Michael Kokalari, CFA
Chief Economist

Vietnam's Economy is Strong. So Why is the Stock Market Selling Off?

Vietnam's benchmark VN-Index (VNI) sold off 11% last week and was down 21% YTD at the end of last week, after having been nearly flat YTD at end-March. Meanwhile, Vietnam's economy is staging a strong recovery, which is driving robust earnings growth, so the primary catalyst for the sell-off in the VNI is the on-going drop in global stock markets.[1] Note also that certain Vietnam-specific factors discussed below have exacerbated the sell-off and that there has been a noteworthy performance dispersion among individual stocks in the market, which presents opportunities for active fund managers like VinaCapital to outperform the broader stock market index.

	VN-Index Performance		Vietnam Earnings Growth*	
As of May 13, 2022	Weight (%)	YTD (%)	1Q22 (%yoy)	2022F (%yoy)
Financials	33.3	-16.5	29%	36%
Real Estate	23.6	-14.4	-10%	58%
Consumer Staples	10.6	-12.2	45%	-10%
Industrials	8.9	-15.7	34%	-10%
Materials	8.7	-18.5	59%	12%
Utilities	6.8	0.9	55%	14%
Consumer Discretionary	3.6	-1.0	25%	44%
Information Technology	2.2	1.4	46%	23%
Energy	1.4	-27.6	-25%	1%
Health Care	0.7	-10.3	32%	11%
VN-Index		**-21.1**	**Total: 29%**	**29%**

*Combined earnings growth for Hanoi & HCM stock exchanges, VinaCapital forecast

The on-going drop in global stock markets is being driven by the US Federal Reserve's aggressive rate hike plans. While we expect the Fed to abandon its rate hike plans if the US stock market continues to plunge, the current sell-off in global stock markets could have further to go. Furthermore, EM/Frontier stock markets will suffer from a 15% yoy surge in the value of the US Dollar/DXY Index[2], because a strong appreciation in the USD typically dissuades investors from investing in EM/Frontier stock markets. That said, Vietnam's economy is very strong, which helped propel 29% yoy earnings growth in Q1, and which we believe will help the market weather the current global stock market turbulence.

Vietnam's Economy is Strong

Most COVID restrictions in Vietnam have been eliminated, enabling consumers to resume their ordinary day-to-day economic activities. Consequently, the growth of retail sales in Vietnam accelerated from a 1.7% yoy increase in 2M22 to 10.4% in March and 12.1% yoy growth in April. Furthermore, there is compelling "on the ground" anecdotal evidence suggesting that those retail sales growth figures understate the current explosion of "pent up demand" consumption happening in Vietnam today.

Consumption accounts for about two-thirds of Vietnam's GDP, so this vigorous, on-going rebound supports our forecast for 6.5% GDP growth this year. Our GDP growth forecast is based on two key factors. First is an assumption that inflation-adjusted "real retail sales" will grow by 5% this year (versus 9% average growth in the five years, pre-COVID). Second is the fact that Vietnam has fully re-opened to foreign tourists, and they are now pouring back into Vietnam (and who we estimate previously accounted for about 10% of Vietnam's total retail sales and foreign tourism accounting for about 10% of GDP), which is likely to add at least 2%pts to Vietnam's GDP growth this year.

Next, the plunge in Vietnam's COVID cases prompted the biggest increase in manufacturing employment in a year during April. Manufacturing accounts for over 20% of Vietnam's GDP and grew by a healthy 8% yoy in 4M22, although an increasing number of companies reported difficulties securing production inputs because of China's "Zero COVID" policy.

[1] The VN-Index dropped 21.1% YTD, versus a 15.6% drop in the SP500, a 18.5% drop in the MSCI-EM index, and a 13.2% decline in the MSCI-Frontier Market index, as of Friday, 13 May 2022, and the VNI dropped another 1% on Monday, May 16th.

[2] The VND depreciated by 1.3% YTD versus the US Dollar, which compares favorably to the circa 3% depreciation of its EM ASEAN peers.

We understand that the supply chain issues in Vietnam caused by China's policy primarily impacted the producers of low value-added products such as garments. We further note a growing recognition outside of Vietnam that China's policy is yet another reason for companies to shift manufacturing to Vietnam, which saw record high FDI inflows in 4M22.

Fundamental Stock Market Strengths

The VN-Index's sell-off comes despite Vietnam's strong economy as well as the compelling fundamental strengths of its stock market. Those strengths include a 11.4x forward P/E ratio versus 21% consensus earnings growth expectation for the stocks in the VNI this year, and a circa 30% valuation discount versus Vietnam's regional peers. That said, there has been a fairly pronounced performance dispersion among the sectors of the stock market, which is generally attributable to fundamental factors, giving investors opportunities to take shelter in defensive sectors.

Three sectors stand out as pockets of relative strength: utilities, consumer discretionary, and IT, the stock prices of which are being supported by strong Q1 results (which can also be seen in the table above) as well as other fundamental factors. Specifically, the earnings and stock price performance of the utilities sector was supported by a doubling of electricity production growth this year, while consumer discretionary stocks are benefitting from the ambitious expansion plans of some of the key companies in the sector. The IT sector's earnings and stock price performance is being driven by a circa 30% increase in outsourcing revenues of FPT, which is the dominant player in the sector, coupled with a near 60% increase in the company's new outsourcing contracts in Q1.

In addition to these resilient sectors, we also note that the earnings of materials companies soared nearly 60% yoy in Q1, driven by a circa 8-fold increase in the earnings of fertilizer companies. Consumer staples companies' earnings increased 45%. Financial companies' earnings increased by nearly 30% yoy in Q1, and we expect 36% earnings growth in FY22, primarily driven by 14% sector-wide credit growth and modest NIM expansion at the country's commercial banks.

Vietnam-Specific Factors

In addition to the global stock market sell-off, forced selling of stocks related to margin lending has weighed heavily on Vietnam's stock market over the last two weeks. The number of retail stock market investors in Vietnam has gone up nearly 70% over the last 12 months and most of those new entrants to the market were enticed to open margin trading accounts in the hope of making quick profits in the stock market.

The correction in the US and global stock markets triggered margin calls and many of these new investors simply abandoned their long positions, in our understanding. Consequently, we estimate that brokers' outstanding balances have dropped by about 25% from peak levels a few weeks ago.

However, in addition to the forced selling of stocks prompted by "margin calls" on individual investors, there is an additional driver of stock margin related selling. Some local companies borrowed money with the stated purpose that the funds would ultimately finance real estate development and/or other projects, but the local business press has reported that certain firms then turned around and used the money to participate in the stock market. We understand that the Government is now cracking down on this misuse of funds, which is another source of forced selling of stocks.

Conclusions

The sell-off of Vietnam's stock market has been consistent with what has been occurring in global markets, although selling pressure was exacerbated by the presence of many new retail investors who are dealing with margin calls for the first time, as well as a crackdown on firms that borrowed money to buy stocks. None of this, however, is likely to have much impact on Vietnam's economic growth or on the aggregate earnings of listed companies.

In Q1, earnings surged by around 30% yoy, and we expect the earnings of all of the companies listed on the Hanoi and HCM stock exchanges to surge by nearly 30% this year, although the earnings of the stocks held by VinaCapital's flagship VVF UCITS fund are likely to increase by over 40% this year and are trading at a 20% valuation discount to the VN Index. Finally, we also note that the value of the VN Dong is nearly unchanged yoy, despite a 15% yoy surge in the US Dollar/DXY index. We believe resilience of the VN Dong despite the sharp appreciation of the USD is an accurate indicator of the underlying strength of Vietnam's economy, which in-turn should support the earnings growth and price appreciation of the market.

Disclaimer

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. 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.