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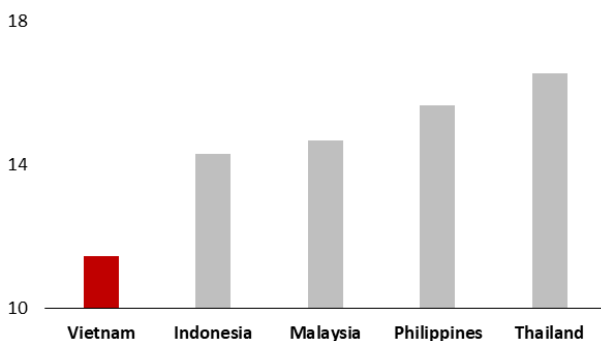
## Looking Ahead at 2023

We expect Vietnam's economy and stock market to "normalize" this year. The economy is returning to its long-term growth trajectory now that the post-COVID re-opening boom has finished, and recent market action suggests that the bear market which wiped 33% off the VN-Index last year (or 35% in USD terms) -- despite Vietnam's fastest GDP growth in 25 years! -- is ending now. In 2023, we expect:

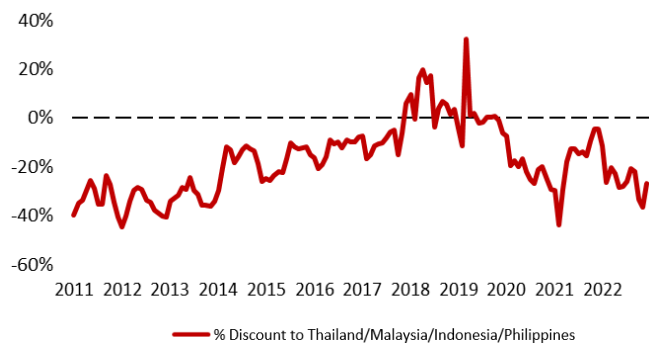
- **GDP growth to slow** from 8% last year to 6% this year, weighed down by the slowing demand for "Made in Vietnam" products from consumers in the US/EU, but supported by the continued resumption of foreign tourist arrivals in Vietnam, especially in light of China's recent re-opening, and supported by a surge in the Government's infrastructure spending.
- **The stock market to rebound**, as the global and domestic factors that weighed on the market last year get resolved. Specifically, global inflation pressures are easing, and we expect Vietnam's Government to address concerns about the ability of local corporations to re-finance USD5 billion of maturing corporate bonds this year, which was one of the main factors that weighed on the VN-Index last year.
- **The continuation of long-term growth drivers**, including continued **FDI inflows**, which will benefit from an intensification of US-China trade tensions last year, and **urbanisation and demographics**, both of which help fuel the continued growth of Vietnam's emerging middle class and domestic consumption.

In addition to the above, we expect Vietnam's macro economy to remain stable this year. The value of the VN Dong depreciated by 3% in 2022 versus 7% depreciation for Vietnam's regional EM peers, and we expect 2-3% appreciation this year. Vietnam's CPI inflation rate averaged 3% in 2022 versus much higher inflation in most other DM/EM countries in the world, but we expect that figure to tick up to 4% in 2023, largely because China's re-opening is likely to put some upward pressure on food and energy prices in Vietnam.

**FY23 P/E Ratio**



**Vietnam vs. Regional Peers' Valuations**



Finally, the consensus expectation is that the VN-Index will increase by over 20% this year, which would imply a normalization of the stock market's valuation. Further to that last point, the VN-Index was trading at a circa 2-standard deviation discount to its own average P/E ratio over the last five years in late 2022, and Vietnam's stock market is currently trading at a considerable valuation discount to its regional peer stock markets (Thailand/ /Malaysia/Indonesia/Philippines) as can be seen above.

### Vietnam's GDP Growth to Slow in 2023

We expect Vietnam's GDP growth to slow from 8% in 2022 to 6% in 2023 because:

- 1) Vietnam's post-COVID re-opening boom is now finished, and the demand for "Made in Vietnam" products is slowing precipitously, along with the global economy, but
- 2) China's reopening boom will support Vietnam's economy in 2H23 (COVID cases in China are likely to peak within the next 1-2 months) by boosting foreign tourism in Vietnam, and
- 3) The Vietnamese Government's planned circa 50% increase in infrastructure spending would increase spending from 4% of GDP in 2022 to 7%/GDP in 2023

Vietnam's GDP grew at its fastest pace in 25 years in 2022, driven by the post-COVID consumption boom, during which Vietnamese consumers enthusiastically engaged in "revenge spending" and foreign tourists started to return to Vietnam. Consumption accounts for nearly two-thirds of Vietnam's GDP, and retail sales (which are a good proxy for domestic consumption) grew on a month-on-month basis throughout most of 2022.

However, this sequential growth tapered off towards the end of the year and retail sales climbed back above pre-COVID levels for the first time in late 2022 as the re-opening boom ran its course. In contrast, foreign tourist arrivals accelerated dramatically in 2H22, but only reached about 20% of pre-COVID levels last year, so we expect tourist arrivals to continue accelerating, driven by China's re-opening, and reach 50% of pre-COVID levels in 2023.

### Key Projections

|                                | 2022           | 2023F         | Pre-COVID Average* |
|--------------------------------|----------------|---------------|--------------------|
| <b>GDP</b>                     | +8.0%          | +6.0%         | +7.0%              |
| <b>Real Retail Sales</b>       | +15.6%         | +9.0%         | +9.0%              |
| <b>Manufacturing</b>           | +8.1%          | +0.0%         | +12.0%             |
| <b>Infrastructure Spending</b> | 4%/GDP         | 7%/GDP        | 3%/GDP             |
| <b>Tourist Arrivals</b>        | ~20%/Pre-COVID | 50%/Pre-COVID |                    |

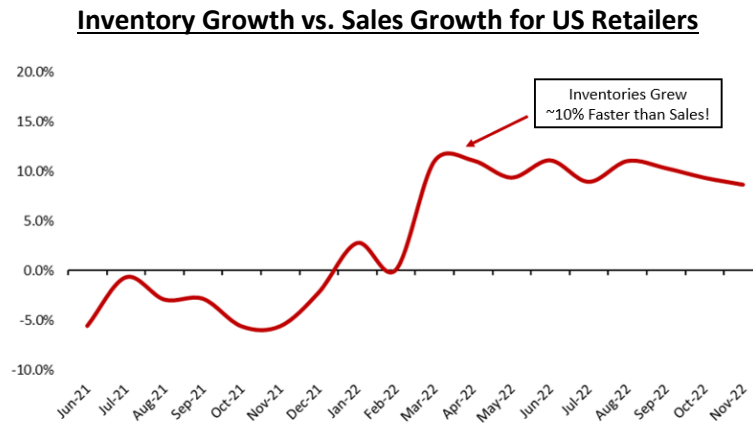
\*Average Over 2015 - 2019

Finally, Vietnam's economy will take a big hit from the slow-down in the global economy (driven by central bank rate hikes/monetary tightening) since manufacturing contributes about one-quarter of Vietnam's GDP and Vietnam's exports equate to over 90%/GDP. However, we believe that the Government aims to offset some of the drag on the country's economy with a big infrastructure spending push, which is discussed below.

### Slowing US/Global Growth to Weigh on Vietnam

Vietnam's manufacturing sector made a big contribution to the country's economy in 2020 and 2021 because the demand from consumers in the US and EU for so-called "stay at home goods" kept Vietnamese workers busy. Manufacturing remained remarkably resilient in the first half of last year, but growth peaked in the middle of 2022 and deteriorated throughout 2H22 as demand slowed dramatically; by the end of last year, output, employment, and orders at Vietnam's factories were all falling fairly sharply.

Inventories at retailers and other consumer-facing firms in the US like Nike and Lululemon reportedly swelled by about 20% in 2022, which led to a decrease in Vietnam's export orders in late-2022, and to a record-high 13% month-on-month drop in US consumer goods imports in November. In December, Vietnam's exports fell 14% yoy while the exports of both China and Korea fell by about 10% yoy.



We do not expect factory export orders to recover until the second half of 2023, because it is likely that it will take at least six months for retailers in the US and EU to work off their excess inventories. In addition, home sales in the US are currently falling at a faster rate than during the 2008 global financial crisis (US home-sales are falling at a record-pace: -35% yoy versus -31% yoy at the worst point during the GFC), which will reduce demand for furniture and other household products made in Vietnam.

Finally, the lagged effect of last year's rate hikes by the Fed and the ECB will continue to slow the economies of the US and Europe this year, and these two economies collectively account for nearly half of Vietnam's total exports.

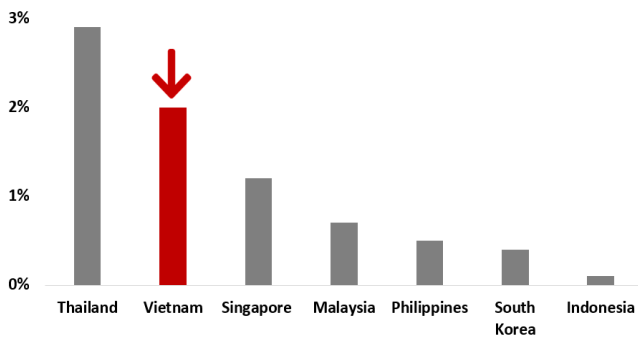
**China's Re-Opening to Offset Falling Demand for "Made in Vietnam" Products**

We expect Chinese tourist arrivals to fully recover in the second half of 2023, and for the number of foreign tourists visiting Vietnam to increase from about 20% of pre-COVID levels in 2022 to 50% in 2023. Chinese tourists previously accounted for one-third of Vietnam's total tourists, pre-COVID (i.e., a recovery of 1/2 of Vietnam's tourist arrivals for 1/2 of the year would equate to an additional ~20% of tourist arrivals in 2023).

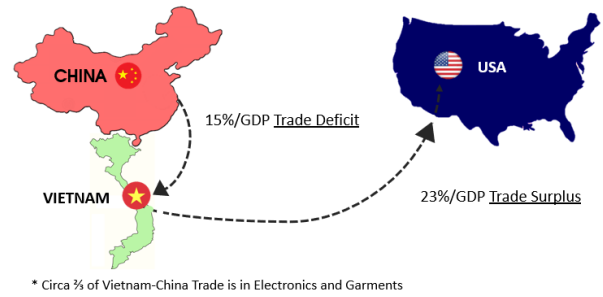
Foreign tourism previously contributed about 10% to Vietnam's GDP, so we estimate that the partial resumption of foreign tourists added about 2%pts to Vietnam's GDP growth last year. The continued rebound of Vietnam's foreign tourist arrivals is likely to boost Vietnam's GDP growth rate by more than 2%pts this year, which would more-than-offset the drop in manufacturing.

Further to that last point, note that Goldman Sachs expects the resumption of Chinese tourists to boost Thailand's 2023 GDP Growth by 3%pts as can be seen in the chart below on the left, which is a good reality-check for our 2%pts estimate for Vietnam, given that tourism contributes about 50% more to Thailand's GDP than to Vietnam's.

**Estimated Boost to GDP From Chinese Tourists in 2023**



**Vietnam's Modest Exposure to China**



Finally, China's re-opening boom will have some other positive impacts on Vietnam's economy, but a full resumption of Chinese tourist arrivals in the second half of 2023 would be the biggest benefit to Vietnam from China dropping its "Zero COVID" policy.

Some observers have mistakenly assumed that Vietnam's economy would accrue other, additional major benefits from China's re-opening since China is Vietnam's biggest trading partner and second biggest export market. However, while some individual industries in Vietnam will benefit tremendously from China's re-opening (for example, exporters of products like fruit and seafood), Vietnam has a large trade deficit with China<sup>1</sup>, as can be seen in the chart above on the right. Accordingly, an increase in Chinese domestic demand will only modestly benefit Vietnam.

**Infrastructure Development to Support GDP Growth**

Vietnam's Government aims to increase Infrastructure Spending from 4%/GDP in 2022 to 7%/GDP in 2023, which would help support the country's long-term economic growth. This new infrastructure is needed to help ensure that FDI inflows continue to flow into Vietnam for years to come, and the projects would also more-than-offset the drag on Vietnam's economy from the slowdown in manufacturing. The Government targets a circa 50% surge in infrastructure spending this year, from around USD20 billion in 2022 to above USD30 billion in 2023, versus circa USD16 billion of average annual infrastructure spending over the last five years (including in 2022).

The Government reportedly has nearly USD40 billion of undisbursed funds deposited in banks, most of which was earmarked for infrastructure projects in past years but did not get spend due to various administrative/bureaucratic issues; it clearly has the financial wherewithal to achieve its spending goals this year. Regarding those administrative bottlenecks, the Government announced Decree 1513 on December 15<sup>th</sup>, 2022 which is intended to expedite progress on several projects, including the long-overdue North-South highway. Decree 1513 explicitly stipulates about USD15 billion of spending that "must" happen in 2023.

Finally, Vietnam's Government debt-to-GDP ratio is below 40%, which is very low compared to most EM and DM countries around the world, partly because Vietnam spent less than 2%/GDP on COVID aid versus 6% on average in EMs, which is highlighted below in the discussion about inflation in Vietnam.

<sup>1</sup> Vietnam essentially imports production materials and capital goods from China which it uses to produce products that are then exported to the US.

**Continued FDI Inflows**

Vietnam's main appeal as a destination for FDI stems from the fact that factory wages are about one-third those in China, and the quality of the workforce is comparable to that of China, according to surveys by JETRO and others. Vietnam's close geographic proximity to Asia's supply chains, especially in the high-tech industry, is another factor. In recent years, an increasing number of multinational firms started diversifying their manufacturing outside of China for a variety of reasons, including China's Zero-COVID policy and the US-China trade war.

In 2022, the Biden administration dramatically escalated the US-China trade war with its passage of the "Chips and Science Act" and by signaling its intention to keep Trump's China tariffs in place indefinitely, evidenced by US Trade Representative (USTR) Katherine Tai's assertion that the tariffs would stay in place "until the day that China chooses a path to have its economy operate more like ours".

That escalation of trade tensions, coupled with China's "Zero-COVID" policy, help explain why Samsung (which is already Vietnam's single largest foreign investor) announced that it will start producing semiconductor parts in the country and Apple announced that it will begin producing Apple Watches and MacBooks in Vietnam, which will be the first time these products will be made outside of China. Apple has "big plans for Vietnam" according to insiders, who also noted that the Apple Watch is particularly complicated to manufacture because of the challenge of squeezing so many components into such a small case.

The net result of all of the above is that FDI inflows increased by another 14% in 2022 to USD22 billion (or 6%/GDP) and we expect a similar magnitude of inflows this year.



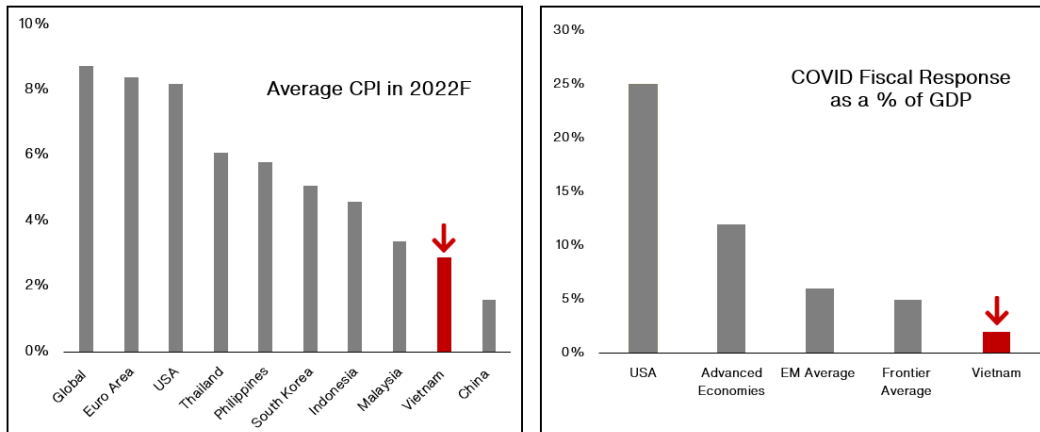
**US-China Trade Tensions Escalated in 2022, Prompting More FDI Inflows to Vietnam**



**Continued Macro-Economic Stability**

Inflation in Vietnam averaged 3.2% in 2022, which is much lower than inflation in most of the world's other countries, as can be seen in the chart below, on the left. One reason inflation was lower than in most Developed Market (DM) countries is that Vietnam's Government did not print and spend enormous sums of money to support its economy during COVID, as can be seen in the chart below, on the right; Vietnam spent less than 2%/GDP on COVID aid versus 6% on average in Emerging Market (EM) countries.

**Vietnam Did Not Print & Spend Money During COVID**



In addition to the points above, note that although Vietnam is nearly energy self-sufficient, the country imports around 3-4%/GDP worth of energy, so while the increase in global energy prices put *some* upward pressure on overall consumer price inflation in Vietnam, the impact was only modest.

That said, petrol prices in Vietnam are in-line with world/fair market prices, but Vietnam’s electricity distribution monopoly Electricity Vietnam (EVN) was slow to raise retail electricity prices in response to rising global energy prices; the SOE firm reportedly lost over USD1 billion last year. Consequently, electricity prices in Vietnam are likely to rise 5-10% this year, which, when combined with inflationary pressures resulting from China’s re-opening, explains why we expect it likely that Vietnam’s average CPI inflation rate will tick up from 3% in 2022 to 4% in 2023.

**A Rebound in the VN Dong**

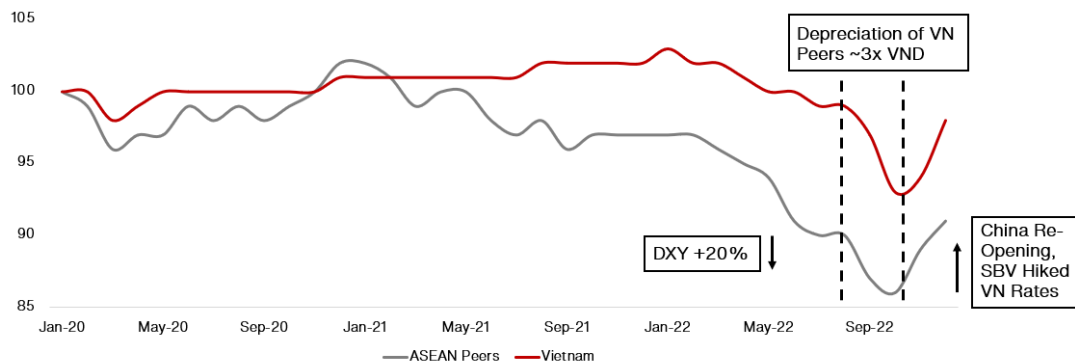
The value of the VN Dong depreciated by 3% in 2022 vs. 7% average depreciation for Vietnam’s regional EM peers last year, and we expect the VND to appreciate by 2-3% in 2023. The Dong had depreciated by as much as 9% YTD in early-November (versus a 12% average depreciation for regional peers), driven by a near 20% surge in the value of the US Dollar/DXY Index.

The State Bank of Vietnam is widely thought to have spent about USD20 billion of its FX reserves defending the VND last year, although the actual level of the SBV’s FX reserves is not officially disclosed. In addition, the SBV hiked policy rates by 100 bps in both September and October, which raised Vietnam’s policy rate from 4% to 6%, in order to defend the VND (recall from above the inflation in Vietnam averaged 3% last year, so these rate hikes were done to protect the VND, rather than to combat inflation).

The SBV’s actions shored up confidence in the VN Dong, and two additional developments also helped boost the value of the VND by 5% from early November to end-December:

- 1) The value of the US Dollar/DXY index fell by 5% in November for reasons related to the US economy (the value of the USD ended up falling by 9% from its peak level until the end of December - but still ended the year up 8%).
- 2) The value of the Chinese Yuan appreciated by about 5% driven by the December 5th announcement that China would drop its “Zero COVID” policy, which boosted sentiment towards the VN Dong.

**VND Outperformed Peers Since COVID**



Finally, we believe the SBV opportunistically purchased as much as USD4 billion worth of US Dollars in recent weeks – starting from late December - in response to the drop in the value of the USD at that time. As such, the VND probably would have appreciated by even more than it did in December and January (month-to-date) had the SBV not purchased USDs and sold VND during that time period.

**The VN-Index's Bear Market is Ending**

The VN-Index fell 33% in 2022 (or 35% in USD terms), so the market's FY22 P/E ratio fell from 20x at end-2021 to 12x at end-2022 (EPS grew by an estimated 5% last year).

Last year's drop in the VNI, despite Vietnam's fastest economic growth in 25 years, was driven by three negative factors: 1) weak global stock markets (including an 20% drop in the S&P500 last year) due to aggressive interest rate hikes by the Fed and other central banks; 2) a surge in the value of the US Dollar by as much as 20% in late-2022 (a higher dollar is bad for EM stock markets); and 3) domestic issues, including three high-profile arrests<sup>234</sup> and the Government's regulatory crackdown that impacted the corporate bond market as well as certain real estate developers.

We believe that the bear market that ravished Vietnam's stock market last year is now over and note that the consensus expects the VN-Index to climb by over 20%, with the rebound essentially attributable to improvements in both the domestic and international factors that weighed on the market last year. Specifically:

- Global inflation pressures are now abating, which means that the aggressive central bank rate hikes that depressed both developed and emerging market stock markets last year will likely end soon.
- We expect the Government to take steps to ease the liquidity issues currently impacting Vietnam's corporate bond market, which would result in a resumption of Vietnamese companies' ability to refinance their maturing debts.

In our view, instilling confidence back into the Vietnamese stock market will be a drawn-out process, but the market's attractive valuation and solid earnings growth prospects probably explain why foreign investors purchased USD1.1 billion worth of Vietnamese stocks in the last two months of 2022. They were also net buyers of Vietnam's stock market for full-year 2022, the first time since 2019 (the consensus expects 7% earnings growth for the VN-Index in 2023, according to Bloomberg).

<sup>2</sup><https://vietnamnet.vn/en/arrest-of-flc-group-chairman-the-aftershocks-826685.html>

<sup>3</sup><https://e.vnexpress.net/news/economy/tan-hoang-minh-chairman-arrested-over-bond-issuance-fraud-4447915.html>

<sup>4</sup><https://e.vnexpress.net/news/companies/property-developer-van-thinh-phats-chairwoman-arrested-for-bond-fraud-4520740.html>

### Investment Themes and Sectors

VinaCapital's research team continues to favor the **domestic consumption**, **infrastructure** and **FDI** investment themes in 2023 (unchanged from year's "Looking Ahead at 2022" report) and added **lower interest rate beneficiaries** and **consolidation** as two new themes for this year.

Regarding domestic consumption, the growth of Vietnam's middle-class is driving reliable growth in the demand for products and services those consumers desire, which benefits consumer discretionary companies. The increased wealth of those consumers also benefits financial services companies because the demand for mortgages, credit cards, and other consumer finance/consumer credit products grows along with their wealth, as does the desire of those consumers to save money and purchase investment products.

Aviation companies in Vietnam also benefit from the continued growth of the country's emerging middle class because of the desire of newly affluent consumers to travel domestically and abroad, and China's reopening will also boost the demand for aviation services.

Infrastructure development has been a consistent investment theme for Vietnam for years, although the Government's expected surge in infrastructure investment this year has made us especially optimistic about the prospects for companies that are beneficiaries of increased infrastructure development, including building materials companies and aviation firms that would benefit from the construction of new airports.

| DOMESTIC CONSUMPTION  | INFRASTRUCTURE  | LOWER RATE BENEFICIARIES   | FDI   | CONSOLIDATION  |
|---|---|--|---|--|
| <ul style="list-style-type: none"> <li>• Aviation</li> <li>• Banks</li> <li>• Brokers</li> <li>• Consumer Discretionary</li> <li>• Real Estate</li> </ul> | <ul style="list-style-type: none"> <li>• Aviation</li> <li>• Industrial Parks</li> <li>• Materials</li> <li>• Real Estate</li> <li>• Utilities</li> </ul> | <ul style="list-style-type: none"> <li>• Brokers</li> <li>• Real Estate</li> </ul> | <ul style="list-style-type: none"> <li>• Consumers</li> <li>• Industrial Parks</li> <li>• Ports &amp; Logistics</li> <li>• Real Estate</li> </ul> | <ul style="list-style-type: none"> <li>• Banks</li> <li>• Consumers</li> <li>• Property</li> </ul> |

Next, FDI Inflows have been one of Vietnam's primary growth drivers in recent years, and as mentioned above, FDI inflows grew 14% last year and are likely to grow by a similar magnitude this year as more-and-more factories to relocate from China or to set up in Vietnam instead of in China. Those inflows also directly benefit industrial park developers, ports, and real estate developers that have projects in close proximity to FDI-funded factories.

Next, interest rates in Vietnam are likely to decline as 2022 progresses because the value of the VN Dong has started appreciating and is likely to continue appreciating (recall from above that the main reason Vietnam's central bank hiked policy interest rates was to defend the value of the VN Dong) and because global inflationary pressures are easing. Lower interest rates should benefit brokers, real estate, and companies with high debt levels, although lower rates may reduce the earnings of banks and companies with significant cash balances.

Finally, a tougher operating environment in Vietnam may spur some consolidation among the country's banks, consumer companies, and real estate developers and/or consolidation of individual real estate development projects.



## Conclusions

We expect Vietnam's economy and stock market to "normalize" this year as the country's economy is returning to its long-term growth trajectory now that the post-COVID re-opening boom has finished, while the bear market of 2022 appears to be ending as evidenced by a resumption of foreign inflows to the stock market.

GDP growth is likely to decelerate from 8% in 2022 to 6% in 2023, partly because the slowing global economy will weigh on Vietnam's exports and manufacturing sector, but China's re-opening is likely to boost Vietnam's GDP growth by 2%pts via increased foreign tourism, and Vietnam's Government guided that it aims to increase infrastructure spending from around 4% of GDP in 2022 to 7%/GDP (or circa USD30 billion) in 2023.

The fact that Vietnam's economy will have forces pushing its economic growth higher this year and weighing on its GDP growth means that some companies' earnings will be stronger, while others may suffer more due to the global slowdown. In this kind of environment, we expect to see more performance dispersion among and within sectors and an active approach to Vietnamese equities with high active share should deliver a better outcome. This was also the case in 2022 – albeit with different factors at play – when all of VinaCapital's offshore funds outperformed the VN-Index by more than 10%pts (note that those funds also outperformed the VN-Index on a 3-year and 5-year horizon).

## Disclaimer

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