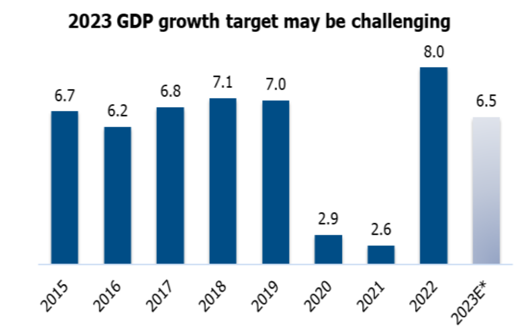
Vietnam Macro

7 June 2023



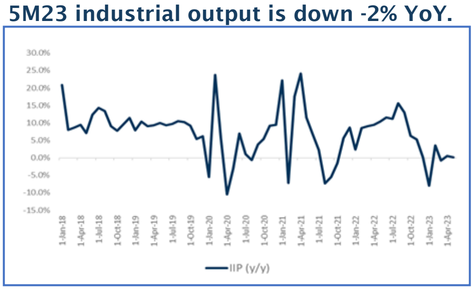
What's new?

- Global demand for Vietnam's manufactured goods is still soft.
- The domestically fostered property crisis continues to dent confidence.
- Credit growth and FDI are weak YTD, reflecting the above trends.
- But it's not all bad: retail spending is solid, public investment should pick up in 2H, and CPI is relatively tame.

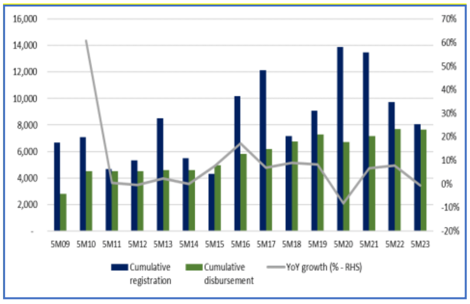
Our View

- We see few reasons for optimism about the 2Q23 GDP growth result in 3 weeks.
- The official GDP growth target of 6.5% for 2023 may be out of reach. Street forecasts are likely to be cut starting from July.
- Low CPI and weak GDP actually support a positive outlook for Vietnam stocks.
- We like banks, brokers, consumer discretionary, and energy suppliers in 2H23.

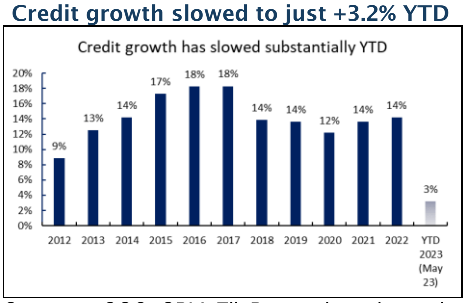
5M23 industrial output is down -2% YoY.



Disbursed FDI is down -1% YoY



Credit growth slowed to just +3.2% YTD



Sources: *GSO, SBV, FiinPro, various domestic media, Bloomberg, Yuanta Vietnam*

Binh Truong
binh.truong@yuanta.com.vn
Matthew Smith, CFA
matthew.smith@yuanta.com.vn

Bloomberg code: YUTA

Mixed results in May and 5M 2023…

…but accommodative policies could herald better things to come.

What's bad? Slumping manufactured export demand, ongoing property market ructions, and resulting weakness in private sector investment are all concerns. We believe that the tepid YTD credit growth (see the top chart at left) reflects weak demand is primarily a result of these trends.

What's good? The increase in CPI has been tame relative to that of developed markets, allowing for further stimulative monetary policies to support growth in 2H23. Additionally, strong retail spending – further supported by reduced debt servicing costs as rates fall – and the probable increased in much-needed government infrastructure investment should be the key positive macroeconomic offsets for 2H23.

Mixed indicators in May. Please see p.2-10 of this note for a more thorough review of the May GSO data and other thoughts on the macroeconomic cycle – and what it means for the financial markets.

Consensus GDP growth forecast cuts are on the way. It may be hard to believe, but the 2Q23 official GDP result should be out in the next three weeks. We see few reasons for substantial improvement on the +3.3% GDP growth posted in 1Q23. As such, the official full-year real GDP growth target of 6.5% could be unobtainable. Given that consensus forecasts tend to cluster around the official target, we would expect downward revisions starting in July. Admittedly, we hedged our 2023E GDP bets with a forecast range of 5-6%, well below the official target. But it's possible that even the low end of that range is overly optimistic.

But we are still broadly positive on stocks and are sticking to our 1300 VNI target for this year. Soft export demand is a concern, but the main listed stocks are not big export manufacturers, a segment that overwhelmingly comprises FDI firms. Moreover, Vietnam stock returns don't typically coincide with GDP cycles – just look back in terror at 2022, which saw +8% YoY GDP growth but a -35% fall in the VNI.

Sector picks for 2H23. The macro trends YTD support our forward expectations for 1) continued falling interest rates, 2) increased financial system liquidity, 3) stepped-up public investment in 2H23, and 4) steady growth in consumer spending. **We prefer banks, brokers, consumer discretionary, and energy** among the major listed sectors for 2H23.

Summary: Mixed indicators in May…

… with accommodative policies pointing toward better things to come in the second half of 2023.

Retail spending is a partial offset for slumping manufactured export demand.

Solid domestic retail spending remains the key positive macroeconomic offset to the worsening slump in manufactured export demand, the ongoing property market weaknesses, and the weakness in private sector investment.

Tourism and hospitality have been among the key growth drivers of retail sales and are likely to remain so over the upcoming summer months. In addition, the government appears to be moving forward with a 2ppt reduction in the VAT, which is very likely to be fully approved in upcoming days.

Consumption should be boosted by 1) the ongoing tourism recovery, 2) reduced VAT, and 3) higher spending power as debt servicing burdens come down.

Additionally, reduced policy rates should reduce debt servicing costs for mortgage borrowers, thus resulting in increased spending power.

These trends should provide further support for future demand and retail sales. Thus, the near-term outlook for domestic consumption looks relatively robust despite the slump in industrial output, in our opinion.

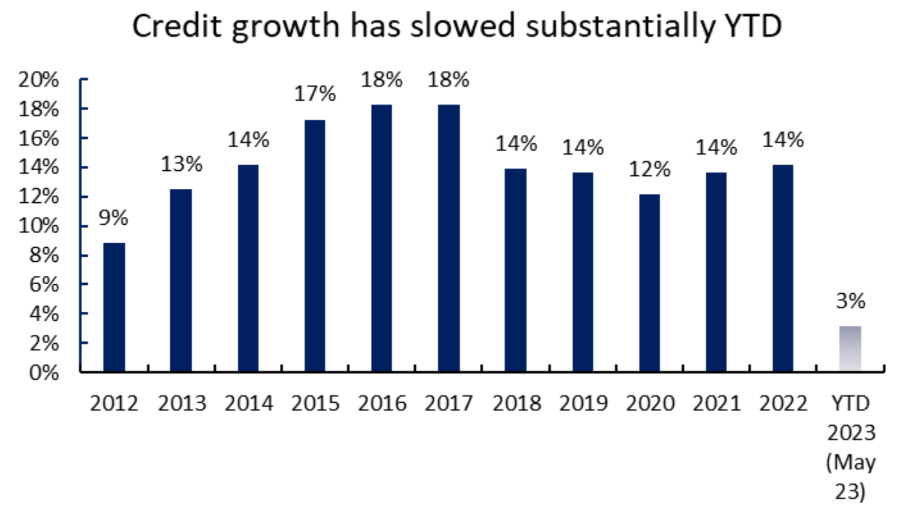
Industrial production remains soft, up +2.2% MoM but basically flat (+0.1% YoY) in May, with the upside primarily driven by increased electricity generation (+5% YoY).

This occurred amid an undersupply of electricity – and especially the weather-related shortage of hydropower – to fill demand driven by the ongoing heatwave, which has led to rolling electricity blackouts. This situation does not exactly boost confidence, to say the least. However, it supports our positive trading call on the decidedly non-green thermal energy producer PV Power (POW VN, BUY).

But soft global demand is impacting industry & trade as well as private sector investment.

International trade also improved slightly in May as export turnover recorded +4.3% MoM increase, following a -6% decrease in the previous month. Vietnam recorded a trade surplus of goods in May that reached US$2.2bn.

However, the combination of lax global demand for manufactured goods and the ongoing property market crisis has unsurprisingly led to a sharp slowdown in private sector investment, as reflected in the weak -1% YoY decline in disbursed FDI in 5M23 and tepid credit growth of just 3.2% YTD up to May 23.



Source: GSO

Meanwhile, inflation is softening as gas prices cool down, although electricity prices are surging. Low CPI should allow for more expansionary policies at some point going forward, although we would not expect an overly rapid pace given the pricing uncertainties for energy and other vital resources.

Of course, global oil prices slid by -10% MoM in May amid a slowdown in demand, mainly from top crude importer China. This signals a potential decline in inflation going forward, which would leave room for further loosening of interest rates policy. But inflation remains a concern for the foreseeable future.

Low inflation implies room for further policy interest rate cuts in our view.

The State Bank of Vietnam (SBV) cut several of its policy rates by another -50bps on May 23. The policy rate cuts apply to the refinancing rate, 1-6 month time deposit rates, and the overnight rate for interbank electronic payments & lending for capital shortages in clearing payments.

The rate cut in combination with USD purchases in May by the SBV pumped liquidity into the economy. This should theoretically support economic growth, but the immediate practical effect has been to alleviate financial pressures in stressed (and distressed) firms.

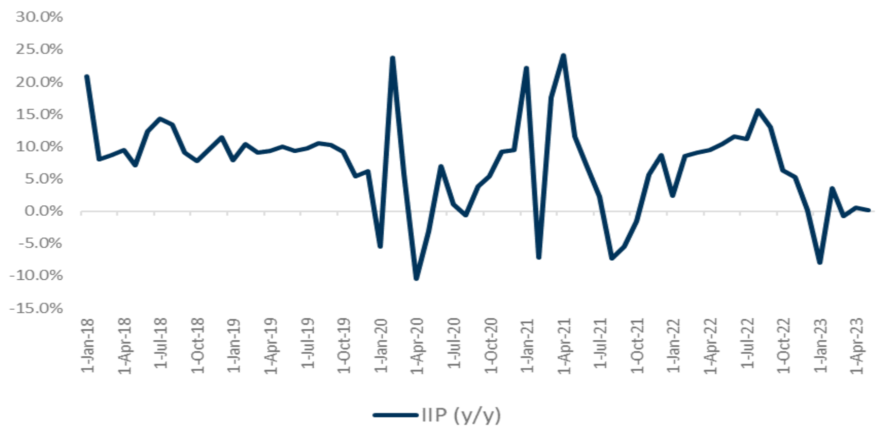
Industrial production improved in May

Industrial production was up +2.2% MoM in May, but it was only flat YoY.

Specifically, the industrial production index (IIP) in May ticked up +2.2% MoM and +0.1% YoY, with the positive YoY growth reversing the decline last month of -2.4% YoY.

Electricity production increased by +5% YoY, more than double the growth rate of the previous month (+2.3% YoY). By contrast, manufacturing and processing output showed continued softness as it only slid by -0.5% YoY, which obvious negative but still much better than the -2.3% YoY decrease in the previous month.

Industrial production ticked up slightly in May



Source: GSO

Industrial output has declined YTD, and the official 6.0-6.5% GDP growth target for 2023 is likely unattainable now.

The IIP still decreased by -2.0% YoY in 5M23 as consumption in the US and EU slid, thus dampening new export orders in 5M23.

Two out of the four major industrial segments exhibited deterioration in 5M2023 on a YoY basis. Specifically, manufacturing fell by -2.5% YoY in 5M23; and mining output declined by -3.5% YoY in the same period. By contrast, electricity production and distribution increased by +0.8% YoY an water supply, waste, and wastewater treatment and management activities increased by +6.4% YoY in 5M23.

Products posting YoY increases in 5M23 output included sugar (increased by +31.1% YoY); gasoline (+13.5%); fabrics made from man-made fibers (+10.6%); NPK compound fertilizer (+9.2%); cigarettes (+8.6%); and televisions (+7.0%).

By contrast, industrial output declined YoY in 5M23 for the following products: automobiles (a decrease of -24% YoY); steel bars (-20.1%); mobile phones (-16.4%); clothing (-9.8%); textiles from natural yarns (-10.1%); and phone accessories (-10.1%).

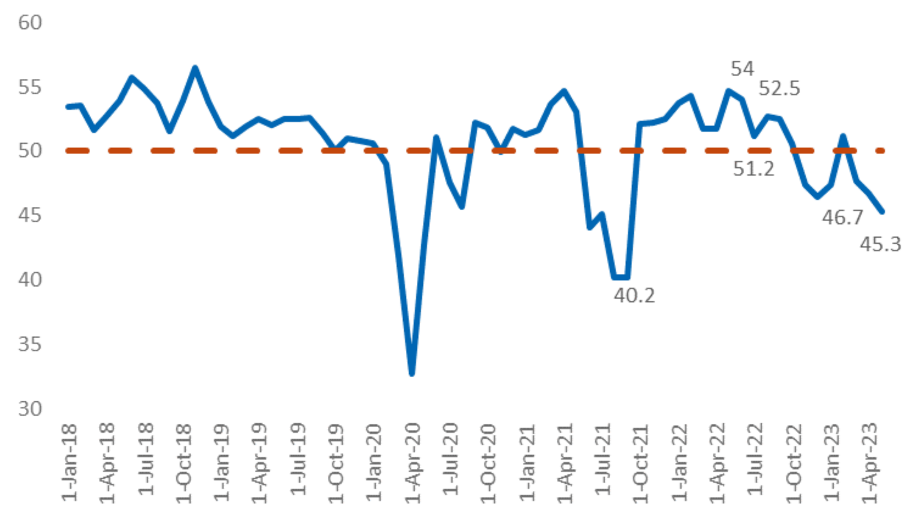
May Manufacturing PMI: Ouch!

New orders dropped at the fastest rate in 20 months. Demand conditions worsened in May, sending the S&P Global (formerly Markit) Manufacturing Purchasing Managers Index into a deeper contraction.

The May manufacturing PMI was the third worst result of the past five years.

The manufacturing PMI fell by the sharpest monthly rate YTD to reach 45.3 in May, down from 46.7 in April. This is the lowest it has been since the COVID lockdowns of 3Q21 and the collapse in the initial COVID rollout of 1Q20.

PMI slid further as new orders decrease at fastest rate



Source: GSO

Searching for the silver lining, we note that the survey reveals that input prices declined for the first time in three years, which means that manufacturers can reduce selling prices. This will eventually help to trigger demand, but the cycle may take time to play out.

Respondents indicate that customer demand weakened further in May. The impact of this is observable via new orders, which decreased substantially and to the greatest extent in the past 20 months. Difficulties in securing sales were reported in both the domestic and export markets. New business from abroad slid for the third month running.

Gross exports to the USA have declined by -22% YoY in 5M 2023 – this is scary stuff, but likely to normalize in the future

Export turnover to Vietnam's biggest export markets – the US and EU -- sunk by -22.0% YoY and -3.6% YoY in 5M23. The demand outlook in these jurisdictions is likely to remain under pressure given interest rate hikes and shifting consumer preferences for services over goods. This is not great news for Vietnam, which is not a major exporter of services (international tourism aside).

As new orders continue to decline, firms have reduced output in response. Production fell for the third month consecutively and at the fastest pace YTD, according to the May survey. Firms also reduced staffing levels and cut purchasing activities in response to low demand. This is illustrated by the -18.4% YoY decline in imports of goods to reach USD 26.81bn in May. Business confidence also fell for the third month consecutively.

International trade improved slightly

Trade is obviously weak, but at least the pace of the decline appears to be moderating.

We can't really see an improvement in goods exports, but at least the pace of the decline appears to be moderating. May's export turnover of goods reached USD 29.05bn, down by -5.9% YoY but substantially better than the -17.1% YoY decline in April. Meanwhile, imports of goods – an indicator of future exports – reached USD 26.81bn, down by -18.4% YoY.

5M23 export turnover of goods declined by -11.6% YoY to reach USD 136.17bn. By target market, exports to the US, Vietnam's biggest export market, fell by -22.0% YoY in 5M23. This rather depressing result was followed by a -3.6% slide in exports to the EU in 5M23.

In total, 23 product items tracked by the GSO saw export turnover in excess of USD 1bn in 5M23, accounting for 87.4% of the total exports. Meanwhile, seven items recorded export turnover in excess of USD 5bn, as illustrated in the table below. Most of these top products recorded substantial declines YoY in the first five months of 2023, with the exception of transportation products and related components.

Largest export items in 5M23 recorded substantial declines

	Estimated 5M23 export turnover (USD mn)	YoY growth (% YoY)
Above USD5bn export turnover		
Mobile phones and parts	21,173	-16.0
Electronic goods, computers and parts	20,328	-9.8
Machinery, instrument, accessory	16,552	-5.1
Textiles and garments	12,320	-17.8
Footwear	8,182	-13.3
Means of transport and components	5,428	12.5
Wood products	5,008	-28.7

Source: GSO

5M2023 import turnover of goods reached USD 126,37 bn, declining by -17.9% YoY. Some 24 items posted import turnover in excess of USD 1bn, accounting for 81.2% of 5M23 total imports. Three items recorded import turnover in excess of USD 5bn of import value, all of which also recorded substantial declines in export turnover, as illustrated below.

Electronics, computers, and parts remain the largest import products in 5M23

	Estimated 5M2023 import turnover (USD mn)	YoY growth (% YoY)
Above USD5bn export turnover		
Electronics, computer and parts	31,694	-13.1
Machinery, instrument, accessory	15,767	-14.6
Fabric	5,134	-22.9

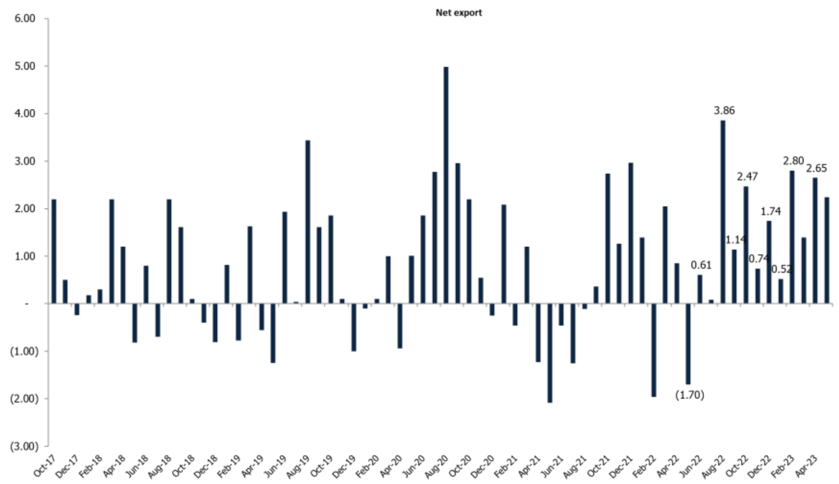
Source: GSO

Shrinking imports – two-thirds of which is used in export manufacturing processes – suggest that exports will remain soft for a while.

Soft import demand indicates a gloomy export outlook as manufacturers are not confident in future demand. As mentioned, the export outlook remains constrained as demand in the key export partners – the US and EU – are under pressure following recent rate hikes and changes in consumer preferences. But at least the rate hikes by global central banks are closer to the peak than to the bottom, in our opinion.

As a result, Vietnam posted a 5M23 trade surplus of goods (i.e., not goods and services, just goods) of USD 9.8bn, extending from USD 6.4bn in 4M23 and a reversal of the previous year's USD 0.24bn trade deficit of goods. SBV has purchased an estimated USD 6bn in foreign reserves in 5M23, to lift its foreign reserves to ~USD 95bn. The enhanced foreign reserves should be positive for financial stability, our our opinion.

Trade surplus (goods only) reached USD 9.8bn YTD in 5M23



Source: GSO

Investment: State outlays are ramping up, private sector not so much

State infrastructure investment should pick up the pace in 2H23, providing a critical offset for weak private sector investment.

Public investment has soared by a double-digit figure YTD to emerge as a main growth engine given the slowdown in export demand. Government investment reached VND 177 trillion in 5M23, an increase of +18.4% YoY but only fulfilling 25.5% of the 2023 budget.

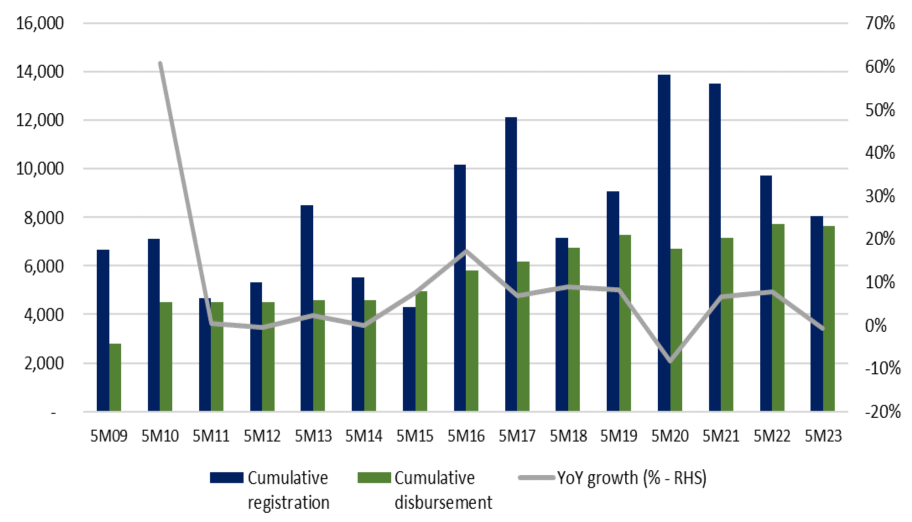
Although the annual total has frequently underperformed the budget in recent years, the seasonality of public investment tends to pick up in 2Q-4Q so we expect dispersals to increase substantially during the remainder of the year.

Notably, the government set its target for 2023 public investment at USD 31 billion, equivalent to 7% of GDP and an increase of +35.4% YoY. Public investment typically speeds up from second quarter each year, and Viet Nam has so far launched three highway projects in 2Q23, which should bring the total length of highways under construction in the South (where these projects are located) to 487km.

Specifically, the investment overseen by central government reached VND 33.6 trillion, equivalent to 25.3% of budget and up by +30.2% YoY. Meanwhile, investment by provincial governments reached VND 143.4 trillion, 25.6% of the annual budget and an increase of +15.9% YoY.

Private investment appears to be less robust. Disbursed FDI reached USD 7.65bn in 5M23, a decline of -0.8% YoY. Manufacturing FDI reached USD 6.25bn, accounting for 81.7% of disbursed FDI in 5M23. Property accounted for USD 368.3mn, accounting for 4.8% of the FDI mix. Gas, hot water, steam, and air-conditioning FDI reached US$546.6 mn, accounting for 7.1% of total disbursed FDI.

Pledged FDI has fallen YTD in 5M232



Source: GSO

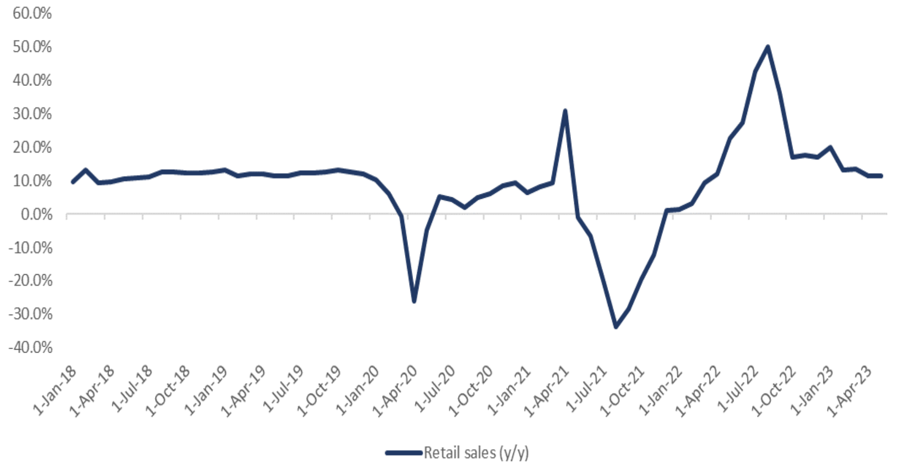
Tourism to drive retail sales growth in 3Q23

Retail sales of goods and services in May reached VND 519tn, up +1.5% MoM and +11.5% YoY, underpinned by a recovery in tourism that pushed hospitality & catering services to grow by +12.1% YoY to reach VND 54.9tn. Meanwhile, retail sales of goods rose by +10.9% YoY to reach VND 409.3tn in May, or 78.6% of total retail receipts.

Tourism is off the trough, helping to further drive growth in retail sales receipts.

Notably, the number of international visitors to Vietnam in May 2023 reached 916,300, down -6.9% MoM but 5.3 times higher YoY. This is an encouraging signal for YoY growth in retail sales during the upcoming summer months.

Retail sales growth remains solid



Source: GSO

In 5M23, retail sales of good and services rose by +12.6% YoY (real growth +8.3%YoY) to reach VND 2,527 tn, driven by +22.1% growth in hospitality and catering sales to reach VND 268.3tn.

According to the GSO, Retail sales of goods in 5M23 reached an estimated VND 1,994 tn, up +10.7% YoY (real growth +6.9%). Specifically, retail sales of food increased by +14.6% YoY, while those of garments increased by +11.1% YoY.

Revenue from tourism and travel in 5M23 is estimated to have reached VND11.6 tn, +89.4% higher than the same period last year. Tourism and travel activities typically increase during the northern summer, so this subsegment should remain a key growth driver for retail sales over the next few months.

On May 6th, the government submitted the 2ppt VAT cut (originally proposed by the Ministry of Finance) for approval by the National Congress, which we think is likely to sail through in the next few days. The reduced VAT should further support consumer demand and retail sales.

Inflation softened in May despite a sharp MoM rise in electricity prices

CPI is well below the government's target for 2023, suggesting ample room for interest rate policy easing.

According to the GSO, electricity, water, and food prices rose in May due to strong demand, which in turn led to an increase in CPI of +0.01% MoM and +2.43% YoY. The YoY increase softened from the previous month's +2.81% and remains well in control.

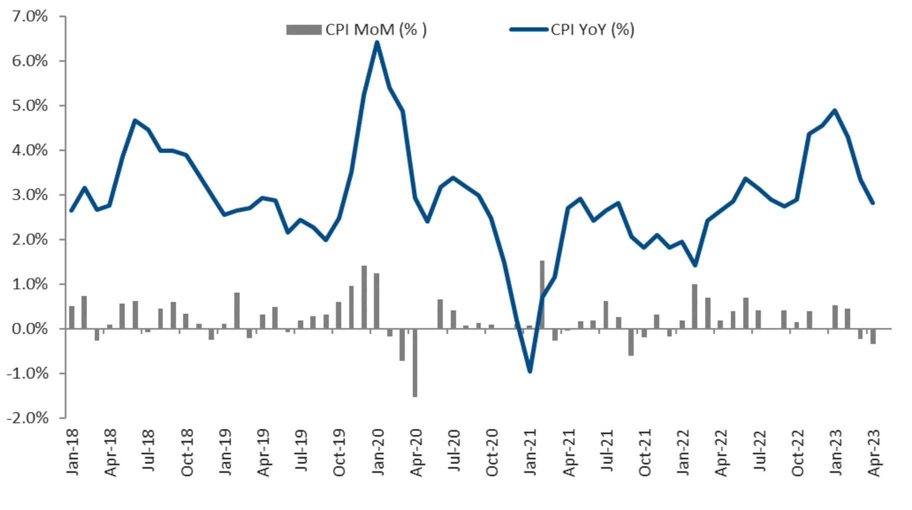
Eight of the 11 items in the CPI baskets posted increased price levels, including prices of:

- Food and foodstuff (33.56% of the CPI basket), which rose by +0.24% MoM as demand increased during the long holiday of late April / early May;
- Housing and construction materials (18.82% of the CPI basket), which rose by +1.01% MoM as electricity price roses by +2.62% MoM; and
- Entertainment (4.55% of the CPI basket), which rose by +0.24% MoM.

By contrast, three of the 11 items in the CPI basket posted declines in price levels, specifically prices of:

- Transportation (9.67% of the CPI basket), which declined by -2.98% MoM as gas prices dropped by -7.83% MoM in line with soft global natural gas prices;
- Telecom (3.14% of the CPI basket), which decreased by -0.17% MoM as demand for smartphone parts declined; and
- Education, which slid by -0.1% MoM as tuition fees were cut in some parts of the country.

Inflation is softening



Source: GSO

Although the electricity price hike's effect on CPI was cancelled out by softer oil prices, YoY CPI remains on a downward slopping trajectory. The softening CPI should establish a strong foundation for more accommodative interest rate policies going forward, as inflation pressures remain subdued relative to the rest of the world.

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Attn: Research
Yuanta Securities Investment Consulting
4F, 225,
Section 3 Nanking East Road, Taipei 104
Taiwan

Hong Kong persons wishing to obtain further information on any of the securities mentioned in this publication should contact:

Attn: Research
Yuanta Securities (Hong Kong) Co. Ltd
23/F, Tower 1, Admiralty Centre
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Hong Kong

Korean persons wishing to obtain further information on any of the securities mentioned in this publication should contact:

Head Office
Yuanta Securities Building
Euljiro 76 Jung-gu
Seoul, Korea 100-845
Tel: +822 3770 3454

Indonesia persons wishing to obtain further information on any of the securities mentioned in this publication should contact:

Attn: Research
PT YUANTA SECURITIES INDONESIA
(A member of the Yuanta Group)
Equity Tower, 10th Floor Unit EFGH
SCBD Lot 9
Jl. Jend. Sudirman Kav. 52-53
Tel: (6221) - 5153608 (General)

Thailand persons wishing to obtain further information on any of the securities mentioned in this publication should contact:

Research department
Yuanta Securities (Thailand)
127 Gaysorn Tower, 16th floor
Ratchadamri Road, Pathumwan
Bangkok 10330

Vietnam persons wishing to obtain further information on any of the securities mentioned in this publication should contact:

Research department
Yuanta Securities (Vietnam)
4th Floor, Saigon Centre
Tower 1, 65 Le Loi Boulevard,
Ben Nghe Ward, District 1,
HCMC, Vietnam

YUANTA SECURITIES NETWORK

YUANTA SECURITIES VIETNAM OFFICE

Head office: 4th Floor, Saigon Centre, Tower 1, 65 Le Loi Boulevard, Ben Nghe Ward, District 1, HCMC, Vietnam

Institutional Research

Matthew Smith, CFA
Head of Research
Tel: +84 28 3622 6868 (ext. 3815)
matthew.smith@yuanta.com.vn

Binh Truong
Deputy Head of Research (O&G, Energy)
Tel: +84 28 3622 6868 (3845)
binh.truong@yuanta.com.vn

Tam Nguyen
Analyst (Property)
Tel: +84 28 3622 6868 (ext. 3874)
tam.nguyen@yuanta.com.vn

Tanh Tran
Analyst (Banks)
Tel: +84 28 3622 6868 (3874)
tanh.tran@yuanta.com.vn

Institutional Sales

Huy Nguyen
Head of Institutional sales
Tel: +84 28 3622 6868 (3808)
Huy.nguyen@yuanta.com.vn

Duyen Nguyen
Sales Trader
Tel: +84 28 3622 6868 (ext. 3890)
duyen.nguyen@yuanta.com.vn