

Econ note

16 May, 2022

**ECONOMIC UPDATE**

**All about the FED**

- After twice hikes of 75 bps, another 175 bps of hikes are now reflected for the rest of the year, pushing the Fed rate at about 2.5% by end-2022.
- We see five major impacts of the Fed's tightening of monetary policy on Vietnam's economy.
- We expect SBV to maintain its accommodative monetary policy at least in the next 3-6 months to support the economic recovery.

**FED tightens monetary policy to deal with high inflation**

At its most recent meeting held on May 3-4, 2022, the Federal Open Market Committee (FOMC) voted to increase the fed funds rate by 50 basis points to a target range between 0.75% and 1.0%. The decision to raise policy rates by 0.50% marked the most aggressive increase made in a single meeting since May 2000. The central bank officials also suggested that they will further raise policy rates throughout this year in an effort to tame inflation. According to CME Group survey, market expects Fed to raise the policy rate by 175-200 basis points for the rest of 2022 to a target level of 2.5% to 3.0%. Fed's officials also agreed to begin reducing its balance sheet in June 2022, initially by US\$47.5 bn per month (US\$30bn in U.S. Treasuries and US\$17.5bn in mortgage-backed securities), then by US\$95bn per month after three months (US\$60bn in U.S. Treasuries and US\$35bn in mortgage-backed securities).

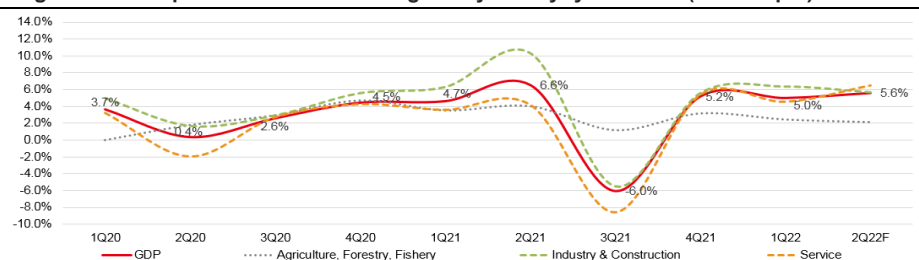
**FED's monetary policy has a broad impact on Vietnam's economy**

Tighter global financial conditions could dampen growth prospects for the global economy, leading to lower demand for Vietnam's exports. Rising USD interest rates put pressure on Vietnam's interest rates, whereby VND deposit rates are expected to increase further by 20-40 basis points for the rest of 2022. A stronger USD affects Vietnam's exchange rate, although the impact is minimal as supportive factors for dong stability remain such as stronger trade surplus and high foreign exchange reserves. In addition, a stronger USD also increases the foreign debt repayment obligations of the Vietnam's government and enterprises.

**SBV is likely stick to its own pace with more attention to domestic recovery**

We keep our expectation that the State Bank of Vietnam (SBV) will maintain its accommodative monetary policy until at least the end-2Q22 as (1) Although inflationary pressures are expected to intensify in the coming months, the average consumer price index for 1H22F is forecasted at 2.5% yoy, still well below the government's target of 4% yoy (2) Domestic demand remains weak and has not yet fully recovered to pre-pandemic levels and (3) The SBV still prioritizes the goal of maintaining low lending interest rates to support businesses. Any monetary tightening will only take place in the second half of 2022 (more likely in 4Q22F), and major rate hikes will be limited, around 0.25-0.5%.

**Figure 1: We expect Vietnam's GDP to grow by 5.6% yoy in 2Q22F (+/-0.2% pts)**



Source: GSO, VNDIRECT RESEARCH

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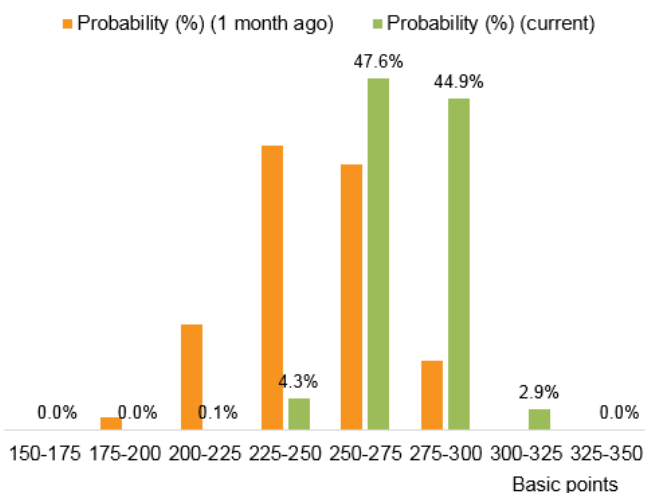
## ALL ABOUT THE FED

### FED tightens monetary policy to deal with high inflation

At its most recent meeting held on May 3-4, 2022, the Federal Open Market Committee (FOMC) voted to increase the fed funds rate by 50 basis points to a target range between 0.75% and 1.0%. The decision to raise policy rates by 0.50% marked the most aggressive increase made in a single meeting since May 2000. The central bank officials also suggested that they will further raise policy rates throughout this year in an effort to tame inflation. According to CME Group survey, market expects Fed to raise the policy rate by 175-200 basis points for the rest of 2022 to a target level of 2.5% to 3.0%.

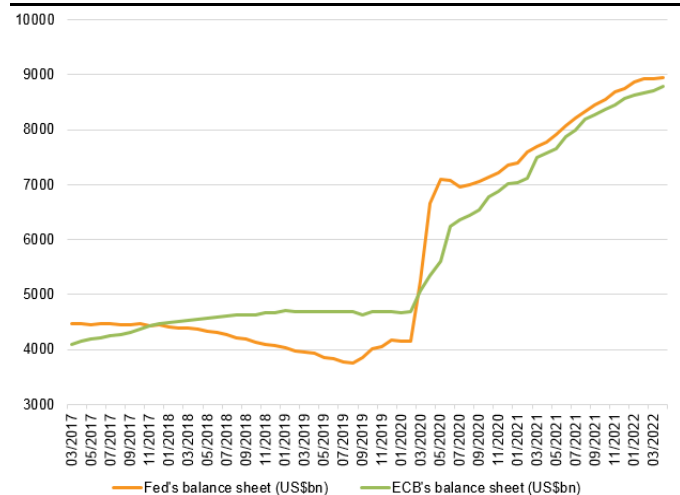
Fed's officials also agreed to begin reducing its balance sheet in June 2022, initially by US\$47.5bn per month (US\$30bn in U.S. Treasuries and US\$17.5bn in mortgage-backed securities), then by US\$95bn per month after three months (US\$60bn in U.S. Treasuries and US\$35bn in mortgage-backed securities). Under the above plan, the Fed could shrink its balance sheet size by about US\$427.5bn in the second half of 2022. This scale is relatively small (accounting to only 5% of the current Fed's balance sheet size), so the impact on global financial market liquidity is quite limited.

Figure 2: Target rate probabilities for 14 Dec 2022 FED meeting



Source: BLOOMBERG, VNDIRECT RESEARCH

Figure 3: Balance sheet of major state bank



Source: Bloomberg, VNDIRECT RESEARCH

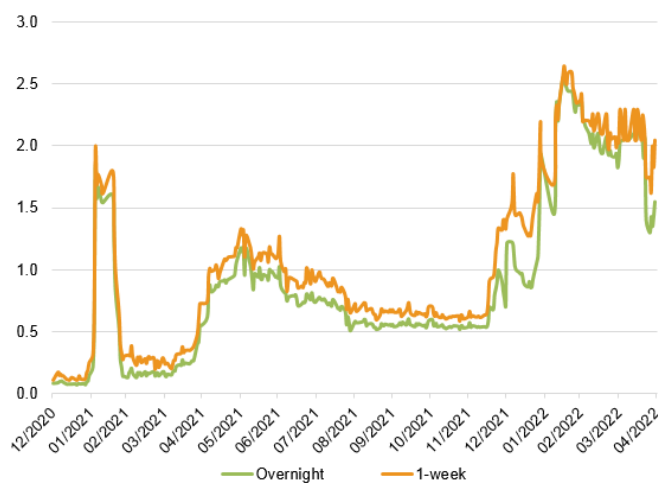
### We believe that the FED's tightening of monetary policies brings five major impacts on Vietnam's economy

- Tighter global financial conditions could dampen growth prospects for the global economy, leading to lower demand for Vietnam's exports. The Fed's tightening of monetary policy will increase borrowing rates (in USD) thereby reducing consumption demand of people as well as weaken the need to expand investment of businesses. Many research organizations around the world have recently lowered their growth forecasts for the global economy as well as the US economy, in which one of the main reasons is the tightening global financial conditions. Therefore, Vietnam's export activities could slow down in the coming quarters as consumers in key export markets such as the US and Europe tighten their spending.
- Deposit interest rates (by Vietnam Dong) are under pressure to increase in the remainder of 2022. As of 26 Apr, 2022, the 3-month term deposit rates and the 12-month term deposit rates of state-owned banks remained unchanged compared to the level at the end of 2021 (refer Figure 12) while the 3-month term deposit rates and the 12-month term deposit rates of private banks edged up 14bps and 13bps, respectively, compared to the

level at the end of 2021. We expect deposit rates to further increase in the rest of 2022 due to an increase in USD deposit rates and higher inflationary pressures in Vietnam for the remainders of this year. However, we think the increase will be minimal, about 30-50 basis points for the whole year 2022. We see the 12-month deposit rates of commercial bank could climb to 5.9-6.1%/year at the year-end of 2022 (currently at 5.5-5.7%/year), which are still lower compared to pre-pandemic level of 7.0%/year.

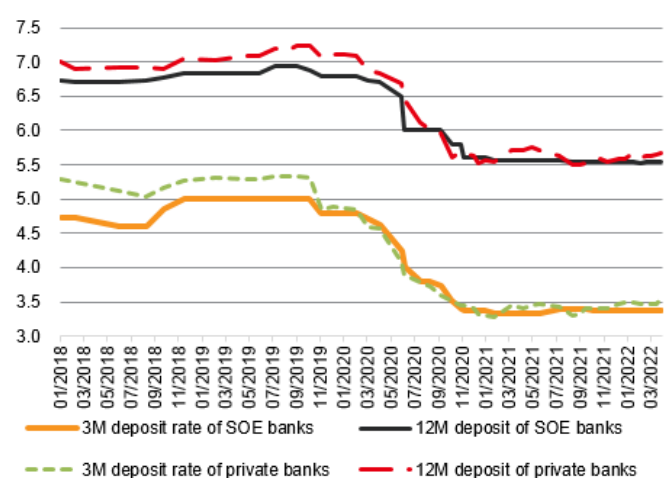
- Rising USD interest rates put pressure on foreign debt repayment obligations of the Vietnam's government and enterprises. According to our estimation, Vietnam's external debt accounts for 39% of GDP by the end of 2021. In the context of tighter liquidity in international financial markets, it will be more difficult for the Vietnam's government and businesses to raise capital in the international market and at higher interest rates.
- Regarding financial market, foreign indirect investment (FII) may continue to be net withdrawn in the coming months due to the impact of taper tantrum. However, foreign investors have been net sellers on Vietnam's stock market in the last 2 years, so the impact of foreign net selling will be moderate because the market has prepared in advance. Meanwhile, foreign direct investment (FDI) flows into Vietnam will be minimal impacted as Vietnam remains an attractive investment destination in the trend of global supply chain diversification.
- A strong USD puts pressure on Vietnam's exchange rate. As at 31 Apr 2022, the dollar index (which measures the strength of the US. dollar against a basket of currencies) reached 103 points, its highest level in 20 years. A strong USD pulls the USD/VND exchange rate up by about 0.6% in the first 4 months of 2022. However, the Vietnam Dong still remains one of the most stable currencies in the Asia-Pacific region. We see that the fundamental factors to keep Vietnam Dong stable in recent years still remain, including current account surplus and higher foreign exchange reserves (FX reserves). We expect current account surplus to widen to 1.9% GDP in 2022F from an expected deficit of 1.0% GDP in 2021. We also expect Vietnam's FX reserves to reach US\$122.5bn at the end of 2022 (equivalent to 4.0 months of import) from a current level of US\$105bn. As a result, we see the US\$/VND stable at 22,600-23,050 in 2022F and the Vietnamese Dong may move in a relatively narrow range (+/-1%) vs. the US\$.

**Figure 4: Interbank interest rate kept falling in April 2022 (%)**



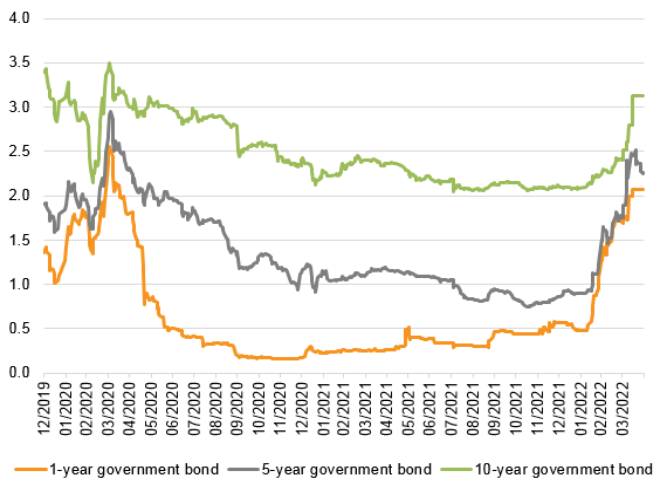
Source: BLOOMBERG, VNDIRECT RESEARCH

**Figure 5: Deposit interest rate slightly edged up in April 2022 (%)**



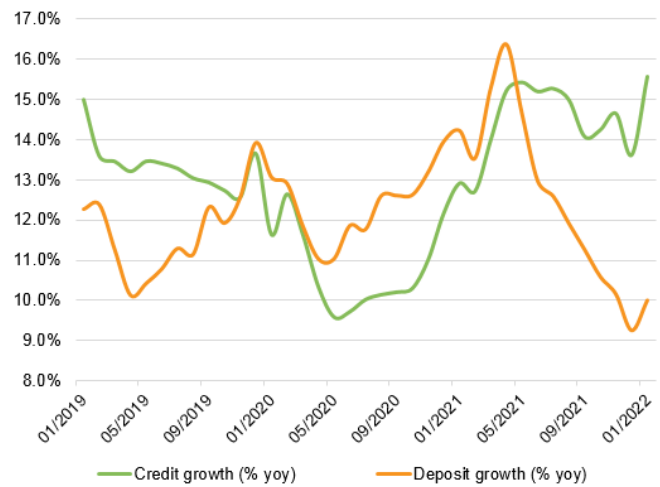
Source: Commercial banks, VNDIRECT RESEARCH

**Figure 6: Vietnam's government bond yields climbed to the highest level in 2 years (%)**



Source: BLOOMBERG, VNDIRECT RESEARCH

**Figure 7: The gap between credit growth and deposit growth further widened**



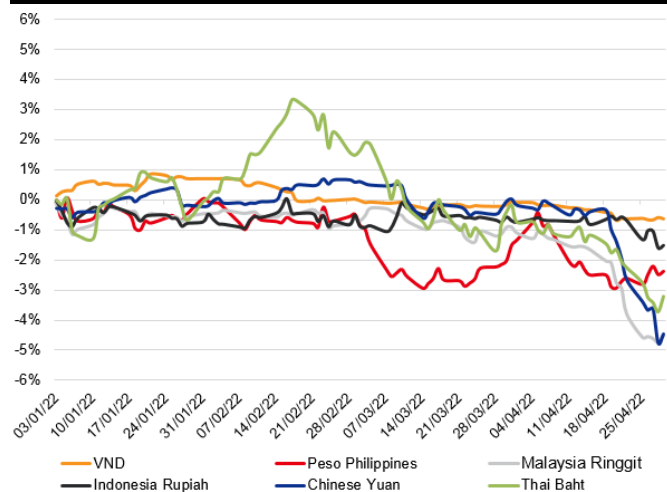
Source: SBV, VNDIRECT RESEARCH

**Figure 8: The Dollar index reached the highest level in 20 years**



Source: BLOOMBERG, VNDIRECT RESEARCH

**Figure 9: Vietnam dong outperformed regional currencies in Apr (% YTD)**



Source: BLOOMBERG, VNDIRECT RESEARCH

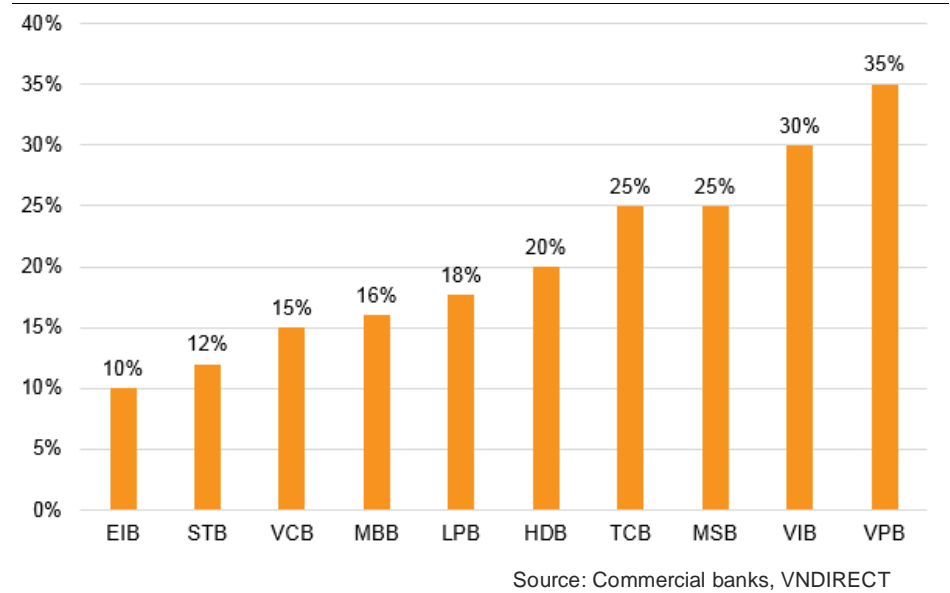
**We expect SBV to maintain its accommodative monetary policy at least in the next 3-6 months to support the economic recovery.**

We keep our expectation that the State Bank of Vietnam (SBV) will maintain its accommodative monetary policy until at least the end-2Q22 as (1) Although inflationary pressures are expected to intensify in the coming months, the average consumer price index for the first half of 2022 is forecast at 2.5% yoy, still well below the government's target of 4% yoy (2) Domestic demand remains weak and has not yet fully recovered to pre-pandemic levels and (3) The SBV still prioritizes the goal of maintaining low lending interest rates to support businesses and the economy to recover.

Any monetary tightening will only take place in the second half of 2022 (more likely in 4Q22), and major rate hikes will be limited, around 0.25-0.5%. We expect the SBV to allow credit growth to remain high to support the economic recovery. Credit capital flows will be prioritized for manufacturing and services especially in priority businesses such as industry, export-import activity, agriculture, forestry, fishery sector. In addition, the SBV will carefully control

credit flows into high-risk areas such as real estate, securities and BOT (Build-Operate-Transfer) projects. We maintain our view that Vietnam's credit remains strong at 14% yoy growth in 2022F.

**Figure 10: Credit growth plans of commercial banks**



Regarding to lending interest rates, the SBV is implementing an interest rate compensation package with a scale of VND3,000bn. It offers lending rates of only 3-4%/year for businesses strongly affected by the COVID-19 pandemic. Moreover, the Government plans to expand the scale of the package of interest rate compensation for businesses to VND40,000bn, focusing on a number of priority audiences, including (1) small and medium-sized enterprises, (2) businesses participating in a number of key national projects, and (3) business in certain industries (tourism, aviation, transportation). We expect that the interest compensation package could help reduce lending rates by 20-40 bps in 2022F, on average. However, the actual impact of the interest rate compensate package on businesses and the economy could be reduced if commercial banks raise lending rates on other conventional loans to offset the increase in deposit rates.



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## RECOMMENDATION FRAMEWORK

### Stock Ratings

Definition:

- Add** The stock's total return is expected to reach 15% or higher over the next 12 months.
- Hold** The stock's total return is expected to be between negative 10% and positive 15% over the next 12 months.
- Reduce** The stock's total return is expected to fall below negative 10% over the next 12 months.

*The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.*

### Sector Ratings

Definition:

- Overweight** An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
- Neutral** A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
- Underweight** An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

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