

Michael Kokalari, CFA
Chief Economist

Looking Ahead at 2021

The trajectory for the world in 2021 now seems clear, with economic growth in every country – including Vietnam – likely to roar back as the year progresses.

Numerous research reports have already been published on topics like the roll-out of COVID-19 vaccines, the resumption of international travel, and the likelihood of continued fiscal and monetary stimulus by governments around the world. This report focuses on the Vietnam-specific factors that are likely to drive investment returns in Vietnam this year, including:

- 1) A rebound in Vietnam's **GDP growth**, driven by manufacturing and consumption
- 2) Vietnam's **stable macro economy**, characterized by falling Inflation and an appreciating VN Dong
- 3) A **smooth political transition** at the National Party Congress on January 25th
- 4) **FDI inflows**, prompted by continued US-China trade tensions and COVID

The two biggest Vietnam-specific risks to an otherwise very optimistic outlook for 2021 are the risk of temporary tariffs on Vietnam's exports to the US, and a significant increase in non-performing loans after the above-mentioned National Party Congress concludes.¹ That said, COVID-related issues are obviously still a major risk for all countries, including Vietnam, although Vietnam's Government has demonstrated its prowess at handling the public health challenges entailed while minimizing the economic impact.

Vietnam 2021 GDP Growth Forecasts	
S&P Global Rating	10.9
Bank of America Merrill Lynch	9.3
UBS	8.4
Fitch	8.6
Moody's	8.2
Goldman Sachs	8.1
HSBC	8.1
Standard Chartered	7.8
Bloomberg Consensus Average	7.7
Citigroup	7.1
World Bank	6.8
IMF	6.7
VinaCapital	6.5
Government Target	6.5
ADB	6.1

Source: Bloomberg, VinaCapital

¹ Banks were given extraordinary regulatory forbearance in 2020, and are likely to be compelled to reported higher NPLs after the NPC

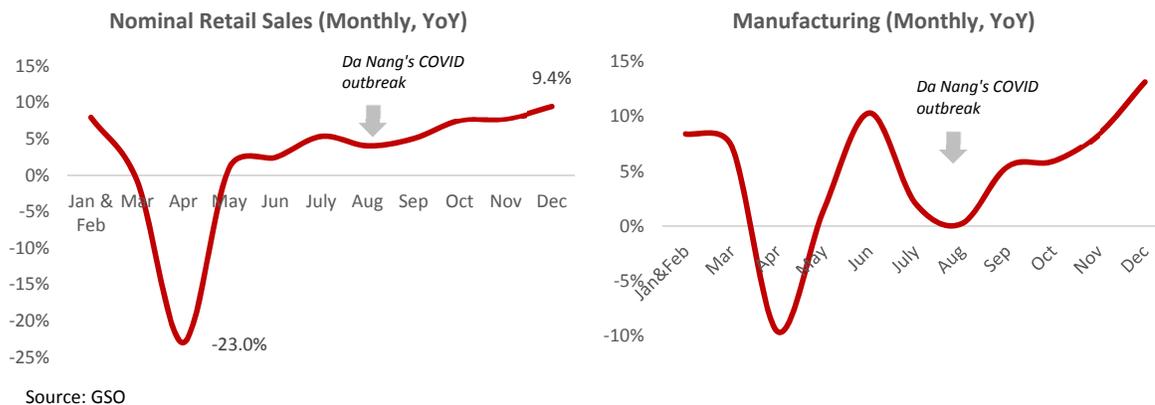
Finally, in addition to the topics listed above, this report also briefly discusses our forecast that Vietnamese stock prices should continue rising in 2021, after having increased by about 15% in 2020. Real estate prices are also likely to continue rising in 2021, with real estate development activity likely to surge as the year progresses, partly because certain bottlenecks to development that are discussed below are likely to be resolved after the National Party Congress.

Positives for Vietnam in 2021

- GDP Growth:** Vietnam’s economic growth is likely to surge from 2.9% in 2020 to nearly 6.5-7% in 2021, driven by domestic consumption and manufacturing. We expect domestic consumption to rebound from a slight decline in 2020 to about 9% growth in 2021 (in-line with Vietnam’s 5-year average), and for the growth of Vietnam’s manufacturing output to double from nearly 6% in 2020 to 12% in 2021 (which is also in-line with Vietnam’s 5-year average).

The two reasons why we are confident in our forecasts are: 1) Vietnam’s retail sales and manufacturing output growth have been accelerating every month since a “second wave” COVID outbreak in July-August, as can be seen in the charts below, and there are clear signs that this acceleration is set to continue well into 2021, and 2) Vietnam’s Government has demonstrated its competency in containing COVID without overly constraining the economy. As such, we would not expect the economy to be derailed by any small-scale COVID outbreaks that could occur in the months to come.

Further to #1, Vietnam’s high-frequency leading economic indicators point to a continued acceleration of both manufacturing output and consumption in the months ahead. For example, FDI companies are currently ramping up their imports of components required to manufacture electronics products (imports of such components surged 50-60% yoy in the month of December).



Finally, note that Vietnam’s manufacturing activity was bolstered by demand in the US and EU for products such as laptop computers, office furniture, and home fitness equipment that have become to be known as “stay at home goods”, and there is some speculation that the demand for such goods could slow down as COVID vaccines get distributed and life begins to return to normal in the US and EU.

However, we believe that the “stay at home” theme will continue to support Vietnam’s manufacturing and exports in 2021 because over 70% of people in the US now prefer to work at home at least two days per week according to a survey by Price Waterhouse Coopers. That said, the current pace of demand for

such products is clearly unsustainable, which is likely to dampen the growth in the production of those products in 2022.²

- **Modest Inflation:** In 2020, Vietnam's CPI inflation peaked at above 6% yoy in January, but then fell to nearly 0% by December, resulting in the country's inflation rate averaging at about 3% last year. In 2021, we expect inflation to bounce back somewhat in Q2 due to the year-on-year base effects related to COVID,³ but then range between 2-3% for the rest of the year.

Last year, Vietnam's inflation rate was driven by the African Swine Fever epidemic that caused pork prices in Vietnam to surge by over 100% yoy at the peak (pork accounts for over 3% of Vietnam's CPI basket, and food accounts for ~35%). The ASF epidemic was completely contained by mid-2020 and Vietnam's pig population has been rebounding since that time, so pork prices fell 3% YTD by the end of 2020.



Source: GSO, HSC, VinaCapital

Although the dramatic year-on-year surge in pork prices will continue to put *downward* pressure on the CPI in 2021, we expect global oil prices to climb towards USD60 by the end of 2021, which will put *upward* pressure on inflation in Vietnam as the year progresses. That said, we don't see any endogenous factors (such as excessive credit growth) that will drive Vietnam's inflation rate higher this year, which helps explain the plunge in the yields of 10Y Vietnam Government Bond (VGB) yields from 3.7% to 2.5% in 2020.⁴

- **Stable VN Dong:** Vietnam's trade surplus ballooned from USD10.9 billion in 2019 (~4% of GDP), to over USD19 billion in 2020 (7% of GDP), driven by the export of "stay at home" goods (Vietnam's exports to the US surged by 25% last year and electronics exports surged 24%). In addition, FDI inflows remained above 8% of GDP, and remittances from overseas Vietnamese likely remained above 6% of GDP in 2020,

² In 2020, sales of AV equipment (including TV's etc) in the US surged 12%, versus the long-term average of about 3% annual growth, spending on furniture surged 16%, versus 4% long-term average growth, purchases of major appliance sales increased 8%, which is double the typical growth rate, etc.

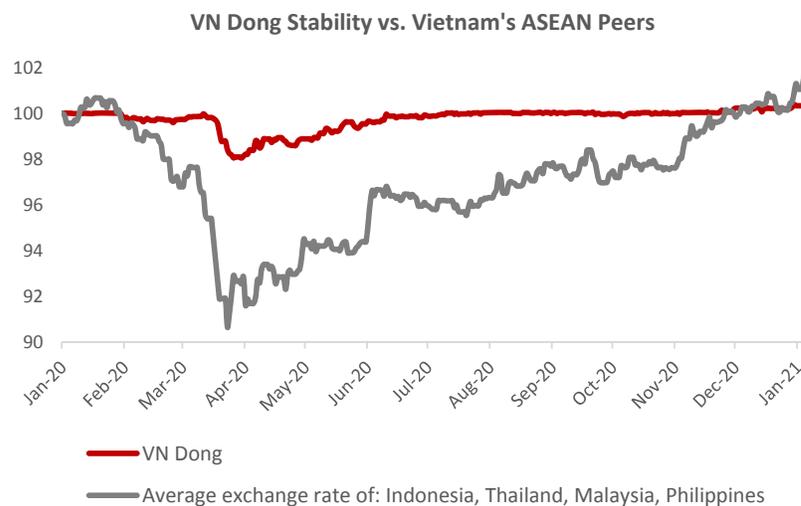
³ Inflation is likely to rebound in Q2 globally because the low base effect cause by the negative price shock at the peak of the COVID epidemic around April 2020.

⁴ Bond yields fell dramatically in most countries in the world last year, but Vietnam's 2.5% 10Y bond yields at end-2020 compared to 6% in Indonesia and 3% in the Philippines – and both of those countries have investment grade credit ratings!

all of which supported the value of the VN Dong and enabled the State Bank of Vietnam to acquire an estimated USD20 billion worth of FX reserves in 2020 - bringing the country's total FX reserves up to nearly USD100 billion, which is equivalent to about five months' worth of exports or 35% of GDP.⁵

Consequently, the USD-VND exchange rate was nearly unchanged in 2020 and vacillated in a tight band around 23,200 all year. We expect the VN Dong to appreciate modestly in 2021, first-and-foremost because all of the positives discussed above are likely to remain in 2021 (for example, exports of "stay at home" goods should continue growing this year driven by the still nascent preference of employees to work from home for at least a few days each week).

However, in addition to these positives (i.e., trade surplus, FDI inflows, remittances from overseas Vietnamese), the recent designation of Vietnam as a "currency manipulator" by the US Treasury Department will almost certainly prompt Vietnam's central bank to allow the value of the VN Dong to appreciate - all of which is discussed in the "Risks" discussion below.



Source: Bloomberg, VinaCapital

- Political Stability:** The Communist Party of Vietnam (CPV) will hold its next 5-yearly National Party Congress (NPC) on January 25th – February 2nd, at which the top four leadership positions will be filled (Chairman of the CPC, Prime Minister, President, Chair of the National Assembly).

In our opinion, the two most important things for investors to know about this topic are: 1) the Government's economic policies and priorities are unlikely to change after the NPC, and 2) the long-awaited selection of Vietnam's next set of political leaders should unleash a small torrent of activity in sectors of the economy that require Government approvals and/or Government spending (i.e., infrastructure spending and the resumption of stalled HCMC real estate projects).

Further to #1, there is currently speculation about which of the widely rumored candidates for the nation's key political positions will lead the country over the next five years, stemming partly from the fact that there are some fairly pronounced differences in the personalities, and personal leadership styles among the speculated, leading candidates. However, there is not much difference between the economic and political beliefs of each of the rumored candidates, so investors can expect continued political stability and "more of the same" economic policies in Vietnam for the foreseeable future.

⁵ Note that Vietnam's central bank does not clearly disclose the amount of FX reserves it holds.

- **Foreign Direct Investment (FDI):** Vietnam's disbursed FDI inflows only fell 2% in 2020, to USD20 billion, despite COVID, and the amount of newly planned FDI investments only fell 7% (to USD21 billion), after having risen by 7% in 2019, all of which means that FDI inflows are likely to remain stable this year.

Multinational companies continue to pour FDI into Vietnam, in order to diversify their production away from China. That's because COVID showed firms that they are over-reliant on China as a production base, and because the US-China trade war that Trump initiated is unlikely to evaporate under Biden.

Further to that last point, US public opinion towards China is at a low point (about 75% of people in the United States now have an unfavorable view of China according to various surveys), so the stance towards China within the ranks of senior civil servants in the US government has shifted to "responding to China's growing challenge", according to various reputable sources.⁶

- **Free Trade Agreements (FTAs):** Vietnam's participation in 15 FTAs (with a further two being negotiated) helps the country attract the attention of foreign investors, and FTAs may give the country a modest advantage in attracting FDI into certain low-margin industries (such as garments, furniture, etc.). However, Vietnam's other growth drivers such as the country's young demographics and growing consumption by the emerging middle class are more important than free trade agreements in propelling economic growth.

For example, Vietnam garnered some positive attention in the international business press when both the UK-Vietnam FTA was signed, and Vietnam was one of the 15 countries that joined the China-led Regional Comprehensive Economic Partnership (RCEP) in December.⁷ However, the influential Petersen Institute only expects RCEP to boost the size of Vietnam's economy by about 0.5% over the next ten years.

Finally, in addition to all of the Vietnam-specific factors discussed above that will drive the country's economic growth, and support the stock and real estate markets, we would also like to briefly mention some of the most important *exogenous* factors that should benefit Vietnam in 2021:

- A weakening of the US Dollar in 2021, driven by the "USD Smile" phenomenon and by the fact that money supply growth in the US is currently above 20% yoy, versus ~10% in the EU and Japan.⁸
- An appreciation of the Chinese Yuan, which will make Vietnam's exports more competitive vis-à-vis its biggest competitor and which is being driven by the combination of loose fiscal policy and relatively tight monetary policy.⁹
- Heightened investor interest in Asia stock markets, motivated by the "Asia handled COVID well" narrative

⁶ For example:

<https://foreignpolicy.com/2020/11/06/biden-china-trump-election/>

<https://www.economist.com/china/2020/11/19/joe-bidens-china-policy-will-be-a-mix-of-trumps-and-obamas>

⁷ Some observers have characterized the RCEP trade pact as China's answer to the Trans-Pacific Partnership (TPP).

⁸ The Dollar tends to be strongest when the world's economy is in distress and investors flee to "safe haven" investments denominated in USD (including US Treasuries), or when growth in the US is much higher than in the rest of the world. In 2021, global growth is likely to broaden out, which usually favors other currencies over the USD.

⁹ George Soros calls this combination of fiscal and monetary policy "Regan's Imperial Circle", because similar conditions drove an appreciation of the USD in the early-1980s. Note the FII inflows are also driving the value of China's currency higher.

- Quantitative Easing (QE) is likely to continue at an elevated pace in 2021, and some of the newly created liquidity is likely to end up in Asia stock markets, just as it did in the early 2010s when the Fed ramped up QE, and again in 2017 when the European Central Bank (ECB) was aggressively printing money.

Negatives and Risks for Vietnam in 2021

- **“Currency Manipulator” Designation & Tariff Risk:** The US Treasury Department accused Vietnam and Switzerland of being “currency manipulators” in a 70-page report to the US Congress it published in December. Treasury Department officials essentially accused the State Bank of Vietnam (SBV) of manipulating the value of the VN Dong to about 9% below its “fair value” in 2019, although the officials involved in that investigation reportedly believe that the degree of undervaluation shrank to about 5% below fair value last year.

At the time that the Treasury Department’s report was published, we believed there was a real risk that the Trump administration could impose stiff tariffs on Vietnam's exports to the US. However, we now believe that risk was significantly tempered by the events of January 6th in Washington, DC. Furthermore, the US Treasury Department’s own report highlights several of arguments against labelling Vietnam as a currency manipulator!¹⁰

If Trump *does* impose tariffs on Vietnam before leaving office, the motivation for doing so would probably be a desire to impede the incoming Biden administration’s ability to reverse Trump’s “America First” policy.¹¹ Biden would almost certainly undo any economic sanctions that Trump puts on Vietnam, but that could take months, potentially leaving the levelled “temporary tariffs” in place for much of 2021.

All of that having been said, VinaCapital has been forecasting for over a year that the VN Dong will begin a sustained, multi-year appreciation starting from 2021. The US Treasury Department’s designation of Vietnam as a “currency manipulator” makes it even more clear to us that the VN Dong will appreciate against the US Dollar this year. That’s because the easiest way for the SBV to respond to the accusation that Vietnam is a “currency manipulator” would be to allow the value of the Dong to start appreciating against the US Dollar.

Finally, even if the US were to impose 10% tariffs on all of Vietnam’s exports to the US, it’s unlikely that FDI companies would be dissuaded from setting up new factories in Vietnam. That’s because factory wages in Vietnam are far below those of most of the realistic, potential competitor countries for Vietnam’s FDI inflows, and one-half to two-thirds below China’s factory wages.¹²

- **Non-Performing Loans:** At the height of the COVID epidemic in March, the State Bank of Vietnam gave local banks considerable latitude in determining which of their loans should be classified as NPLs. Furthermore, the SBV also enabled banks to mask the true health of their loan books by requiring all banks to account for interest payments from borrowers on a cash basis, rather than on an accrual basis.¹³

¹⁰ We covered this topic in a recent article published by the Vietnam Investment Review : <https://www.vir.com.vn/unearned-currency-label-unlikely-to-stick-81766.html>

¹¹ Trump is leaving “a whole pile of trade problems with China” for Biden to deal with, according to William Reinsch at the CSIS think tank.

¹² Factory wages in China nearly tripled over the last decade, and wage inflation in China (in USD terms) was roughly double that in Vietnam over that time.

¹³ In the past, bank analysts in Vietnam were able to ascertain asset quality of a particular bank by monitoring the “Accrued Interest” item on that bank’s balance sheet – because a surge in accrued interest typically signalled that borrowers were unable to re-pay their loans.

We expect these regulatory forbearance measures to remain in place until late-2021, and believe there is a small-but-not-inconsequential risk that another NPL crisis may be brewing in the country's banks, given the current lack of transparency about Vietnam's NPLs.

To be clear, we are not overly concerned about this possibility, given our expectation for a robust rebound in Vietnam's economic growth this year and our understanding that local policy makers do not want to endure the same difficulties they faced after the country's last NPL crisis in 2011-12. However, we believe local bank analysts are generally underestimating the risk that Vietnam's actual, system-wide NPL ratio could surge from ~2-3% pre-COVID, to a possible peak of 8-10% by end-2021 (in our worst case scenario).

Finally, Vietnam's banks are likely to report ~3% system-wide NPLs at end-2020, but if all the forbearance measures mentioned above were not in place, we believe Vietnam's reported NPL ratio would be around 6-7%.

- **International Tourism:** Foreign tourists contributed about 8% of Vietnam's GDP prior to 2020, so we estimate the plunge in foreign tourist arrivals from a rise of 16% in 2019 to a decline of 79% in 2020 reduced the country's GDP growth by about 4%pts last year. McKinsey does not expect international travel to fully recover for 2-3 years, so tourism is unlikely to make a major contribution to Vietnam's economy in 2021 – which helps explain why our 6.5%, 2021 GDP growth forecast is so far below some of the estimates by other economists/analysts.¹⁴

That said, the fact that tourism arrivals *already* plunged in 2020, and can only realistically go up from the very low levels experienced last year, so our forecast can be thought of as a floor for Vietnam's likely GDP growth rate in 2021, with significant upside potential if tourists start flocking back to the country earlier than we currently expect.

The Stock Market in 2021

We expect the VN-Index (VNI) to surge in 2021, driven by 23% EPS growth, following a 15% increase in 2020, and note that:

- Our 23% EPS growth forecast is slightly below the market-wide consensus forecast for 28% earnings growth this year.
- Monetary conditions in Vietnam are very loose¹⁵ (credit growth was circa 10% yoy in late-2020, versus M2 growth of about 14% yoy), so: 1) excess liquidity is flowing into the stock & real estate markets instead of into the "real economy", and 2) the interest rates banks pay on 1-year deposit rates fell from as high as 8% pre-COVID to below 6% by end-2020.
- Further to that last point, the number of new retail stock market trading accounts opened more than doubled in 2020, driven by the desire of local investors to achieve higher returns as the interest rates

¹⁴ The first page of this report included a table of forecasts for Vietnam's GDP growth in 2021, some of which were considerably above our 6.5% forecast. We believe that some of the very high forecasts assume a rapid resumption of international tourism in 2021 due to the widespread adoption of vaccines, etc. However, we do not believe travellers will change their behavior this quickly - and note that international tourism did not fully recover from the 9/11 tragedy for about two years.

¹⁵ The State Bank of Vietnam (SBV) bought an estimated USD20 billion of FX reserves in 2020 and paid for those US Dollars with freshly printed VN Dong in what economists call "unsterilized" currency intervention. The resulting flood of liquidity depressed interbank interest rates to below 0.3% in 2H20, and we expect this phenomenon to continue in 2021 for a variety of reasons, including a surge in Vietnam's trade surplus to above 7% of GDP - which will enable to SBV to continue aggressively accumulating FX reserves.

paid on their bank deposit accounts plunged. This is important because local retail investors account for about 85% of Vietnam's daily stock market trading volume.

- The widely discussed narrative that “Asia handled COVID well” has started to prompt foreign investors to pour money into regional markets in late-2020, which helps explain why China's FII stock market inflows surged by more than 25% yoy to a record high of over USD200 billion last year.
- We expect foreign inflows to Asian stock markets to accelerate in 2021, and believe that Vietnam's attractive valuation should entice foreign investors to buy Vietnamese stocks, especially given that the VNI's 14x P/E ratio is only slightly above its 13x, 10-year average, and that 14x figure is predicated on VinaCapital's very realistic 23% EPS growth forecast which does not entail any “heroic assumptions”.
- Further to that last point, Vietnam's stock market valuation is attractive compared to its regional peers, as can be seen in the table below. Also, we have greater confidence in the earnings outlook for Vietnam than of its regional peers, given Vietnam's demonstrated ability to contain COVID while minimizing its impact on the economy, as well as the country's political stability.

	2021F EPS Growth	2021F P/E
Philippines	45%	19.8
Thailand	30%	19.4
Indonesia	71%	16.5
Vietnam	23%	14.3
Malaysia	63%	14.0

Source: Bloomberg, VinaCapital

The Real Estate Market in 2021

Vietnam's *residential real estate* market remained resilient in 2020 despite COVID, and is likely to continue powering ahead in 2021:

- The total number of new apartments sold in Ho Chi Minh City and Hanoi dropped by more than 40% in 2020 due to COVID and certain legal/zoning issues discussed below. However, the prices of housing products suitable for middle-class homebuyers increased by about 10% last year, partly because the demand for such products is greater than the supply.
- Further to that last point, starting from 2018, it became difficult for developers to secure approvals for new real estate projects in HCMC, primarily because of increased scrutiny of prior zoning decisions/project approvals and land sales from State-Owned Enterprises to developers. The HCMC market subsequently became about 50% undersupplied by some measures, and a similar corruption crackdown began to constrain the supply of new units in Hanoi last year.
- All of these issues are likely to be resolved after the National Party Congress, but the supply and demand of new housing units in Vietnam is unlikely to come back into balance until 2022, given the amount of time it typically takes to secure approvals for new projects. That said, Vietnam's major real estate developers raised over USD7 billion of new capital by issuing corporate bonds in 2020, so the developers have the ability to ramp up their development activities when the project approval issues are resolved.

- Finally, we are very optimistic about the prospects for continued strong demand for housing units in 2021 and beyond for a variety of reasons, including: 1) we estimate that the combined demand for new housing units in HCMC and Hanoi is around 200,000 per year, but only 60,000 units/year were developed in recent years – and that figure probably dropped to about 30,000 in 2020, and 2) mid-tier housing units (circa USD1,300/SQM) are still well within the range of affordability for most emerging middle-class families.

Vietnam's **industrial real estate** market was the hottest segment of the country's real estate industry in 2020, and likely to remain so in 2021:

- The US-China Trade War prompted many manufacturers to re-locate to Vietnam, and COVID has accelerated this trend, so industrial land rental rates in northern Vietnam have been rising at about a 10% annual rate for the last few years, and rental rates in the south have been increasing at about double that pace.
- Further to that last point, the supply of industrial land in the south is particularly constrained, so it is apparently rare to find 5-10 ha of immediately occupiable space within 30km of HCMC's CBD. That is partly because much of the agricultural land plots that are slated to be converted into industrial park space are currently rubber plantations, and the process of converting rubber plantations into industrial park space is particularly cumbersome for a variety of reasons.
- According to our network of industry insiders working at I/P operators, logistics firms, and FDI firms, the demand for industrial park space is set to further accelerate in 2021, so all of the foreign commercial real estate brokers (Savills, CBRE, JLL, etc) dramatically expanded their industrial real estate brokerage teams last year.

###

Disclaimer

© 2021 VinaCapital Fund Management JSC (VCFM). All rights reserved. This report has been prepared and is being issued by VCFM or one of its affiliates for distribution in Vietnam and overseas. The information herein is based on sources believed to be reliable. With the exception of information about VCFM, VCFM makes no representation about the accuracy of such information. Opinions, estimates, and projections expressed in this report represent the current views of the author at the date of publication only. They do not necessarily reflect the opinions of VCFM and are subject to change without notice. VCFM has no obligation to update, amend or in any way modify this report or otherwise notify a reader thereof in the event that any of the subject matter or opinion, projection or estimate contained within it changes or becomes inaccurate.

Neither the information nor any opinion expressed in this report constitutes an offer, or an invitation to make an offer, to buy or to sell any securities or any option, futures, or other derivative instruments in any jurisdiction. Nor should it be construed as an advertisement for any financial instruments. Officers of VCFM may have a financial interest in securities mentioned in this report or in related instruments. This research report is prepared for general circulation and for general information only. It does not have regard to the specific investment objectives, financial situation or particular needs of any person who may receive or read this report. Investors should note that the prices of securities fluctuate and may rise and fall. Past performance, if any, is no guide to the future.

Any financial instruments discussed in this report may not be suitable for all investors. Investors must make their own financial decisions based on their independent financial advisors as they believe necessary and based on their particular financial situation and investment objectives. This report may not be copied, reproduced, published, or redistributed by any person for any purpose without the express permission of VCFM in writing. Please cite sources when quoting.