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## **China’s Re-Opening Will Only Modestly Boost Vietnam’s 2023 GDP Growth**

**China** is Vietnam’s biggest trading partner, and investors, policy makers, and others have asked about the impact that China dropping its “Zero COVID” restrictions will have on Vietnam. There was some initial uncertainty, and even skepticism, about how quickly China would remove its COVID restrictions after the December 7th announcements from key government officials. Last week, China dropped many/most COVID testing requirements, scrapped contact tracing, and essentially stopped reporting COVID case numbers. Meanwhile, **China’s Central Economic Work Conference (CEWC)** reiterated the government’s commitment to an “overall improvement” of, and “reasonable growth” for **China’s economy next year**.

Given all of the above, a consensus is now forming that **China’s domestic consumption growth** will surge from about 0% in 2022 to about 7% year-on-year (yoy) in 2023, and that **China’s energy usage will grow by about 10% next year¹.** Consequently, investors (and others) are enquiring about how Vietnam might benefit from a resumption of Chinese consumption growth, although concerns are also mounting about the possibility that **China’s reopening** will exacerbate inflation, both in Vietnam and globally.

We expect **China’s re-opening to boost Vietnam’s GDP growth** by over 2%pts next year, driven by the full resumption of Chinese tourist arrivals in the second half of 2023 (note that **Vietnam Airlines resumed** some flights to China on December 9th and that Chinese visitors accounted for one-third of **Vietnam’s total tourist arrivals**, pre-COVID). We also anticipate modest **inflation pressures from China’s re-opening next year** and note that inflation pressures in the rest of the world have clearly peaked and are now abating. Finally, while the **most important impact** of China’s re-opening on Vietnam is a likely full resumption of Chinese tourist arrivals in 2H23, the **most immediate impact** has been an improvement in the sentiment towards the VN Dong.

### **VND Appreciation Driven by CNY Appreciation**

*(Chart showing VND vs USD rate from Jan-22 to Dec-22 with a sharp rebound in Dec-22 marked by “China Announced end of Zero COVID”)*

The value of the VND appreciated by over 5% during the last week in November and first week in December (which was the time frame that encompassed **China’s December 7th Zero COVID policy shift**), driven by a circa 5% appreciation in the value of **China’s currency** over those two weeks. The VN Dong had depreciated by as much as 9% YTD in mid-November due to this year’s **surge in the value of the US Dollar**, so the Dollar’s recent, modest decline also helped ease depreciation pressure on the VN Dong, but the surge in the **value of China’s currency was the primary factor** that drove the rebound in the value of the VND that can be seen in the chart above.

¹ https://www.bloomberg.com/news/articles/2022-12-14/china-s-covid-pivot-is-set-to-worsen-the-global-energy-crunch?leadSource=uverify%20wall

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Further to that last point, the value of the US Dollar/DXY Index was essentially unchanged during the above mentioned two weeks, and some fairly negative news about Vietnam’s trade balance and balance of payments came out during those two weeks, both of which make it clear that it was the appreciation in the value of the CNY that drove the appreciation of the VND.

It’s not obvious from an economic point-of-view why the recent appreciation in the CNY prompted an appreciation in the VND; Vietnam has a consistent ~17%/GDP trade deficit with China, and an appreciation in China’s currency versus the VN Dong exacerbates Vietnam’s trade deficit with China in the short-term via the so-called “J-Curve Effect”². That said, market sentiment often overwhelms economic factors in FX markets, and the positive sentiment that China’s re-opening spawned led to a sharp appreciation in both the value of the Yuan and the value of the VN Dong. The opposite occurred in August 2015, when the sudden 3% depreciation in the value of China’s currency triggered an immediate 3% depreciation in the value of the VND, despite Vietnam benefiting from China’s depreciation.

We expected a similar sentiment phenomenon to boost the VN-Index, but we observe that China’s stock market achieved only a modest bounce in response to the government lifting its COVID restrictions and that Vietnamese investors are currently, primarily focused on various domestic issues that have impacted the market this year.

**Modest Economic Impact on Vietnam’s GDP Growth**

China is Vietnam’s largest trading partner, but Vietnam’s exposure to China’s domestic economy is quite modest, resulting in Vietnam’s GDP growth not being significantly hindered by Chinese COVID restrictions that impacted as much as one-quarter of that country’s economy this year. Vietnam’s export growth to China was nearly flat in 9M22, but only 14% of Vietnam’s exports are sold to China, so Vietnam’s GDP soared 8.8% yoy despite China’s lockdowns, in part because exports to the US and the EU, which account for nearly one-half of Vietnam’s total exports, grew by 25% yoy in the first nine months of the year.

Furthermore, most of Vietnam’s exports to (and imports from) China are of production inputs and/or other intermediate goods entailed in the manufacture of electronics and garments accounting for two-thirds of the trade between the two countries. Some Vietnamese companies will benefit from China’s reopening, such as those that sell seafood and other agricultural products, but exports of products that are ultimately consumed by Chinese customers only account for around 5% of Vietnam’s total exports.

**Effect on Tourism and FDI**

Foreign tourism contributed about 10% of Vietnam’s GDP pre-COVID, and foreign tourist arrivals are on track to reach 25% of pre-COVID levels this year. We expect the number of foreign tourists will climb above 50% of pre-COVID levels in 2023 based on the assumption that Chinese tourist arrivals fully recover in the second half of next year. However, the pace of recent developments in China point to a possible faster full resumption of Chinese tourist arrivals, which could lead to an even larger contribution to Vietnam’s GDP growth next year than we currently expect.

We are aware of concerns some investors have that the re-opening of China’s economy could detract from Vietnam’s appeal as a destination for FDI investment. We see no possibility of this happening given that: 1) China has irrevocably damaged its appeal as an investment destination for multinational firms, and 2) US-China trade tensions have dramatically escalated this year. Further to #1, concerns about China’s increasingly erratic policy pronouncements are well publicized but we would emphasize that Chinese authorities held steadfast to the country’s “Zero COVID” policy for years and then abruptly dropped the policy, following what amounted to a one-day warning, when the Politburo announced its desire to “push for an overall improvement in the economy.”

Further to #2 above, US-China trade tensions prompted multinational manufacturers to re-locate production facilities from China to Vietnam, or to set up new factories in Vietnam instead of China, evidenced by the fact that Vietnam’s trade surplus with the US tripled (from USD25 billion in 9M18 to USD75 billion in 9M22) while its trade deficit with China widened (from USD19 billion to USD52 billion over that same time period). The Biden administration dramatically escalated trade tensions with China this year by announcing what amounts to an indefinite extension of Trump’s tariffs on imports from China, and with other severe measures, including a prohibition for US persons to work at some chip factories located in China.

² https://fraser.stlouisfed.org/files/docs/publications/FRB/pages/1985-1989/32427\_1985-1989.pdf

Readers should also recall that there were already strong structural factors prompting FDI inflows to Vietnam before US-China trade tensions emerged. Factory wages in Vietnam are around two-thirds below those in China, but the quality of Vietnam’s workforce is comparable to that of China according to surveys by JETRO and others. Also, Japan and Korea, which account for over half of Vietnam’s FDI inflows, both face serious demographic and intractable economic issues that compel companies in both countries to invest abroad.

**Effect on Inflation**

Many economists believe China’s re-opening could fuel global inflation, but there is no concrete consensus that China’s re-opening will do so. Some analysts argue that a resumption of Chinese production could help further ease the supply chain tensions that account for about half of the current US CPI inflation rate, according to economists at the San Francisco Fed. We expect China’s re-opening to put upward pressure on food and energy prices in Vietnam (which account for nearly half of the CPI basket) and note that some well-placed Chinese economists expect a 20% increase in Chinese pork prices next year, for example.

In the past, surges in Chinese food prices understandably drove Vietnamese food prices higher given the geographic proximity of the two countries, but there are some factors that are likely to limit the surge in **China’s inflation rate (including food price inflation)** in 1H23. First, **China’s mandatory government lockdowns** appear to be giving way to voluntary lockdowns in the country’s cities (which account for **~80% of the country’s consumption**) because of widespread concerns among the population about contracting COVID at a time when **the country’s hospitals are likely to be overwhelmed**. Consequently, economic activity and price pressures in China are both likely to get worse before bottoming out sometime in Q1. Epidemiologists at the University of Hong Kong expect China’s COVID wave to peak around late-January.

Finally, **China’s reopening boom will not be as powerful as the reopening in the US and Europe** because unlike the governments in much of the developed world, China did not over-stimulate its economy with freshly printed money and direct stimulus payments to individuals. Consequently, China’s **money supply growth**, which fuels consumer price inflation, remained modest through COVID, and there is less **“pent up savings”** in China to drive a surge in the country’s consumption and consumer prices.

**Conclusion**

Analysts and economists generally believe that China dropping its COVID restrictions will have a major impact on the economies of countries in Asia and around the world next year. We expect China’s reopening will have a bigger impact on the economies of other ASEAN countries than it will for Vietnam due to those countries’ **greater exposure to China’s domestic economy**.

The most immediate impact of China’s **scrapping of its COVID restrictions** has been a circa 5% appreciation in the value of the VN Dong, driven by a 5% appreciation in the value of **China’s currency**. That said, the major benefit that Vietnam will accrue from China’s re-opening is likely to be a circa **2ppts boost to GDP growth** next year driven by a resumption of Chinese tourist arrivals. Finally, **China’s re-opening is likely to cause some upward inflationary pressure in Vietnam**, the impact could be mitigated by several factors, including a more prolonged reopening compared to the US and Europe, as well as less pent-up savings and demand in China compared to the US and EU.

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