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## There's Little Risk the US Will Impose Draconian Tariffs

The US government has started investigating concerns that Vietnam is suppressing the value of the Vietnam Dong in order to boost its exports, but it is unlikely that Vietnam will be targeted with draconian tariffs by the US because:

- 1) Vietnam is an important regional ally of the US
- 2) The criteria for determining if a country is a "Currency Manipulator" is actually ambiguous
- 3) It is increasingly likely that Joe Biden will be elected the next US President, and would probably be less antagonistic towards allies like Vietnam

Further to #2 above, the US Treasury Department has three criteria to determine if a country may be artificially depressing the value of its currency, and Thailand met all three of these criteria for years. However, no significant action was ever taken against Thailand, presumably because of its strategic importance to the US in the region and despite it running trade surpluses with the US at that time.

Further to #3 above, the initiation of the Section 301 investigation into the value of the Vietnam Dong by the United States Trade Representative (USTR) reportedly came directly from President Trump, but the timing was peculiar as it is not obvious how this investigation could help his re-election prospects. That said, the US ran an enormous USD67 billion trade deficit in the month of August, which was the worst in 14 years, and the third worst in history, which may help explain the timing.

This surge in the trade deficit may have influenced the timing of the USTR investigation into Vietnam's trade practices, given that Vietnam now has the world's fourth largest trade surplus with the US following a jump from USD35 billion in 2018 to USD47 billion in 2019 driven by the US-China trade war. Vietnam's exports to the US are up nearly 25% this year, and its trade surplus with the US already reached USD44 billion in the first nine months of 2020.

### No Major Tariffs on Vietnam

- The US is unlikely to take any major actions against Vietnam for geopolitical reasons, although there may be some *symbolic* measures taken (see next section). Ironically, Vietnam is now the US's strongest ally in the region, since every other country in Southeast Asia "pivoted" away from the US and towards China in recent years (although Thailand and the Philippines now seem to be trying to reverse some of their earlier pro-China positioning).
- Further to that last point, in recent weeks tensions between the US and China have escalated as evidenced by: China's air force has repeatedly invaded Taiwanese airspace; a very large weapons sale from the US to Taiwan is in the works, and; the US ambassador to China resigned, which is particularly problematic because Ambassador Branstad had very good relations with both Trump and Xi Jinping, and was said to be a conduit between the two, in a role that went above-and-beyond a typical ambassador's.

In addition to the geopolitical points above, it is important to note that there are no automatic or definitive consequences for a country that the US labels a "Currency Manipulator".

### What to Expect

- Vietnamese policy makers will almost certainly respond to US concerns by: 1) allowing the value of the VN Dong to appreciate, and 2) reducing Vietnam's trade surplus with the US by importing large amounts of LNG (which will also help Vietnam meet its growing electricity demand).
- Further to that last point, the inevitable import of LNG from the US to Vietnam is still years away, because of physical infrastructure must be constructed in order for Vietnam to be able to accept large volumes of LNG imports. The Government previously hoped to reduce its trade surplus with the US by purchasing passenger airplanes and jet engines, but that option is obviously no longer available.
- In addition to the points above, note that Vietnam's trade surplus with the US surged in 2019 because many Chinese companies were found to be "re-exporting" their products to the US via Vietnam in order to circumvent tariffs. Vietnam's trade surplus with the US rose from USD35 billion in 2018 to USD47 billion in 2019, but its trade deficit with China increased from -USD24 billion to -USD34 billion.
- The Vietnamese Government clamped down on re-exporting (which has largely been shut-down), but Vietnam's exports to the US have skyrocketed by about 25% this year driven by the purchase of "stay at home" goods such as laptop computers, furniture, and gym equipment due to COVID (about 25% of Americans are now working at home according to the University of Chicago). However, this surge will eventually flatten out, which will also help organically reduce Vietnam's huge trade surplus with the US.
- While we do not expect the US government to impose draconian tariffs on imports from Vietnam (as it did to China), it is possible that some type of symbolic action will be taken that has limited economic consequences. For example, tariffs could be imposed on tyre imports from Vietnam, especially given the fact that this whole issue came about as a result of concerns that Chinese-owned tyre makers operating in Vietnam were dumping their products into the US market at below fair-market prices.

### Ambiguous Criteria

- The US Treasury Department asserted that the VN Dong was nearly 5% under-valued in 2019, and it had previously put Vietnam on the "Watch List" of potential "Currency Manipulators" in 2018.
- The US Treasury Department has three numerical criteria for determining if a country is a "Currency Manipulator" that artificially depresses its own FX rate, to boost its exports, and Vietnam meets all three:
  - 1) A country's trade surplus with the US is over USD20 billion; Vietnam's was nearly USD50 billion last year.
  - 2) A country's current account surplus is over 2% of GDP; Vietnam's was nearly 5% last year.
  - 3) A country's central bank sold more than 2% of GDP worth of its own currency in 12 months; the State Bank of Vietnam sold over 8% of GDP worth of VN Dong last year and bought US Dollars.
- However, while that last criteria above (#3) sounds objective, it is actually ***much*** more ambiguous than #1 and #2. The SBV ***has*** been consistently buying USD and selling VND into the free market over the last two years, but unlike the case of Japan in the early 1990s (which wanted to weaken the value of the Yen),

Vietnam's intention is to strengthen the value of the Dong by building up its FX reserves and increasing confidence in the VN Dong !

- Further to that last point, Vietnam's FX reserves are likely to reach USD100 billion, or five months' worth of imports by the end of this year, which is a bit higher than the three-month minimum recommended level of FX reserves. Nevertheless, Vietnam's reserves are below the circa seven months' worth of FX reserves held by the central banks of Vietnam's peers.
- In addition, the IMF has a metric called the "Assessing Reserve Adequacy (ARA)" metric which is a more sophisticated approach to determining the suggested level of FX reserves for a country, and Vietnam was about 10% below the IMF's recommended level at the end of last year.<sup>1</sup>
- The previous two points are important because Vietnam's Government will likely argue against the USTR's concerns that Vietnam aggressively bought USD and sold VND in order to depress the value of the VN Dong by arguing that Vietnam's FX reserves will now be in-line with the IMF's ARA recommended level reserves (following the accumulation of circa USD8 billion of reserves in 2020), and that Vietnam's FX reserves are below those of its regional peers. Both of these facts are strong arguments that Vietnam did not sell excessive amount of VN Dong in order to depreciate its value.

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<sup>1</sup> The IMF's ARA metric is a more sophisticated approach to determining how much FX reserves a country should hold than the simplistic guideline that a country should hold a minimum three months' worth of imports of FX reserves which especially disadvantages Vietnam since the country's imports are around 100%/GDP - and grew rapidly in recent years. In contrast, the ARA approach incorporates such factors as the amount of short-term debt the country has, as well as the volatility of its trade flows and other flows of money in and out of the country.