**VinaCapital** **Economist’s Note** *October 7, 2022* **Michael Kokalari, CFA** Chief Economist

# **Vietnam Economic Update: GDP Growth Surged in Q3, and the Government Hiked Policy Rates to Protect the VN Dong**

Vietnam’s **GDP grew by 13.7% yoy in Q3**, which was much stronger-than-expected, and the **country’s central bank hiked policy interest rates by 100bps to 5% on September 23rd**, which was also unexpected. This report briefly summarizes recent economic developments as a follow-up to VinaCapital’s [annual investor conference](https://www.vinacapital.com) this week, where we shared the reasons why we expect Vietnam to “de-couple” somewhat from the difficult global economic conditions the world is likely to experience over the next 1–2 years.

In short, we believe Vietnam’s strong domestic-driven economic growth, coupled with the strong resolve of Vietnamese policy makers to maintain a stable macro-economy make Vietnam somewhat of an “economic safe haven” among emerging markets. Inflation in Vietnam is still below 4%, and the value of Vietnam’s currency **has depreciated by less than 5% YTD**, despite the near 20% YTD surge in the value of the USD and circa 10% depreciation in the value of China’s currency. Furthermore, we believe the State Bank of Vietnam (SBV) hiked rates to protect the value of the VN Dong, and note that Vietnam’s robust economic growth is currently, primarily being driven by domestic consumption.

|  | **FX Rate (YTD)** | **Policy Rate** | **CPI (YoY)** |
| --- | --- | --- | --- |
| Indonesia | 6.7% | 4.25% | 4.7% |
| Malaysia | 11.4% | 2.50% | 4.7% |
| Thailand | 12.9% | 1.00% | 7.9% |
| Philippines | 15.2% | 4.25% | 6.3% |
| **Vietnam** | **4.6%** | **5.00%** | **3.9%** |

*(Vietnam Policy Rate chart shown – First Hike Since 2011)*

Vietnam’s modest level of inflation partly reflects the **Government’s prudent handling of COVID**; the Government did not incur significant amount to debt to support the economy during COVID, and is running a budget surplus this year. Also, Vietnam is a food exporter, so food price inflation in Vietnam is below 4%. Finally, the modest depreciation in the VN Dong **illustrates the effectiveness of the Government’s efforts to stabilize the value of the VN Dong**. Vietnam is now one of the only countries in the world in which policy interest rates are above the inflation rate, making it attractive for Vietnamese savers to hold their money in VN Dong rather than selling it to buy USD.

### **Strong GDP Growth, Driven by Domestic Consumption**

Vietnam’s **GDP grew by 8.8% yoy in 9M22**, driven by domestic consumption, so we are lifting our 2022 GDP growth forecast from 7.5% to 8%. Consumption accounts for two-thirds of Vietnam’s GDP, and real retail sales (i.e., excluding the impact of inflation), which is a good proxy for household consumption in Vietnam, surged 16.8% yoy in 9M22. Part of that impressive growth was obviously due to the “**low base effects**” caused by the COVID lockdowns in Q3 last year, during which Vietnam’s retail sales fell by more than 30% yoy. However, domestic consumption in Vietnam has also been growing **sequentially all year** as 2022 progresses, including by nearly 3% month-on-month in September.

Next, **manufacturing accounts for over 20% of Vietnam’s GDP**, and previously we expected fairly weak growth this year, owing to weakening global demand for “Made in Vietnam” products. But Vietnam’s manufacturing output grew by **10.7% yoy in 9M22**, supported by the movement of factories from China to Vietnam (which we discussed in [this report](https://www.vinacapital.com)) and which is evidenced by a 16% yoy increase in FDI disbursements.

Finally, the Government is accelerating its infrastructure spending, resulting in construction activity increasing from 3.7% yoy growth in the first half of the year to 8.6% growth in 9M22. In 2023, we believe domestic demand will likely slow as the **country’s re-opening boom winds down** and demand for “Made in Vietnam” products continues to decline due to the slowing global economy. However, we expect an increase in public spending and a resumption of foreign tourist arrivals to offset some of that weakness, so we only expect **Vietnam’s GDP growth to slow from 8% in 2022 to 6% in 2023**.

### **Vietnam Hiked Policy Rates to Support the VN Dong**

In 2015, the State Bank of Vietnam began prioritizing maintaining a stable USD-VND exchange rate in the wake of the steep depreciation of the Chinese Yuan; the SBV switched to a “floating peg” FX regime at that time, and embarked on an aggressive effort to increase the country’s FX reserves. We believe that the SBV’s “stable VND” policy was inspired by a similar strategy followed by China’s policy makers in the late 1990s/early 2000s, during which time that country’s stable USD-RMB exchange rate helped encourage investment inflows into China¹ because investors had confidence that they could invest in China without the risk of suffering losses from FX depreciation on those investments.

In 2022, the VN Dong has depreciated by nearly 5% YTD, but we expect it to stabilize around the current level for the rest of this year, because US Dollars continue to flow into Vietnam via FDI inflows (circa 5% of GDP), via overseas remittances (4%/GDP), and via Vietnam’s trade surplus (circa 2%/GDP), as well as due to the SBV’s adept interventions into the currency market. The SBV has reportedly spent over USD12 billion of its FX reserves this year to stabilize the VN Dong, reducing its total reserves to below USD100 billion, and it has committed to sell another circa USD6 billion via FX forwards that mature by Q1; these actions would reduce the country’s FX reserves to about USD90 billion – or approximately three months’ worth of imports (EM Asia FX reserves have declined by the most on record this year, according to Standard Chartered).

![Graph: Vietnam FX Reserves (inc. FX Forwards) – Source: Bloomberg]

There is speculation that some of the US Dollars sold by Vietnam’s central bank to the country’s commercial banks were ultimately used by local businesses to repay USD denominated loans, since the interest payments on those loans is increasing as the Fed raises rates. The SBV has ample FX reserves to enable private sector businesses in Vietnam to repay their USD denominated debts, and there is an additional, substantial amount of US Dollars in Vietnam held outside the formal financial system.

The country’s FX reserves peaked at 30% of GDP at end-2021, and some well-informed economists have made “off the record” estimates that the amount of USD in Vietnam that is outside of the country’s banking system could be over 20%/GDP. Vietnam’s external debt is reportedly around 30%/GDP, but we understand that about half of this is owed by the Government to the World Bank, ADB, and other international development financial institutions.

Finally, higher VND deposit rates should encourage some of those US Dollars to flow back into the banking system, which would ultimately help the SBV rebuild its FX reserves, albeit at the expense of the stock market. Many leading banks in Vietnam are now offering one-year deposit rates of over 8%, which some savers see as an attractive alternative to channeling their savings into the stock market.

### **Conclusions**

Vietnam’s robust economic growth, which is primarily being driven by domestic demand, coupled with the Government’s prudent economic policies, make Vietnam somewhat of an “economic safe haven” within EMs. The Government’s recent rate hike is the latest in a series of policy moves aimed at maintaining a stable USD-VND exchange rate, which will in-turn also help protect the interests of foreign investors. In our view, the current market turmoil offers investors an attractive opportunity to buy Vietnamese stocks based on growth and price, given their current cheap valuation of 11x Forward P/E versus 15% expected EPS growth in 2022, making them especially attractive compared to the average 15x Forward P/E ratio of regional peers (Indonesia/Malaysia/Thailand/Philippines).

¹ https://www.imf.org/en/Publications/WP/Issues/2019/03/07/Chinas-Evolving-Exchange-Rate-Regime-46649

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