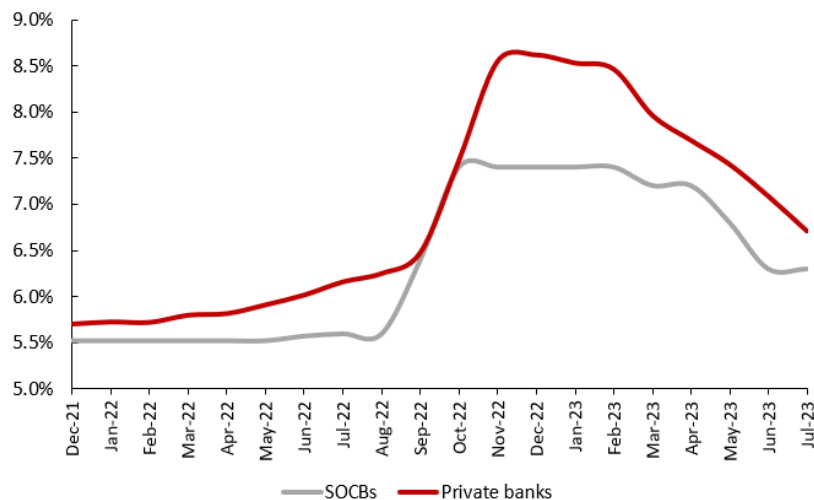


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VIETNAM'S POLICY RATE CUTS ARE BOOSTING STOCK PRICES

The State Bank of Vietnam has cut policy interest rates four times this year, by 150bps to 4.5% (for the refinancing rate), which stands in stark contrast to the US Federal Reserve, which has hiked US interest rates four times in 2023, by 100bps to 5.5%. Vietnam's central bank cut rates and took other measures in an effort to boost the country's GDP growth, which plunged from 6.4% yoy in 1H22 to just 3.7% in 1H23. These policy rate cuts prompted local commercial banks to lower their deposit and lending rates (deposit rates are down about 150bps YTD), which helped boost the VN-Index by over 20% YTD as of August 8th.

Average 12M Deposit Rates



We expect a sharp recovery in both GDP growth and earnings growth next year to propel stock prices even higher. That said, we do *not* expect the SBV's monetary easing will have much of an impact on 2023 GDP growth because banks are currently hesitant to extend loans (which is discussed below), and because higher interest rates are not the main source of Vietnam's slow economy this year.

This year's economic slowdown has been largely driven by a collapse in demand for "Made in Vietnam" products, which in-turn depressed manufacturing activity (slower manufacturing accounts for most of the near 3%pts drop in H1 GDP growth mentioned above). In addition, we estimate that household consumption in Vietnam, which typically grows at an 8-9% pace on an inflation-adjusted basis, is currently growing at only a circa 2-3% rate. Consumers' concerns about Vietnam's "frozen" real estate market (which we discussed in [this report](#)), and other issues depressed consumption growth, although overall consumption growth in Vietnam is being supported by a resumption of foreign tourist arrivals, which have reached nearly 70% of pre-COVID levels.

Stock Prices Supported by Rate Cuts

The SBV hiked policy interest rates twice late last year by 200bps to support the value of the VN Dong. To be clear, the Fed aggressively hiked rates to tame inflation in the US, and those rate hikes drove a surge in the US Dollar/DXY Index by nearly 20% in late-2022. In contrast, inflation in Vietnam averaged 3% last year, so the SBV's rate hikes were specifically aimed at maintaining a stable USD-VND exchange rate.

The SBV's rate hikes prompted local commercial banks to lift their 6–12-month deposit rates by as much as 250bps YTD in late-2022, which was unfortunate timing because deposit rates were already being driven higher at that time by some issues in Vietnam's corporate bond market and banking sector that we discussed in [this report](#), and in response to tight liquidity in the banking system. Further to that last point, credit growth in Vietnam outstripped deposit growth by about 3%pts a year on average over 2020-2022, pushing most banks' Loan-to-Deposit ratios up to uncomfortably high levels, which in-turn prompted banks to pay higher interest rates to attract deposits.

One of the reasons that the VN-Index fell by 33% in 2022 (or 35% in USD terms) is because the very attractive levels of bank deposit rates encouraged savers to sell stocks and deposit the proceeds into banks. In late 2022, it was possible to earn double digit deposit rates for 1-year deposits at some reputable banks¹, although many savers opted for 6-month deposits with slightly lower rates. One of the reasons that the VN-Index is up more than 20% YTD this year is because those 6-month deposits are now maturing, and interest rates have dropped, so savers are reallocating the money back into the stock market.

¹ Note that the chart of deposit rates on the first page of this report shows the **average** level of banks' 12M deposit rates for mass clients, but several reputable private sector banks paid higher deposit rates than the circa 8.5% peak level shown in that chart, with some priority/affluent clients offered rates of 10% or more.

Finally, we mentioned Vietnam's disappointing H1 GDP growth. We expect some improvement in H2 given various pro-growth policies by the Government, including rate cuts, but also because we believe the worst for Vietnam's economic slowdown has passed since exports and manufacturing have bottomed out (which will be the topic of our next VinaCapital Insights report). Furthermore, we expect earnings growth in Vietnam to surge from 6% yoy in 2023 to over 20% in 2024, so the current VN-Index market recovery – which was initially driven by lower interest rates – should be sustained by higher earnings next year.

Vietnam's Trade Surplus Enabled Rate Cuts

In 2022, the US Federal Reserve hiked rates by 425bps, prompting the SBV to hike policy rates by 200bps to defend the USD-VND exchange rate. The SBV aimed to keep short-term interbank rates in Vietnam about 200bps above short-term USD rates at that time, and the strategy worked, as evidenced by the fact that the VN Dong only depreciated by just over 3% last year, versus 4-9% depreciations for Vietnam's regional EM peers.

This year, Vietnam's Government shifted to reprioritizing growth in light of the above-mentioned plunge in H1 GDP growth, resulting in Vietnam being one of the first countries in the world to cut policy rates. Furthermore, the SBV has cut rates despite the fact that the Fed is still hiking rates - and could hike rates again in September – so short-term VND interbank rates plunged to ~400bps below USD rates, which is a record-high gap, and can be seen in the chart below:

VND Versus USD Interest Rates*



*Difference Between Short-term VN Dong Inter-bank Interest Rates and USD Inter-bank Rates in Vietnam

Despite the large interest rate differential between the VN Dong rates and US interbank rates, the value of the VN Dong has depreciated by less than 1% YTD, which is because the VND is being

supported by a surprising surge in Vietnam's trade surplus, from 0%/GDP in 7M22 to 6% of GDP in 7M23. This surplus, coupled with FDI inflows of over 4%/GDP in 7M23, helped support the value of the VN Dong, enabling the SBV to cut interest rates while maintain a remarkably stable USD-VND exchange rate.

Impact of Lower Rates on Stock & Real Estate Markets

We mentioned above that the VN-Index is up more than 20% YTD, partly because savers have been taking money out of the bank and plowing it into the stock market as their 6-month deposits mature and because the market was oversold last year. The increase has been driven by a 30% YTD surge in bank share prices and a 20% YTD increase in the prices of real estate stocks. The heavy weighting of these sectors in the VN-Index (at 35% and 18% respectively) means that the increase in the share prices of both sectors drove over two-thirds of the YTD increase in the VNI.

The improvement in sentiment towards bank share prices stems from investors' reduced concerns about asset quality issues and expectations for higher credit growth in H2, prompted by lower interest rates. But it is important to note that declines in lending rates by banks are not uniform, especially given the liquidity issues mentioned above, which are particularly acute at some smaller banks.

Lower interest rates boosted sentiment in the real estate market, where transactions are starting to pick up again, partly because mortgage rates dropped more than 50bps at many banks over the last month. We expect another 50-100bp decline in mortgage rates over the next 6-12 months and note that the improved sentiment in the real estate market has, not surprisingly, boosted the sentiment towards major real estate stocks as well as towards the beneficiaries of higher real estate development activity (i.e., construction companies, steel companies, etc.)

Conclusions

The 20% surge in the VN-Index this year has been largely driven by a circa 150bp fall in banks deposit rates. In short, savers have been taking the proceeds of their maturing 6-month deposits and putting that money into the stock market. Lower interest rates have helped improve sentiment and transaction activity in the real estate market and have led to an expectation for higher credit growth in H2.

The aggressive policy rate cuts in Vietnam come at a time when the US and the EU are still raising interest rates. A widening gap between interest rates in Vietnam and in the US has put some depreciation pressure on the USD-VND exchange rate, but that depreciation pressure has been

mitigated by a stunning improvement in Vietnam's trade surplus from 0% of GDP in 2022 to 6% in 2023.

Finally, we expect a sharp pick-up in earnings growth in 2024, which means that the VN-Index stock market recovery, which has been driven by lower interest rates in 2023, will likely be sustained by higher earnings in 2023, as well as by the market's current, attractive level of valuation. The VN-Index's FY23 P/E ratio is currently 30% below its average over the last five years, and more than 10% below the P/E valuation of Vietnam's regional peers.

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