MACRO's 2018 REVIEW & 2019 OUTLOOK

2018 review: Ended with a high note

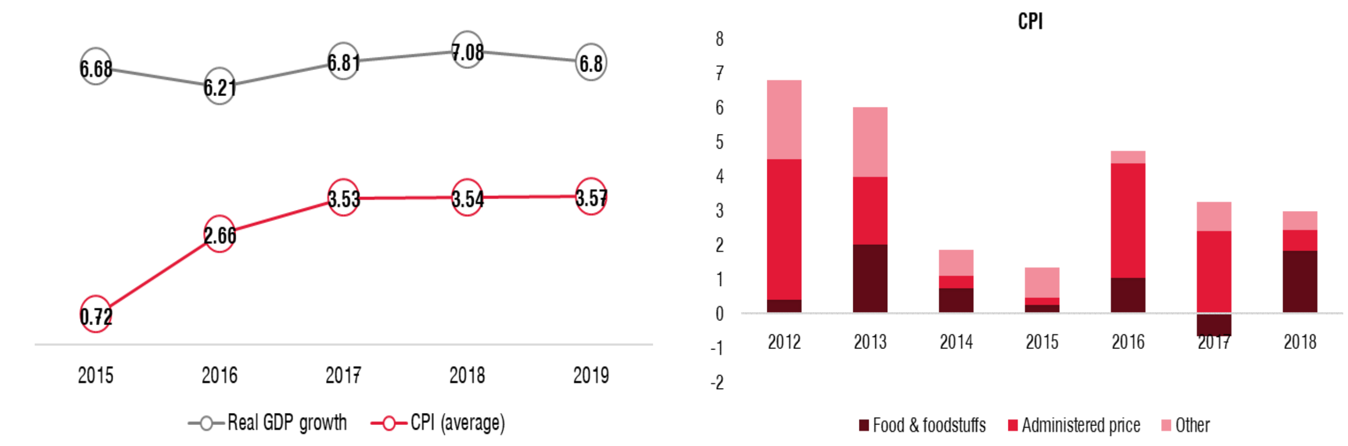
Vietnam economy growth hit a multiple year high in 2018, with a positive surprise in 4th quarter data. Q4 **GDP growth** is extremely high, at 7.31% YoY, only playing second fiddle to growth back in previous quarters in 2018 (7.65% GDP). Such top-tier growth in terms of global growth is more than enough to boost full year growth to 7.08% YoY, a pinnacle achievement and the highest since 2007. By sector, growth drivers originated from manufacturing (+12.98%) and construction (+9.1%), and also from the agriculture sector having posted growth at a 6-year high. By expenditure, final consumption increased 7.17%, and fixed asset formation jumped by 8.22% YoY.

For **retail sales**, nominal growth is 11.7% YoY, and real growth was similar to last year (9.4% vs 9.3%).

As for the **tourism** sector, Vietnam received 15.5 mil pax of international tourist arrivals, another massive increase, this time at +20% YoY.

High growth still remains to be associated with low **inflation**, as December CPI was -0.25% lower MoM, by and large primarily influenced by a lower oil price. For the full year, CPI increased by 3.54% YoY on average, lower than the government target of 4%. Major drivers for the CPI in 2018 include the gasoline price (adding 0.63% to headline CPI on average), healthcare (0.54%), pork (0.44%), and the education fee (0.37%). Core inflation is quite low, just 1.48% YoY on average.

Vietnam GDP growth, CPI and CPI breakdown



Source: GSO, SSI Research

In fact, the level of growth is close to the recent peak last seen from 2005-2007. The major difference resides within the quality of growth. During 2006-2007, the percentage of total factor productivity to GDP growth is quite small (around 5%), while it was 43.5% for 2018 (2016-2018 average: 43.29%). In layman terms, it means Vietnam needs less capital, yet requires a workforce increase in order to achieve a similar level of growth. Looking at the data, it becomes evident that the improvement in manufacturing and the construction sector, along with tamer inflation (as CPI was lower in both Nov-Dec), resulted as key catalysts for this impressive growth.

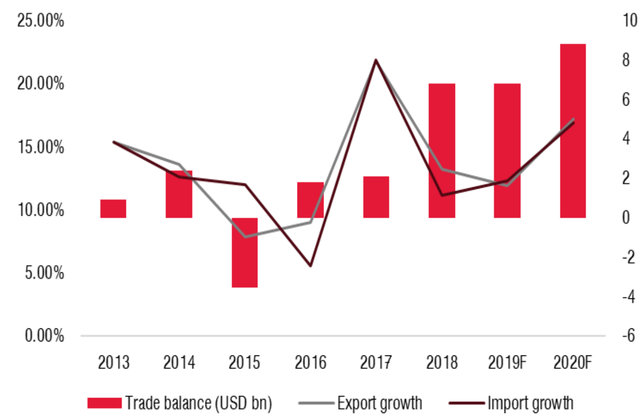
On **the investment** side, in total there was an increase to 11.2% YoY (at about $80 bn, or 33.5% GDP), and once again the private sector led the charge on growth (+18.5% YoY), followed by the FDI sector (+9.6%) and then the public sector (+3.9%). Please note that in the breakdown, the public sector only includes 100% state owned enterprises, so there might be some other SOE investment counted in the private sector that comprises of part state-owned enterprises in the mix.

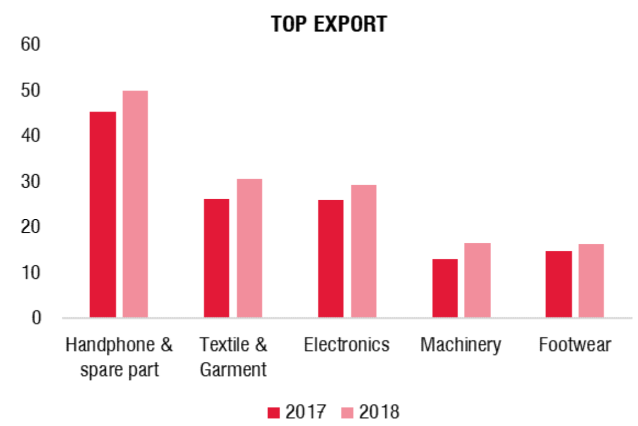
For **FDI** in particular, we saw impressive rebound for FDI into Vietnam during the final month of 2018. In this surprise upside report, newly registered FDI added $2.22 bn USD, and helped to pare the decrease of registered FDI in 2018 to about -13.83% YoY, totaling $25.6 bn. Disbursed FDI came to approximately $2.6 bn in Dec 2018, leaping by +73% YoY and pushing the full year number to $19.1 bn, a 9.1% gain from last year's results. With such relatively high registered foreign investment being maintained (1.85x of annual disbursement), it could ensure further growth in terms of FDI implementation in 2019.

For **FII**, 2018 figures are also impressive at $9.89 bn, which also leaped nearly +60% YoY. So all together, registered foreign investment (FDI plus FII) was about $35.46 bn. This was just 1.2% lower than 2017, a bumper crop year for investment into Vietnam.

On the monetary side, **M2** increased by 12.5% YoY (2017: 14.19%), and **credit growth** was 14% (2017: 18.1%). It did show that monetary policy is more on the tightening side, which started from 2H 2018 after growth is in line with expectation and global volatility is rising. On the fiscal side, a **budget deficit** was not in sight, but the full year balance might be reported as deficit, as normally carry-over to 2019 is allowed. Anyway we could still say that state budget is at a surprisingly healthy level by end of 2018. This is mostly owed to the government that spent less than expected (development investment was at 65.1% of the full year plan).

Vietnam trade data and top export





Source: Vietnam Customs

The most impressive factor, amongst other things, for Vietnam is on the trade front, **export** growth was 13.2% YoY ($243.5 bn), and **import** growth was 11.1% YoY ($236.7 bn), pushing the Vietnam trade balance to a **huge surplus of $6.8 bn**, a record high level. Beside decent export growth also seen in Machinery +28.2%; Camera +37.8%; Textile & garment +16.7% YoY, the key drivers for trade surplus come from (1) ***Strong net export of handphone*** (USD 33.21 bn in 2018 vs USD 28.84 bn in 2017), thanks to higher local content of mobile production: The number of factories in Vietnam listed in Apple supplier list increased from 16 in 2015 to 22 in 2018. On the other hand, localization rate of Samsung products jumped from 34% of total product value in 2014 to 57% in 2017 and (2) ***Import substitution effect,*** such as i) Production of Binh Son refineries (maintenance last year) and Nghi Son refineries (newly operated), which replaces imports of refined products. As a result, import of petroleum products reduced by 11.4% and ii) Formosa production, which supplies HRC input for local companies (thus replacing imports). Imports of steel reduced by 9.8% in volume in 2018, while export increased 33.1% YoY.

In short, high growth coupled with ensured macro stability (tamed inflation, strong local currency and relatively low credit growth) is the key summary for Vietnam economy. However, concerns are still on the global volatility (with potential trade war) and locally, the anti-corruption campaign which might result in slower approval for new property or infrastructure projects.

2019 Outlook: A bud in the mud

- **Vietnam's high growth trajectory might well extend into 2019**, thanks to new production capacity and stable FDI. In November, the National Assembly approved the plan for 2019 goals, with GDP growth at 6.6-6.8% YoY, CPI at about 4% on average, and budget deficit at 3.6% GDP. The government target will be at the higher end of the National Assembly plan, as it wants to push ahead growth and reform to mark the completion of the 5 year plan (2016-2020).

  Currently, the government is promoting the idea of "fast and sustainable growth". Inspiration might come from 2018, a year in which GDP growth clocked in at a sizzling 7.08%, CPI at 3.5%, and credit growth was just 14%. Other tracked metrics including current account surplus and currency performance were also solid.

  We are without a concrete definition for what sustained fast growth means per se. However, when looking at historical data of Vietnam achieving decade-long 6%+ growth sprints, it dares one to imagine the prospect of 7% growth for a decade, resulting in GDP doubling within just a decade's time. It might be a bold idea, but there is regional historical precedent in countries like China, Japan, South Korea, Thailand, Hong Kong, and Singapore to justify making such a claim. For Vietnam, it's not a surprise to see the government is committed towards growth, as for decades they have benefited from a catch-up growth strategy.

  With limited natural resources at this moment in time, the government has called for institutional reform, investment into infrastructure, and implementation of digital economy being things that are considered integral components to achieve consistently fast growth. For institutional reform, it's about creating an attractive business environment, promoting the potential of the private sector, and reforming SOEs. These implementations might be sooner than skeptics may think. Vietnam has made it clear that it intends to move forward with implementations of reform sometime in the foreseeable future, and has historically attracted investors with little appetite for political instability. Vietnam has also established itself as having a reputation as a critical manufacturing hub in the global supply chain, with favorable demographics of able, skilled young workers in a region where societies are becoming increasingly geriatric in countries such as China and Japan. While these statements from top political brass espousing a solid vision for the country is certainly a good thing to see, we might need to see further clarification of all on-going or future reforms to see if this ambition could transform from the theoretical realm to actual implementation.

Vietnam 2019 growth scenarios

No		Q1 2019	Q2 2019	Q3 2019	Q4 2019	1H 2019	9M 2019	2019
	GDP growth	**6.93%**	**6.7%**	**7.03%**	**6.63%**	**6.8%**	**6.89%**	**6.8%**
1	***Agriculture***	***2.97%***	***2.56%***	***3.12%***	***3.36%***	***2.69%***	***2.84%***	***3%***
2	***Industrial and construction***	***8.87%***	***8.89%***	***9.01%***	***7.84%***	***8.88%***	***8.93%***	***8.57%***
2.1	Industrial	9.31%	8.91%	8.85%	7.2%	9.09%	9%	8.43%
2.1.1	*Mining*	*-1.8%*	*-4.8%*	*-5.2%*	*-5.04%*	*-3.46%*	*-4.05%*	*-4.4%*
2.1.2	*Manufacturing*	*12.7%*	*13.05%*	*12.2%*	*10.86%*	*12.89%*	*12.63%*	*12.09%*
2.2	Construction	6.18%	8.78%	9.7%	10.21%	7.73%	8.56%	9.2%
3	***Service***	***6.57%***	***6.88%***	***6.85%***	***6.92%***	***6.74%***	***6.78%***	***6.83%***

Source: Government resolution 01.2019

In the meantime, Vietnam has become **a highly preferred alternative location** where manufacturing conglomerates can diversify their production bases against the backdrop of the trade war of attrition currently ongoing between the US and China. Vietnam is seen as an attractive alternative for a production base, especially given the openness of the economy and its proximity to China.

Therefore, the manufacturing sector could maintain its current momentum, thanks to new production capacity and stable FDI inflow. Construction of infrastructure projects could also bring in support, starting in 2H 2019. There is potential room for growth in this segment if the public investment engine could fire back up after a long lull as Vietnam wraps up its 5-year cycle. This growth cycle is occurring just as there are ongoing domestic reforms afoot within the country. These reforms are not just limited to SOEs sector or the banking system, but also are aimed towards more access to global markets through a number of new free trade agreements, such as the CPTPP or EU-Vietnam FTA, which should bring in additional waves of foreign investment.

- For **inflation,** we believe that pressure is relatively tranquil and along schedule. This relatively lower pressure on inflation in turn paves the way for an acceleration in subsidies removal upon electricity and other sectors. There is a looming 5-7% hike in costs for electricity, possibly taking effect as early as January 2019, as well as price hikes around the corner for such staple costs as domestic coal (Jan), healthcare (Jan), education (2H 2018), plus the imposition of the new environmental tax, also effective starting January 2019. Food & foodstuff prices are already at a high base in 2018, which might translate to a buffer to keep inflation in check. This is worth remembering, as foodstuffs account for nearly 40% of the CPI basket in total.

  Anyways, the rebound on the commodities price, the El Nino impact on agriculture products, and less bang for the buck with VND would be key risks to our assumptions. The National Assembly recently reminded the government that in the 2016-2020 plan, the inflation target for 2020 is "lower than 3%". The stance from the National Assembly essentially sets the tone from the top, one of inflation control, and a stance that will likely continue to remain a national priority for years to come.

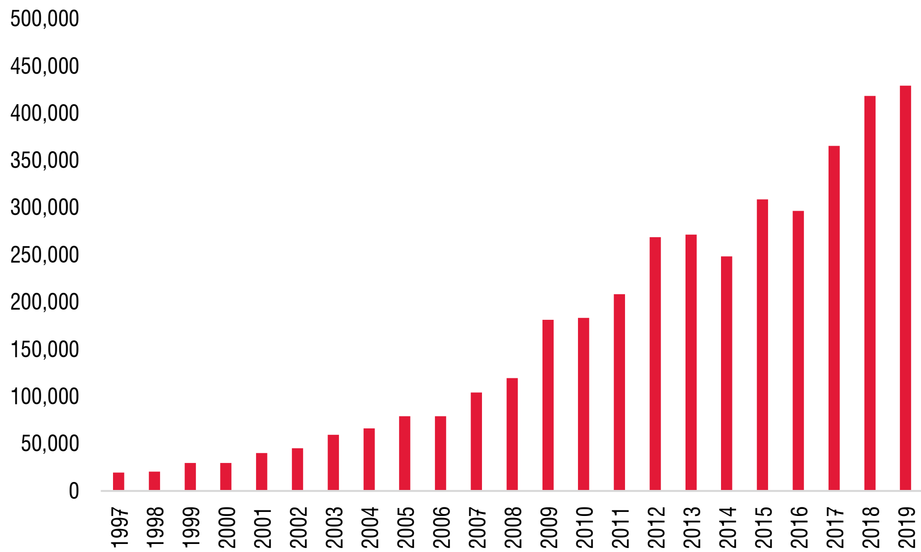
- With less pressure on inflation in the short-term, **monetary policy could see a slight dovish-tinged tightening** which means policy-makers could switch to easing if needed to support growth, which might be feasible with a tamer inflation print. While credit growth limit for 2019 is only 14%, signalling tightening stance, but flexibility is still there if weaker growth being witnessed . Meanwhile, **fiscal policy might be accommodative** given budget surplus in 2018, to allow fuel for public investment to focus on infrastructure projects.

- For **interest rates,** a precedent of a tightening monetary policy would lead to higher lending rates by about 30 to 50 bps in 2019. Inflation risk is not significant, but there is a dynamic of a rising cost of funds (to comply with Basel II and other requirements from the central bank). While we believe the current trend of shifting more towards retail lending (which have higher yields) will continue at most banks, we also expect the lending rate for retail borrowers to increase at a larger scale. This is especially the case for long-term loans such as mortgages, loan instruments of which often carry favorable fixed rates in the first 1-2 years before converting into floating and commercial rates in the following years. On the upside risk, improved recapitalization for the banking system could be a positive catalyst for the manifestation of more stable interest rates.

- As the USD might peak soon, **we believe that forex fundamentals for Vietnam are still alive and well**, with inflows from stable FDI disbursement, FII (on SOE divestment and IPOs, banking system recapitalization, and M&A in private sector), remittance, trade surplus, and other vectors that in aggregate helps to keep the balance of payment in surplus. So, the pressure on exchange rates might be less pronounced than it was in 2018. The X-factor is the trade war intensification, which can have a material impact on the CNY, and on VND indirectly.

- Relating to **public investment**, one of the wild cards for growth in 2018**,** most of the overhaul in regulation framework was cleared in late 2018 on high expectations of an overclocked boost in the public investment disbursement rate come 2019. We may not only see an increase from the previous 60-70% execution of the annual plan on average, but we may witness an attainment of 90% of the 2019 plan, plus *carry-over* from last year's undisbursed amount. However, political will is the potential fly in the ointment. While technically ample political will would be all that is needed to give disbursement a boost to these levels, compliance with investment disbursement is mired in complicated procedures. This breeds an over-cautious sentiment from local authorities, which could in turn discourage taking such a path, and derail the process of catching up on public investment disbursement schedules.

Vietnam development investment. Unit: VND bn



Source: CEIC, MoF

- **On the trade front**, Vietnam would be still able to post another trade surplus for 3 years in a row, based on:
  - ✓ Growth in manufactured exports (not just from mobile phone, but also from other electronics)
  - ✓ Improved value-added exports (not just limited to processing, but also with more developed supporting industries, and more build-up of integrated value chains)
  - ✓ Import substitution (steel, petroleum products)
  - ✓ Benefits from potential trade war/new FTAs (CPTPP, EVFTA, etc.)

On the other hand, protectionism, weaker global demand (not just for slower growth in general, but weaker demand for some important sector to Vietnam such as smartphone) could pose a big risk to the growth potential.

On SOE reform, we expect state-owned enterprise (SOE) IPOs and divestments to accelerate in 2019-2020, a welcome change after a lull starting back in 2Q 2018 (due to weak market conditions, stricter regulations on valuation, and cautious sentiment due to the anti-corruption campaign). 2018 is a disappointing year for privatization. Regarding IPOs, the government ideally plans to equitize 127 SOEs during 2017-2020 (44 in 2018, 64 in 2019), but currently implementation of these equitizations is in actuality quite less than that (with only 24 by 2017 and 3 in 2018). Regarding divestment, the government planned 135 SOE divestments in 2017 (actual: 13) and 181 SOEs in 2018 (18 completed as of November). On listing, by mid-2017 there was then 747 unlisted SOEs. After a lot of efforts, there are still 667 unlisted SOEs as of Nov 2018.

On the positive side, the process for transferring SOEs to Commission for the Management of State Capital at Enterprises (CMSC) progressed at a more rapid clip recently. For a quick recap, CMSC will directly represent state ownership of 19 economic groups and state corporations (including state investment arm SCIC, which also directly represents state ownership in smaller SOEs), PetroVietnam, EVN, Petrolimex, Vinachem, VRG, Vinacomin, VNPT, MobiFone, Vinataba, Vietnam Airlines, Vinalines, VNR, VEC, ACV, Vinacafe, Vinafood I, Vinafood II, and Vinafor. It indeed looks to be that the transfer for this stage would be on time, and most required regulations (i.e. to form a government body to oversee the process, or to allow for book-building), are effective starting late

2018, so we believe it's just a matter of time to see the political will to come back to the fray, resulting in boosted demand from both local and foreign investors (including industrial buyers) for attractive names in hot sectors like retail, banking or industrials.

In short, we believe that Vietnam economy faces a mixed bag of issues in 2019, with more headwinds from global economy slowdown, rising protectionism and a tightening monetary policy. On the other hand, tamed inflation and stronger fiscal position could leave ample room for policy makers in case growth is not on the right track. Political will is there, as always, but implementation is always a risk in practice.

Vietnam economy in summary

	2012	2013	2014	2015	2016	2017	2018	2019F	2020F
GDP growth (%- 2010p)	5.25	5.42	5.98	6.68	6.21	6.81	7.08	6.8	7
Agriculture (%)	2.68	2.67	3.49	2.41	1.36	2.9	3.76	3.4	3.7
Industry & Construction (%)	5.75	5.43	7.14	9.64	7.57	8	8.85	8.5	8.8
Construction (%)	3.25	5.40	7.07	10.82	10.00	8.7	9.1	8.4	9.1
Manufacturing (%)	5.80	7.44	8.45	10.60	11.90	14.4	12.98	12.1	14.7
Service (%)	5.90	6.56	5.96	6.33	6.98	7.44	7.03	7.3	7.5
Retail Sale (%)	16.00	12.60	10.60	9.50	10.20	10.86	11.7	12.1	12.7
Industrial Production Index (%)	4.80	5.90	7.60	9.80	7.50	9.4	10.2	9.7	10.5
CPI (average, % YoY)	9.21	6.60	4.09	0.72	2.66	3.53	3.54	3.57	3.16
CPI (year-end, % YoY)	6.81	6.03	1.86	1.34	4.74	2.6	2.98	3.65	2.42
Exports (USD bn)	114.60	132.20	150.00	162.40	175.94	213.77	243.5	269.67	307.62
Imports (USD bn)	113.80	131.30	148.00	165.60	173.26	211.1	236.7	262.86	298.79
Trade Balance (USD bn)	0.80	0.90	2.00	-3.20	2.68	2.7	6.8	6.81	8.83
% of Export	0.70%	0.68%	1.33%	-1.97%	1.52%	1.26%	2.79%	2.44%	2.76%
Exchange rate (USD/VND)	20,900	21,250	21,250	22,520	22,790	22,750	23,245	23,880	24350
Current Account Balance (USD bn)	7.00	8.80	9.36	1.00	9.60	4	9	7	9
Foreign reserve (USD bn)	25.40	26.00	34.30	28.40	36.70	50	56	62	70
Foreign reserve/imports (weeks)	11.61	10.30	12.05	8.92	11.01	12.29	13.1	12.39	12.38
Credit growth (%)	8.91	12.50	14.00	17.29	18.80	18.2	14	14	14
Deposit rate (VND -%)	8.00	8.00	6.00	6.00	6.00	6	7	7.5	7

Upcoming IPO list

Company Name	Sector	Market cap	IPO ratio	IPO size	Timeline
Mobifone	Telecom	4,581	30.00%	1,374	2019
Agribank	Bank	3,436	30.00%	1,031	2020
VNPT	Telecom	3,084	30.00%	925	2019
SATRA	Retail	1,982	30.00%	595	2019
Vinacomin	Mining	1,648	30.00%	494	2019
Vinataba	Consumer	881	49.00%	432	2019
VICEM	Construction Material	1,000	40.00%	400	2019
RESCO	Real Estate	1,123	30.00%	337	2019
Saigon Tourist	Hospitality	1,013	30.00%	304	2019
GENCO 2	Utilities	1,804	13.00%	235	2019
Ben Thanh Group	Real Estate	458	49.00%	224	2019
Sawaco	Utilities	344	49.00%	168	2019
GENCO 1	Utilities	1,263	13.00%	164	2019
HUD	Real Estate	330	49.00%	162	2019
TOTAL		22,948		**6,846**	

Upcoming divestment list

USD mil (price as of Dec 7th, 2018)	Market cap	Divestment ratio	Divestment size	Timeline
VNM	10,000	36%	3,600	2019
ACV	7,563	30.40%	2,299	2019
SAB	6,801	36%	2,448	2019
VEA	2,154	88.50%	1,906	2019
BHN	825	82%	677	2019
PLX	3,036	24.90%	756	2019
HVN	1,837	35.20%	647	2019
DHG	474	43%	204	2019
VGC	340	56.70%	193	2019
TVN	279	93.90%	262	2019
MBB	2,085	10%	208	2019
DVN	159	65%	103	2019
VGT	262	53.50%	140	2019
TOTAL	35,815		**13,443**	

Source: Government plan, SSI Research estimates