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### **With “Currency Manipulator” Risk Off the Table, the VN Dong is Set to Appreciate**

The US Treasury Department unexpectedly reversed its designation of Vietnam and Switzerland as “currency manipulators,” and chose not to designate Taiwan as a currency manipulator in its latest report to the US Congress titled “Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States”. The Biden administration’s decision not to label these countries as currency manipulators, despite the fact that all three met the US Treasury Department’s numerical criteria (as can be seen in the table below), reflects Biden’s less confrontational stance towards the US’s trading partners than that of his predecessor.

#### **US Treasury Department’s Currency Manipulation Thresholds**

|  | **Trade Surplus with the US** | **Current Account (% of GDP)** | **FX Reserves, acquired over a year (% of GDP)** |
| --- | --- | --- | --- |
| **Vietnam** | $70 billion | 3.7% | 4.4% |
| **Switzerland** | $57 billion | 3.7% | 15.3% |
| **Taiwan** | $30 billion | 14.1% | 5.8% |
| **Threshold** | $20 billion | **2.0%** | **2.0%** |

This reversal of the US Government’s December 2020 position is positive for investors in Vietnam’s stock market for several reasons, including:

1. **It eliminates the tariff risk** on Vietnam’s exports to the US for the time being, despite the fact that Vietnam’s trade surplus with the US soared from USD15 billion in 4M20, to USD25 billion in 4M21, and will continue surging as 2021 progresses.
2. It should prompt an **appreciation of the Vietnam Dong (VND)**, because the US Treasury asserted that the VN Dong is about 10% undervalued, after having depreciated by about 2% in real terms during 2020 (i.e., stripping out the impact of inflation). The easiest way for Vietnamese policy makers to rectify this situation – and to thus avoid the future risk of tariffs – is to let the VN Dong appreciate. ¹
3. It appears motivated by a desire to **support Vietnam’s economic development** and to help bolster countries that are potentially important partners to the US in helping it achieve its regional geo-political objectives.

Further to that last point, the highly influential Atlantic Council think-tank published a report titled “The Longer Telegram: Toward A New American China Strategy”, which proposed a US-Asia strategy for the next 30 years, and which implies that the US should encourage Vietnam’s economic development as part of that strategy. This report was published in January 2021 with the stated intention of influencing the Biden administration’s Asia strategy, and likely helped prompt Vietnam’s “currency manipulator” label being dropped less than three months after it was published.²

Finally, the numbers in the table above are from the US Treasury Department, and do not match data from Vietnam’s Customs Department and/or Vietnam’s General Statistics Office (GSO). The differences between the US and Vietnamese figures is partly attributable to certain technical issues, but the US Treasury Department’s numbers paint a much more **benign picture** of Vietnam’s trade data than do the Vietnamese Government’s own figures. It appears that US Treasury officials made certain technical adjustments to the numbers in order to reduce the reported magnitude of Vietnam’s current account surplus and FX reserves accumulations (as a % of GDP) in 2020.

¹ Vietnam ran a 9% of GDP balance of payments (BoP) surplus in 2019 and an estimated 7% surplus in 2020, and the State Bank of Vietnam now has an adequate amount of FX reserves (over four months’ worth of imports), so achieving 2–3% appreciation in the value of the VN Dong over the next few years should be easy to achieve.

² *The “Longer Telegram” report predicts that “Beijing is likely to double down on its economic and diplomatic offensive across Southeast Asia to consolidate the gains already made in Cambodia, Laos, Philippines, Malaysia, Singapore, and Myanmar, while making Indonesia the central focus for the decade ahead”, and advises US policy makers to “prevent further strategic drift by Southeast Asia towards China”.*

# **Stable VN Dong Policy Benefits Investors**

The State Bank of Vietnam (SBV) prioritized stabilizing the USD-VND exchange rate over the last decade, and policy makers intensified those efforts³ following the 12% depreciation in the value of the Chinese Yuan in 2015–16 – which wreaked havoc in Southeast Asia FX markets, as can be seen in the chart below. The SBV’s policies have been remarkably effective, as evidenced by the steady performance of the VN Dong throughout the COVID outbreak, which can also be seen below.

**Chart: USD-VND FX Rate, vs. Average of ASEAN Peers’ FX Rates**

* Red line: USD-VND (stable from ~2015–2021)
* Grey line: Ave. of USD-THB, USD-PHP, USD-IDR, and USD-MYR (more volatile and depreciating trend)

In our understanding, Vietnamese policy makers are fixedly focused on maintaining a stable, predictable value in the USD-VND exchange rate in order to encourage investment inflows to the country.⁴ Vietnam’s Government officials often implement tried and tested strategies that have worked in China and other EM countries, and those policy makers (including several trained at Harvard’s Kennedy School of Government) are likely well aware of the role that a stable USD-CNY exchange rate played in helping to attract foreign investment inflows into China, especially during the early-2000s when China was at a similar stage of development as Vietnam is today.

We estimate that the total amount of foreign investment flows into Vietnam – including FDI, FII and a major portion of remittances from overseas Vietnamese – has consistently been well over 10% of GDP in recent years (FDI alone is circa 7% of GDP). Stable FX rates help encourage those inflows, and new investment inflows obviously benefit existing investors. However, an abundance of foreign capital also puts downward pressure on interest rates and risk premiums, which specifically benefits investors in Vietnam’s stock market. In addition, the stability of the USD-VND FX rate by itself also reduces the risk premium that foreign investors apply to Vietnamese stocks.

Finally, there are several parallels between China’s economic development in 2005, and Vietnam’s in 2020 – as well as parallels between the FX reserves and trade balances (as a % of GDP) of both countries in the lead up to the 7-year appreciation of the Chinese Renminbi, starting from 2006. At some point, Vietnamese policy makers will probably need to respond to an **appreciation** in the value of the VN Dong, although we expect a “Goldilocks” appreciation of the country’s currency to unfold, in which the appreciation of the VND meaningfully boosts foreign investors’ returns, but is not steep enough to impede Vietnam’s export growth.

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**³** The SBV instituted a “crawling peg” FX regime in early 2016 to avoid the buildup of speculative pressures on the VN Dong, and local policy makers redoubled efforts that were initiated in 2010 to stabilize Vietnam’s macro-economy.  
 **⁴** Maintaining a stable USD-VND FX rate also stabilizes the prices of imported consumer goods, but the vast majority of Vietnam’s imports are of production materials required to produce exports, which is another reason that maintaining a stable USD-VND exchange rate primarily benefits foreign investors, including FDI investors (note that Vietnam’s imports and exports were both around 100% of GDP in 2020).

*Classified: Public*