**VinaCapital** **Economist’s Note** *June 23, 2022* **Michael Kokalari, CFA** Chief Economist

# **Vietnam’s Resilience to Fed Rate Hikes and Other Global Risks Has Improved**

The US Federal Reserve’s efforts to rein in inflation, which has been largely driven by global supply chain issues, have prompted stock market selloffs around the world. Some investors are particularly worried about the possibility of a “perfect storm” for Emerging Market economies, because of the sharp rise in global interest rates, the circa 10% yoy increase in the value of the US Dollar/DXY index, and the recent surge in energy and food prices.

Vietnam’s stock market has sold off more than 20% YTD, driven in part by the 21% YTD correction in the S&P500 because of the well-known phenomenon that “correlations go to one during a stock market correction,” as well as by certain Vietnam-specific factors that were discussed in this report. We believe that Vietnam’s economy is more insulated from the current difficulties in the US and Europe than in the past, thanks to policy decisions the Government has made over the last decade to insulate the country’s economy from global economic storms.

**Chart section: Reduced Vulnerability to Global Shocks (USD-VND Exchange Rate)** Comparisons across three years:

* 2008 (significant VND depreciation)
* 2015 (depreciation due to Chinese yuan devaluation)
* 2022 (flat exchange rate)

Vietnam’s improved resilience puts it in a better place to deal with Fed rate hikes than in past rate hiking cycles. This improved resilience is reflected by the dampened impact that current turmoil in global markets is having on the USD-VND exchange rate – compared to in the past – as can be seen in the three charts above.

The key message we want to give investors in this report is that VN-Index (VNI) may currently be selling off along with global stock markets, but the country’s economy is still in very good shape, primarily because **domestic consumption** – which accounts for two-thirds of Vietnam GDP – is booming. Consequently, the consensus expects the VNI’s earnings per share (EPS) to grow by nearly 20% this year, according to Bloomberg. For that reason, we expect that to support a strong rebound in Vietnamese stock markets when the Fed eventually relents on its aggressive rate hikes. The same cannot be said for all EMs, however, especially those with current account deficits and huge USD denominated debts.

### **Vietnam’s Improved Resilience to Global Monetary Tightening**

Past episodes of global stock market volatility hit Vietnam hard, including the Global Financial Crisis in 2008, the Fed Taper Tantrum in 2013, and China’s 2015 depreciation of the Chinese Yuan. We are always wary of stock market prognosticators who claim that *“this time is different,”* but we and others have observed several fortifications to Vietnam’s macro-economy that should significantly strengthen Vietnam’s resilience to the current, escalating global economic storm.

For example, the Dallas Fed published research which analyzed the countries that got hit the hardest during the 2013 Taper Tantrum and concluded that the EM and frontier market countries which were the most impacted by the Fed’s significant monetary tightening at that time were those that had too little FX reserves and/or had too much US Dollar-denominated debt. Vietnam currently has nearly USD100 billion in FX reserves, which is in-line with the IMF’s recommended level, and Vietnam’s foreign currency denominated debt is below 40%/GDP, about half of which is essentially “soft” loans that are owed to supra-national lenders (e.g., the World Bank) on concessionary terms.

¹ https://www.dallasfed.org/research/economics/2021/0810

Furthermore, in late-2021 the *Economist* magazine and others published rankings of which EM/frontier countries² would be the most vulnerable to Fed rate hikes and quantitative tightening (QT) this year. Vietnam was essentially ranked as the least vulnerable country because of its modest debt levels, macroeconomic stability (including modest inflation), and persistent current account surpluses.

### **Vietnam’s Resilience Was Forged by Prudent Policy Decisions**

The above-mentioned benign predictions of the *Economist* magazine have been substantiated by economic developments in Vietnam this year. The VN Dong has depreciated by less than 2% YTD, versus a 5% depreciation in the Chinese Yuan, and inflation in Vietnam has remained modest – in stark contrast to most developed and emerging economies.

Further to that last point, Vietnam’s year-on-year inflation rate is currently below 3%, and we expect the country’s inflation rate to average 3.5% this year (Vietnam’s CPI inflation will likely peak at around 5.5% yoy in H2, and then fall back to 4.5% by the end of the year). The government aims to keep the average inflation rate below 4% this year, so our forecast implies that the State Bank of Vietnam (SBV) would **not** need to hike policy interest rates – which are currently around 4% – in contrast to Vietnam’s EM ASEAN peers that are **all** hiking interest rates or are expected to do so in the weeks ahead.³

Finally, Vietnam’s improved resilience to global economic storms is a result of policies that were implemented over the last decade following a decision that was made at the highest levels of Government in Vietnam around 2011. At that time, policy makers shifted their approach to managing Vietnam’s economy, from tacitly condoning uncontrolled GDP growth to balancing macro-economic stability and growth. The policy decisions that came out of that strategy shift included a variety of macro-prudential regulations, a crackdown on wanton credit growth by the country’s commercial banks, and a concerted effort to dramatically increase the country’s level of FX reserves, the result of which can be seen below.

**[Chart: Vietnam FX Reserves (% GDP)]**

* Data range: 2009 to 2021
* Shows a steady rise in FX Reserves from ~7% GDP in 2009 to ~27% GDP in 2021

Furthermore, when the 2015 Chinese devaluation rocked global stock markets (including Vietnam’s), the SBV switched from trying to maintain a fixed USD-VND exchange rate to implementing a “managed float” regime, which has further helped stabilize the country’s macro economy, which in-turn has bolstered Vietnam’s resilience to global economic storms.

### **Conclusions**

The Fed’s aggressive rate hikes, which exacerbated the already prevailing economic stresses caused by Russia’s invasion of the Ukraine and China’s COVID lockdowns, have weighed on stock prices across the globe, including in Vietnam. However, Vietnam’s economy is much more resilient to global economic storms than in the past, largely because of policy decisions by the Government to balance economic growth and economic stability.

That resilience, coupled with Vietnam’s high GDP growth and earnings growth should fuel a surge in the VN-Index surge if-and-when the Fed abandons its current aggressive rate hikes. That said, we expect the “bottoms up” earnings growth outlook for our VVF UCITS fund is nearly twice that for the overall index, and we would expect that fund’s net asset value to continue to outpace the VNI, which it has already done by 14% YTD as of June 23rd.

² Economist Ranking Article  
 ³ Note that China and Japan are the only two large central banks in the world that are not hiking interest rates.

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