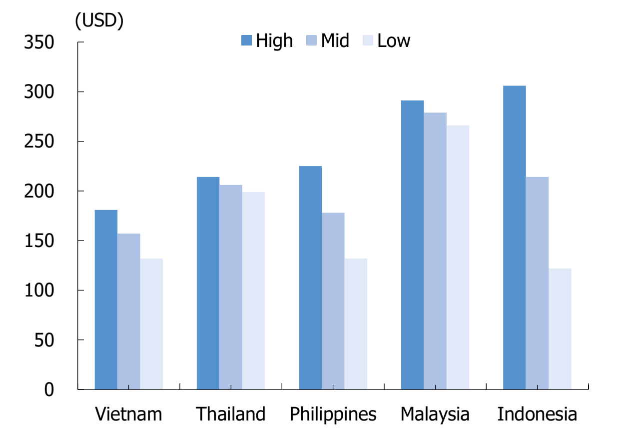


Source: GSO, KIS

V. Vietnam preserves the FDI attractiveness

We expect foreign direct investment (FDI) to recover in Vietnam, supported by some factors as follows.

Figure 15. Monthly minimum wages in ASEAN



Source: Asia briefing, KIS

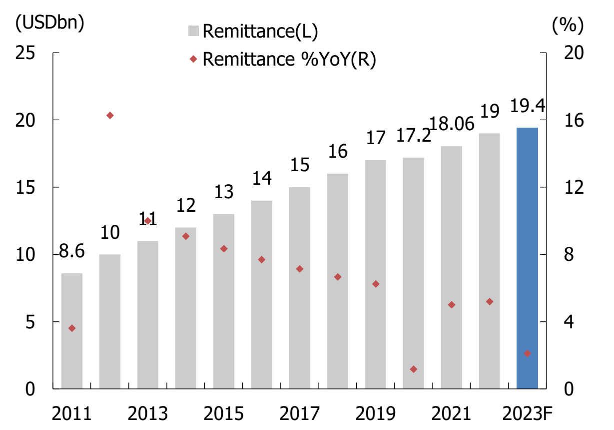
Figure 16. Vietnam strategic location

Source: KIS

- **Public investment for infrastructure development**, along with the recently approved National Power Development Plan VIII, and the supportive policies of the Government for socio-economic recovery and development, will serve as significant driving forces in attracting long-term foreign direct investment (FDI).
- **Cheap labor cost advantage:** Low-cost labor in Vietnam is a magnet for foreign manufacturers compared to its competitors. With a labor market of around 52 million people, one of the largest in the ASEAN region, and a labor participation rate of 76 percent, Vietnam offers a substantial workforce. Moreover, the monthly cost of labor in Vietnam is approximately USD 171, which is considerably lower compared to its competitors.
- **Strategic location:** Vietnam has a strategic location in Southeast Asia. It is bordered by China to the north, Laos and Cambodia to the west, and the Gulf of Thailand, Singapore, and the South China Sea to the east and south. This location gives Vietnam access to major shipping routes in the South China Sea and the Indian Ocean, as well as to large markets in China, Japan, and South Korea.
  Additionally, The Port of Singapore is a crucial hub that links over 600 ports across more than 100 countries. It plays a significant role in global trade, handling approximately 20% of the world's cargo containers and facilitating the transportation of almost half of the global crude oil supply. With a cargo handling capacity of around 537.6mn tons, this port receives roughly 140,000 ships annually for loading and unloading operations. Thus, Vietnam's advantageous location and the Port of Singapore's capabilities as a leading maritime hub complement each other, offering significant benefits for businesses engaged in regional and global trade and logistics.

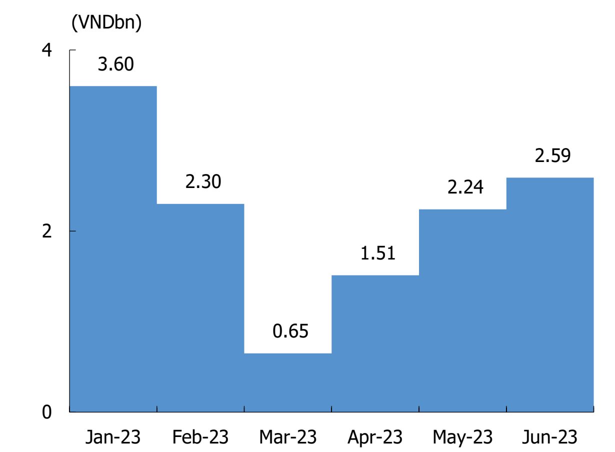
- **The stabilization of USDVND:** According to the March meeting minutes of the Federal Reserve, two additional rate hikes may be necessary this year to address high inflation, potentially raising rates to 5.6%. However, there are currently no significant exchange rate pressures due to various factors. Firstly, Vietnam is expected to receive substantial remittance inflows amounting to VND19.4bn in 2023, as well as USD inflows from recent mergers and acquisitions. Secondly, The State Bank of Vietnam has also purchased around USD6bn, contributing to the abundant supply of dollars. Thirdly, Vietnam's trade surplus in the first half of 2023 was estimated at USD12.25bn, further bolstering USD inflows. These factors play a crucial role in stabilizing the exchange rate and attracting foreign direct investment inflows.

Figure 17. Remittance inflow of Vietnam



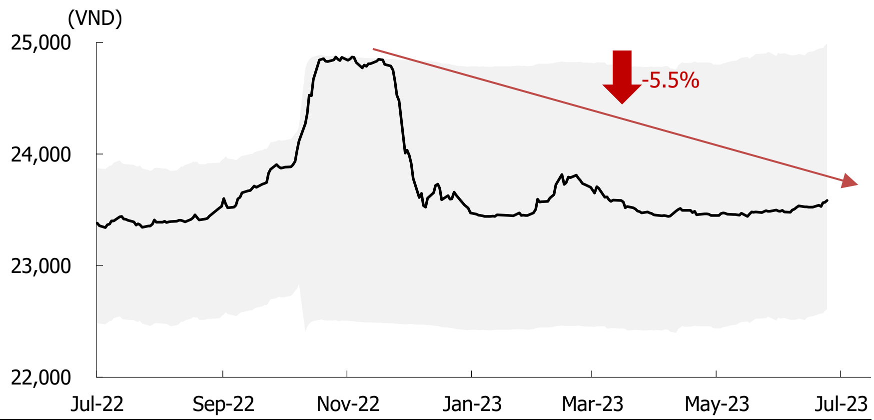
Source: World bank, KIS

Figure 18. Trade balance of Vietnam in 6M23



Source: MPI, KIS

Figure 19. Historical data of USDVND



Source: Bloomberg, KIS

Firstly, Vietnam is projected to receive a substantial amount of remittance inflows amounting to VND19bn in 2023, along with inflows of USD from recent mergers and acquisitions (M&A) deals. Specifically, the capital increase deal of Vietcombank is progressing impressively. According to Vietcombank's Annual General Meeting, the bank has actively engaged financial advisors during the second quarter. Subsequently, in the third and fourth quarters, the bank plans to interact with investors through roadshows, followed by involving valuation and legal advisors, and conducting due diligence. If successful, this deal could bring a substantial inflow of USD 1.2bn. Additionally, as aforementioned, the acquisition deal in which Sumitomo acquired a 15% share of VP Bank also contributed a significant amount of nearly USD 1.5bn. Hence, these two major merger and acquisition deals this year can assist the government in stabilizing the USDVND exchange rate.

Moreover, it is estimated that the State Bank of Vietnam (SBV) purchased around USD6bn in the first half of 2023, contributing to the abundant supply of dollars. Lastly, the trade surplus in 6M23 was estimated at USD12.25bn, providing a significant USD inflow for Vietnam. Those factors play an essential role in stabilizing the exchange rate and attracting foreign direct investment (FDI) inflows.

- **A long list of free trade agreements**

With around 19 free trade agreements, Vietnam's entry into the ASEAN Economic Community (AEC), is a good opportunity to connect Vietnam with the world market. Additionally, Vietnam's institutions, laws, and transparency have been gradually improved in association with integration, not only creating conditions for investors to operate in the long term, but also helping businesses participate in global supply chains.

Table 2. Vietnam's FTA as of May 2023

FTA	Status	Parties
	FTAs in effect	
AFTA	Effective since 1993	ASEAN
ACFTA	Effective since 2003	ASEAN, China
AKFTA	Effective since 2007	ASEAB, South Korea
AJCEP	Effective since 2008	ASEAN, Japan
VJEPA	Effective since 2009	Vietnam, Japan
AIFTA	Effective since 2010	ASEAN, India
AANZFTA	Effective since 2010	ASEAN, Australia, New Zealand
VCFTA	Effective since 2014	Vietnam, Chile
VKFTA	Effective since 2015	Vietnam, South Korea
VN- EAEU FTA	Effective since 1993	Vietnam, Russia, Belarus, Armenia, Kazakhstan, Kyrgyzstan
CPTPP	Effective since 2019	Vietnam, Canada, Mexico, Peru, Chile, New Zealand, Australia, Japan, Singapore, Brunei, Malaysia
AHKFTA	Effective since 2019	ASEAN, Hong Kong
EVFTA	Effective since 1 Aug 2020	Vietnam, EU (27 members)
UKVFTA	Effective since 1 May 2020	Vietnam, The UK
RCEP	Effective since 2022	ASEAN, China, Korea, Japan, Australia, New Zealand
	FTA negotiation completed	
Vietnam - Israel FTA	Negotiations commenced in December 2015, completed in April 2023	Vietnam, Israel
	FTA under negotiation	
Vietnam – EFTA FTA	Negotiation commenced in May 2012	Vietnam, EFTA (Switzerland, Norway, Iceland, Liechtenstein)
ASEAN – Canada FTA	Negotiation commenced in November 2021	ASEAN, Canada
Vietnam – UAE FTA	In the process of initiating negotiations	Vietnam, United Arab Emirates (UAE)

Source: Center for WTO and International Trade, KIS

- **Global minimum tax rate**

It is believed that the global minimum tax rate will cause concern about a strategic disturbance in investment locations, the way multinational companies operate, and FDI attraction strategies, and need a rapid response.

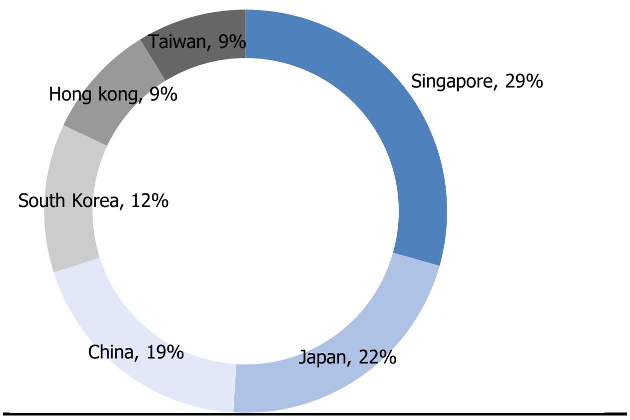
Figures from the General Department of Taxation show that there are around 335 FDI projects in Vietnam that have investment of over USD100mn each. They operate primarily in the field of manufacturing and processing at economic zones and industrial parks and enjoy a preferential corporate income tax rate of less than 15 per cent. These include giant high-tech corporations such as Samsung, Intel, LG, Bosch, Sharp, Panasonic, and Foxconn.

In the short term, the implementation of a global minimum tax rate of 15% on FDI starting from 2024 will remain a major challenge for Vietnam. It is anticipated that the tax will cause concern about a strategic disturbance in investment locations, the way multinational companies operate, and FDI attraction strategies.

However, The Government is expected to propose policy solutions and a roadmap for the application of the global minimum tax as follows.

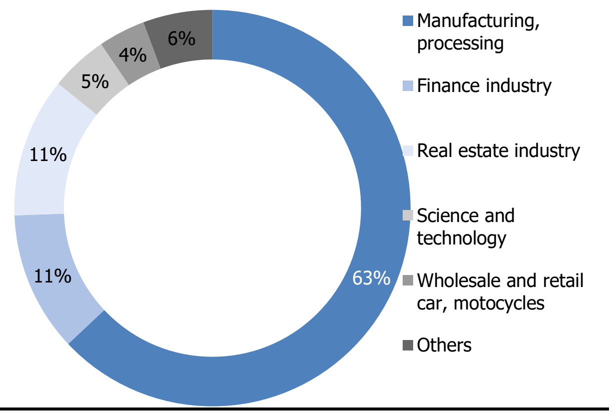
- Provide direct assistance for investment expenses, research and development expenditures, as well as support for the production of prioritized goods to attract investments and stimulate investment in tangible assets and research and development endeavors.
- Extend support for investment costs related to the construction of environmental protection infrastructure and activities aimed at reducing emissions to promote environmental conservation efforts.
- During periods of economic downturn, consider offering support for expenses associated with employee welfare, such as constructing worker dormitories, kindergartens, and medical facilities to cater to the needs of industrial park employees.
- Provide support for expenses aimed at reducing production costs, including subsidies for electricity and transportation for workers.

Figure 20. FDI by country



Source: MPI, KIS

Figure 21. FDI by industry



Source: MPI, KIS

The processing and manufacturing sector will continue to be the primary recipient of foreign direct investment (FDI) inflows. The key factor that makes this sector appealing to foreign capital is Vietnam's advantageous position in terms of labor resources, political stability, and extensive economic and international integration.

Table 3. Notable FDI projects in Vietnam

Project	Origin country	Sector	As of December 2022 (USDbn)	Location
Samsung	Korea	Electronics	22	ThaiNguyen
Formosa	Taiwan	Steels	12.7	Ha Tinh
Sumitomo	Japan	Finance	10.3	Ha Noi
LG	Korea	Electronics	5.3	Hai Phong
SCG	Thailand	Chemical	5	Vung Tau
Wintek	Taiwan	Electronics	1.1	Quang Ninh
Gortek	China	Electronics	1	Bac Ninh

Source: GSO, MPI, KIS

Macro scorecard

	23-Feb	23-Mar	23-April	23-May	23-Jun	3Q22	4Q22	1Q23	2Q23	2019	2020	2021	2022
Real GDP growth (%)						13.67	5.92	3.21	4.14	7.03	2.91	2.58	8.02
Registered FDI (USD bn)	1.41	2.35	3.43	1.98	2.57	4.67	8.96	5.45	13.43	38.02	28.53	31.15	27.72
GDP per capita (USD)										3,398	3,521	3,725	4,110
Unemployment rate (%)						2.28	2.32	2.25	2.25	2.25	2.48	3.22	2.32
Export (USD bn)	25.88	29.57	27.54	29.05	29.30	96.48	89.50	79.17	83.42	263.6	282.7	335.7	371.85
Import (USD bn)	23.58	28.92	26.03	26.81	26.71	90.71	85.07	75.10	76.01	254.4	263	331.1	360.65
Export growth (%)	10.97	(14.78)	(17.15)	(5.86)	(11.41)	17.22	(6.07)	(11.90)	(14.16)	8.16	7.02	18.74	10.61
Import growth (%)	(6.65)	(11.10)	(20.54)	(18.44)	(16.94)	8.12	(3.90)	(14.67)	(22.30)	7.41	3.81	25.9	8.35
Inflation (%)	4.31	3.35	2.81	2.43	2.00	3.32	4.41	4.18	2.41	2.79	3.24	1.84	3.15
USD/VND	23,785	23,471	23,465	23,477	23,525	23,712	23,633	23,471	23,525	23,173	23,126	22,790	23,650
Credit growth (%)	0.31	1.96	3.04	3.04	3.36	10.47	12.87	1.61	3.36	13.75	12.17	12.97	12.87
10Y gov't bond (%)	4.39	3.24	3.21	3.28	3.50	4.39	5.08	3.54	3.50	3.37	2.01	2.11	5.08

Source: GSO, Bloomberg, FIA, IMF

Global Disclaimer

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