*Economist’s Note – November 10, 2020* *Michael Kokalari, CFA – Chief Economist, VinaCapital*

### **The US Election, and What’s Ahead for the VN-Index and the VN Dong**

Biden’s US Presidential election victory, coupled with the high probability that the Republicans will retain control of the US Senate is positive for Asia EM stock markets, but will likely be **especially beneficial for Vietnam** stock market and real estate prices, and ultimately lead to an **appreciation in the value of the VN Dong** against the USD.

The Biden administration will likely pursue economic policies such as Modern Monetary Theory that will depress the value of the US Dollar. The Federal Reserve is also likely to intensify its monetary stimulus measures – which will put additional downward pressure on the USD – because the Republican-controlled Senate is unlikely to embrace aggressive fiscal stimulus to combat the economic impact of COVID.

Some prominent economists and investors, including Stephen Roach at Yale and Ray Dalio at Bridgewater, were *already* forecasting a major decline in the value of the USD over the next 1–2 years, driven by a variety of factors including high US government budget deficits and trade deficits. However, last week’s US election outcome makes a major USD depreciation a foregone conclusion, in our view.

A depreciating USD is positive for EM stock markets, and Asia markets should fare especially well because:

1. Biden will have a less caustic relationship with China, which will make investors feel more comfortable to pour money into China and other Asia EM stock markets, and
2. Asia’s handling of COVID has made the region’s stock markets some of the world’s most attractive investment destinations.

Vietnam’s market should fare even better because Vietnamese policy makers are likely to respond to the drop in the value of the USD by aggressively loosening monetary policy to maintain a stable USD-VND exchange rate.

Finally, control of the US Senate will not be finalized until January, but all of the assertions above are not overly dependent on which party wins. That is because the value of the USD is set to depreciate due to aggressive COVID-related stimulus in the US in a dynamic that is captured by the whimsical diagram below, from Luke Gromen’s, *“Forest Through The Trees”* investment newsletter:

**Whimsical Grid (4-square matrix):**

|  | **Democratic Congress** | **Republican Congress** |
| --- | --- | --- |
| **Trump wins Presidency** | More Federal fiscal stimulus, monetized by the Fed and US banking system | More Federal fiscal stimulus, monetized by the Fed and US banking system |
| **Biden wins Presidency** | More Federal fiscal stimulus, monetized by the Fed and US banking system | More Federal fiscal stimulus, monetized by the Fed and US banking system |

*Source: FFTT, LLC*

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### **The US Dollar, and Vietnam**

Vietnam will benefit from all of the factors discussed above. But if the value of the USD falls significantly next year, then Vietnam’s stock real estate markets will benefit disproportionately. That is because for the first time, Vietnamese policy makers will need to take action to prevent the **appreciation** of the VN Dong in order to maintain export competitiveness.

Our assertion that the State Bank of Vietnam (SBV) will significantly loosen monetary policy in Vietnam in order to prevent the VN Dong from **appreciating** may surprise many readers, given seemingly perpetual consensus concerns about VN Dong **depreciation**. For that reason, we would like to remind readers of our long-standing view that appreciation pressures on the VN Dong have **already been mounting** for more than a year.

Further to that last point, Vietnam is about to achieve its **10th annual current account (C/A) surplus** in-a-row (averaging 3%/GDP), and the SBV’s FX Reserves are likely to reach **35%/GDP** by the end of 2020. China achieved nearly identical economic accomplishments in the 10 years leading up to 2006, after which the value of China’s currency began a 7-year, 25% appreciation. We have been expecting a similar dynamic to unfold for the USD-VND exchange rate starting from 2021, although the value of the VN Dong is unlikely to appreciate by as much as China’s currency did for a variety of reasons.

Critically, the combination of mounting appreciation pressures on the VN Dong, and a major depreciation in the value of the US Dollar will prompt local policy makers to aggressively loosen Vietnam’s monetary policy to maintain a stable USD-VND exchange rate (which would probably entail 2–3% annual appreciations of the VN Dong over the next few years). We expect the SBV to pursue such a loose monetary policy in order to:

1. maintain Vietnam’s export competitiveness, and
2. ensure continued FDI inflows to Vietnam.

### **The Falling USD Will Boost Vietnam’s Stock Market, Real Estate Market and the VN Dong**

Understanding the final piece of our investment thesis requires a quick review of some relatively recent, relevant economic history. Recall that the **1986 Plaza Accord** led to a **50% depreciation in the value of the USD** over two years. This plunge, coupled with Japan’s huge trade surplus at that time prompted Japanese policy makers to aggressively loosen monetary policy to prevent the value of the Japanese Yen from surging (which would have decimated Japan’s exporters).

The Bank of Japan’s (BoJ) aggressive monetary easing initially inflated huge stock market and real estate bubbles that peaked in 1990. However, the BoJ reversed course in 1990 when it began clamping down on excessive money supply creation, which caused the value of the Yen to soar by **over 75%** in the early 1990s.

There are obviously many differences between Vietnam and Japan in the 1980s, but we expect a similar dynamic to play out in Vietnam — albeit on a much smaller scale. Specifically:

1. the SBV will initially respond to the drop in the USD by aggressively printing money,
2. excessive money supply creation will drive Vietnamese stock and real estate prices higher, and
3. when the SBV stops trying to hold down the value of the VN Dong, the VND will appreciate significantly.

### **Timeline: USD Depreciation Drives the VN-Index and the VND Higher**

| **When** | **What** |
| --- | --- |
| **Over The Next 1 Year** | • USD Depreciates • VND Appreciation Pressure Builds |
| **1 – 2½ Years From Now** | • USD Continues to Depreciate • Aggressive SBV Money Printing to Prevent VND ↑ • Vietnam Stock & Real Estate Prices Surge |