VEPR

VIET NAM QUARTERLY MACROECONOMIC REPORT

Quarter 1 - 2017

Supported by:

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SUMMARY

- Q1 witnessed the recovery of many major economies in the world. According to available economic indicators, the US economy outlook has become healthier, with a consistent interest rate increase plan in 2017 by Fed. While the picture of the EU economy painted by recent data is sunny, a number of events are threatening the nascent economic recovery in the coming time. In particular, the UK officially launched Article 50 of the Treaty of Lisbon to leave the EU. In addition, upcoming elections in France and Germany elicit concerns about right-wing extremism. Asian economies are expected to grow relatively well in 2017, thanks to the recovery in industrial production and underlying commodity prices.
- Regarding Vietnamese economy, Q1 surprised with a growth level of 5.1%, the lowest level for the past three years. The recovery of agriculture, forestry, and aquaculture sectors (2.0%), together with the stable growth in the service sector (6.5%) were not enough to compensate for the abnormally low growth level of the industry sector. Notably, manufacturing and processing sector grew at only 8.3%, lower than Q1/2016. The VEPI of 5.8% also reflects a slowdown in the economic growth of Viet Nam in Q1.
- Inflation rate tended to level off in Q1, ending at 4.65% (yoy). The slight decrease in inflation rate was attributed to the moderate decline in prices of basic commodities. Meanwhile, the substantial gap between headline inflation and core inflation suggested a sharp increase in the prices of state-controlled commodities.
- Industry indicators clearly show a slowdown in the growth of manufacturing and processing sector. IPI growth rate in Q1 was 4.1%, the lowest level in recent years, while the inventory index remained consistently high in the first two months of the year.
- Consumption slowed in Q1, even during the Tet (Lunar New Year) season. Retail sales experienced a growth rate of only 9.2% (yoy) and 6.2% (yoy) in terms of value and volume respectively, lower than the same period of the previous years.
- International trade achieved a rapid growth in Q1. Export recovered mainly due to the price factor, reaching the level of 12.8% (yoy), while import increased rapidly in terms of both value (22.7%, yoy) and volume (19.9%, yoy). As a result, the trade balance recorded a deficit of US$ 2 billion in Q1.
- The disbursement of foreign direct investment capital reached US$ 3.62 billion, slightly higher than Q1/2016, albeit lower compared to Q4/2016. The registered capital reached US$ 7.7 billion, equivalent to an increase of 77% (yoy), with a large proportion being additional registered capital. Newly registered capital was US$ 2.92 billion, increasing by only 6.5% compared to Q1/2016.
- The SBV continued to closely follow the stable inflation target in a cautious manner, contributing to reducing the pressure on inflation. Overall liquidity increased by 3.5% (yoy), slightly lower than Q1/2016. On the capital market, the modest decrease in mobilization, together with the sharp increase in credit caused slight disturbances to deposit rates in Q1.
- The exchange rate followed a stable trend in the last few weeks of Q1, significantly reducing the differences between commercial banks' exchange rate, average interbank exchange rate, and the free one.
- Domestic gold price fluctuated in the opposite direction to the world gold price. Compared to Q4/2016, the domestic and world gold price increased by 0.5% and 7.5% respectively, reducing the price gap between the two markets to VND 2.1 million per tael.
- The real estate market was sluggish, with the number of openings and transactions decreasing compared to Q4/2016, and Q1/2016, concentrating mainly on the high- and mid-end segments.

THE WORLD ECONOMY

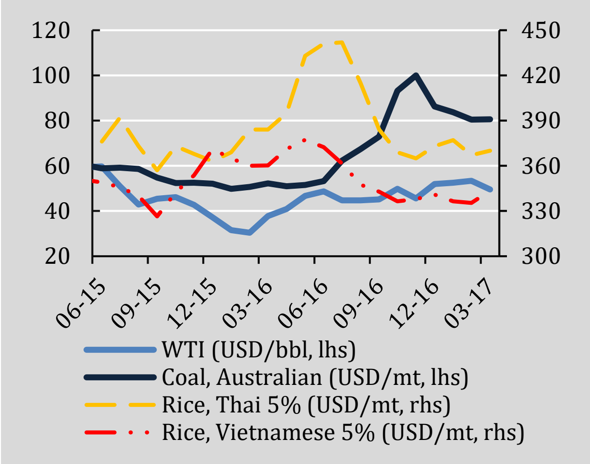
Property and commodity markets

The world commodity market witnessed no wild fluctuations in Q1. Energy prices recovered steadily in the first two months before slipping in March. Meanwhile, food and foodstuff prices remained relatively stable in the whole quarter.

Many agreements on reducing output came into effect, which increased the WTI crude oil price from the average level of 52.0 USD/barrel in December to 52.5 USD/barrel and 53.4 USD/barrel in the next two consecutive months. Nonetheless, the recovery of the USD in the first half of March accompanied by the addition of 14 oil rigs weakened the effect of reducing output of OPEC. WTI crude oil price was merely 49.6 USD/barrel, down 7.2% compared to the previous month. According to the latest announcement of the Energy Information Administration (EIA), there will be a slight excess of supply over demand of oil in 2017 and the balance will be reached until the end of 2018. The WTI crude oil price is forecast to approach 54.9 USD/barrel at the end of 2017, lower than the forecast in January.

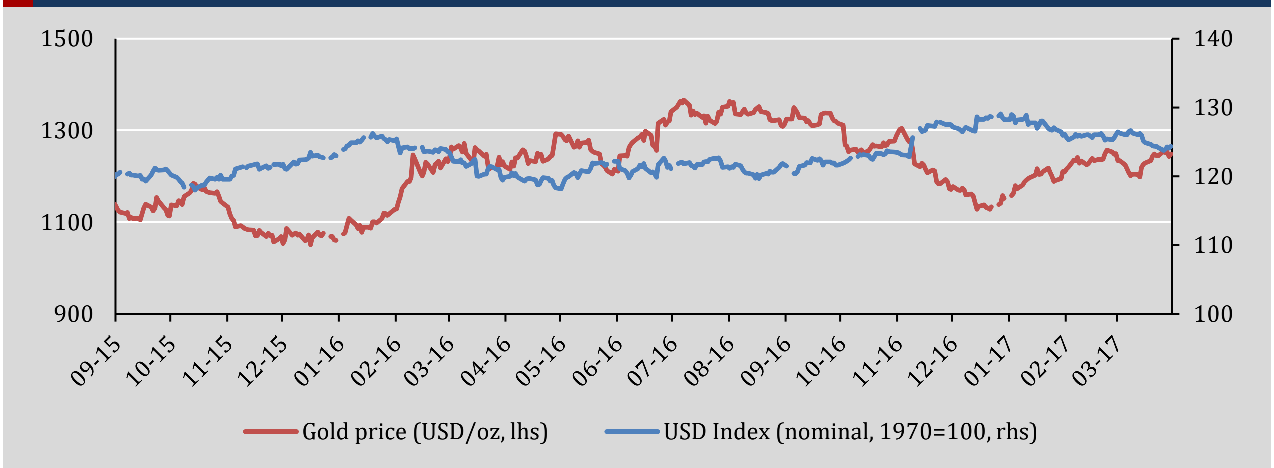
Meanwhile, the decision of China to lower its target growth rate in 2017 to 6.5% significantly affected the energy market. Not only crude oil but also Australia coal and some other energy items witnessed falling prices due to concerns about the

Commodity Prices



Source: The Pink Sheet (WB)

Gold Price and USD Index



Source: Fed, Fxpro

declining demand in the second largest economy. At the end of Q1, the energy price index calculated by the WB plunged to 65.3 points, down 3.1 points compared to the end of 2016.

Meanwhile, the average rice price stayed nearly the same compared to the previous quarter, at 338.5 USD/ton (for Vietnamese rice) and 370 USD/ton (for Thai rice). Price index of agricultural commodities calculated by the WB reached 89.3 points, down 0.1 point compared to the end of 2016.

In the property market, gold price followed an upward trend in Q1. For the whole quarter, the world gold price only plummeted after Fed decision on an interest rate hike in the March meeting. Nonetheless, the gold price quickly recovered and stayed approximately at 1,250 USD/oz, up 8.4% compared to the previous quarter.

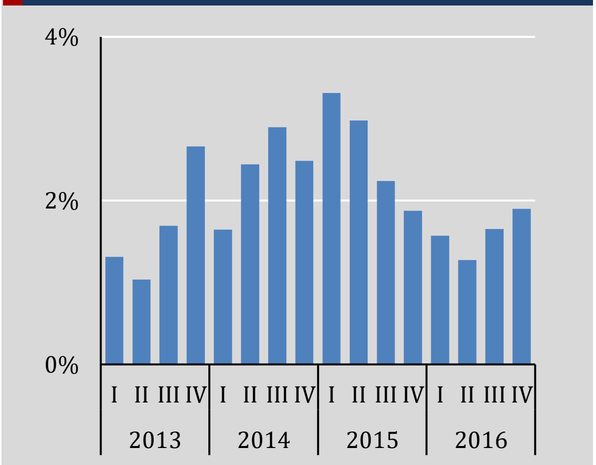
Meanwhile, the US dollar has continuously depreciated since Donald Trump was officially elected as the US president, which reflected investors' concern about Trump's policy proposals. At the same time, Fed's announcement of raising interest rate twice more this year, compared to the investors' expectation of a threefold increase, also caused chaos in the forex market, further devaluating the US dollar in the latter half of March. At the end of Q1, the nominal US dollar index calculated by Fed reached 124.35 points, down 3% compared to other currencies.

Steady recovery of the US economy

The US economy has witnessed a firm recovery for many recent quarters. According to the third estimation of the Bureau of Economic Analysis, the US GDP grew at 2.1% (qoq), up 0.2% compared to the previous estimation. Compared to the previous quarter (seasonally adjusted), growth rate in Q4/2016 was 1.9%, following an upward trend in the third consecutive quarter.

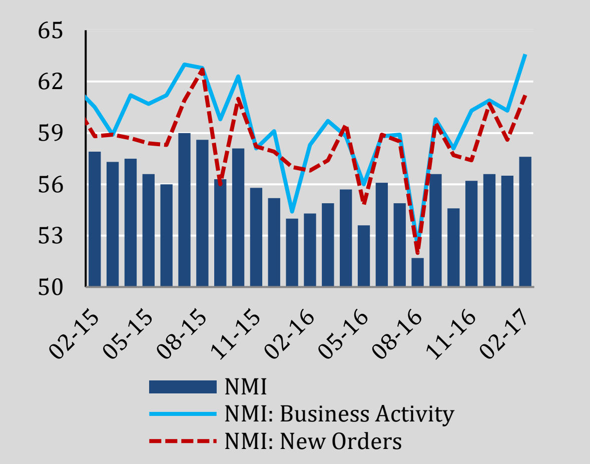
In terms of expenditure, a high growth rate mainly came from personal consumption expense, private investment, accommodation as well as government expenditure. Accordingly, personal consumption expenses (PCE) increased by 3.5% while investment in fixed assets of the private sector went up by 2.9% quarterly.

US Economic Growth (qoq)



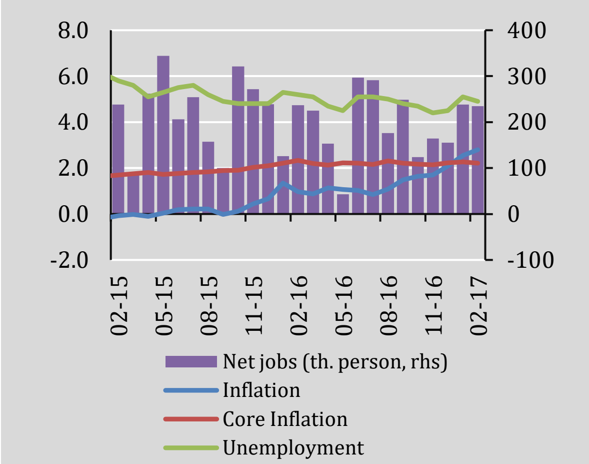
Source: CEIC

US Non Manufacturing Index



Source: CEIC

US Inflation and Unemployment (%, yoy)



Source: CEIC

Meanwhile, that trade deficit remained high incited President Donald Trump to sign two executive orders to seek a comprehensive review of the massive trade deficit as well as strictly enforce anti-dumping laws (export turnover decreased by 4.5% qoq while import turnover increased by 9% qoq). Especially, such executive orders were signed before the meeting with The President of the People's Republic of China Xi Jinping which raised concern over trade protection policies as well as the trade competition between the US and other major trade partners. Earlier, President Donald Trump signed an executive order to formally withdraw the U.S. from the Trans-Pacific Partnership (TPP) on his first day as the US President. It indicates Trump's attempt to pursue trade protectionism. Nonetheless, we need more time to evaluate Trump's policies during his presidential term.

In terms of industries, indices on services also indicated stability of this industry in Q1. The Non-Manufacturing Index in February recorded the highest level of 57.6 points since the end of 2015. Specifically, two component indices of Business activity index and New order index reached 63.6 points and 61.2 points respectively in March.

Quarter 1 also marked the next interest rate hike of Fed. Accordingly, the prime rate was adjusted to increase by 25 bps to reach 0.75% - 1%. Such decision was made after Fed believed that the labor market as well as business activities were continuously strengthened in Q1. The unemployment rate slightly rose in the first two months but still fluctuated around 5%. Meanwhile, in merely the first two months of the year, the net number of new jobs was 473 thousand, higher than Q4/2016 and up 30.3% compared to the same period of the previous year.

The second reason for Fed's decision to raise interest rate was that the headline inflation rate surpassed the target level of

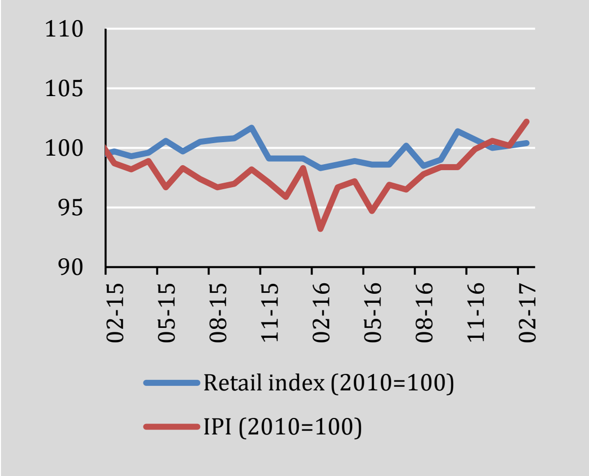
2% in February. It was the first time the headline inflation rate had reached 2.7% (yoy) since the end of 2011 while prime rate still stayed steadily at above 2%.

Japanese manufacturing continuously recovere

Japanese economy in the whole 2016 grew at 1.0%, of which growth rate in Q4 reached 1.6% (yoy). Such result clearly reflected the recovery trend of the manufacturing since the latter half of 2016. Following this trend, the industrial manufacturing index of Japan in February reached 9.7% (yoy), the highest level since early 2014. Meanwhile, non-manufacturing industries seemed to slow down in the first two months. Retail index was 100.2 and 100.4 respectively, slightly down compared to the average level of 100.7 in Q4/2016. Tankan, a leading indicator of the Bank of Japan also revealed a recovery in Q1, especially in manufacturing. Accordingly, this indicator has increased for two consecutive quarters to reach 12 points in Q1. Such result demonstrated optimism of enterprises in Japan in the business sphere in the coming time.

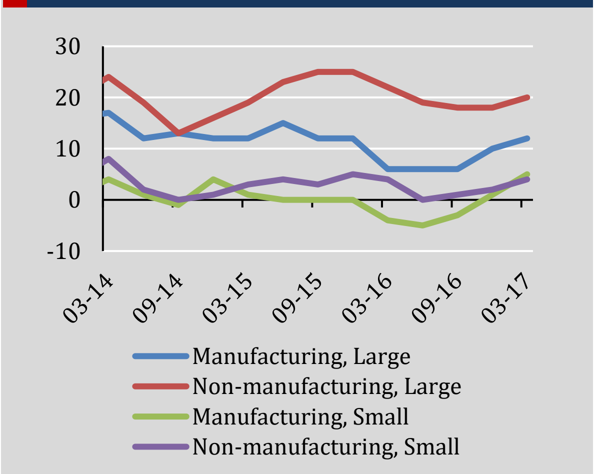
Meanwhile, although headline inflation rate still remained stable compared to the previous quarter, core inflation rate has fallen to lower than 0% for the first time since 2013. Consumer Price Index (CPI),

Japan Retail Sales and Industrial Production (seasonally adjusted)



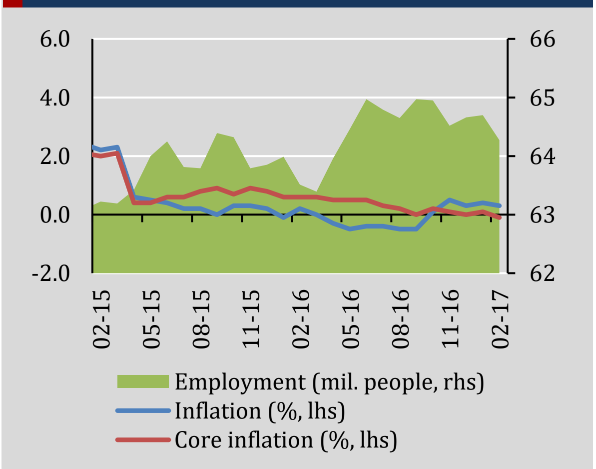
Source: Japan Macro Advisors

Tankan Index



Source: Japan Macro Advisors

Japan Inflation and Employment rate



Source: CEIC

excluding energy and food, in the first two months increased by 0.1% and -0.1% respectively (yoy). Moreover, employment rate slightly fell in Q1. The number of employed workers in February reached 64.3 million people, down 0.6% compared to the end of 2016.

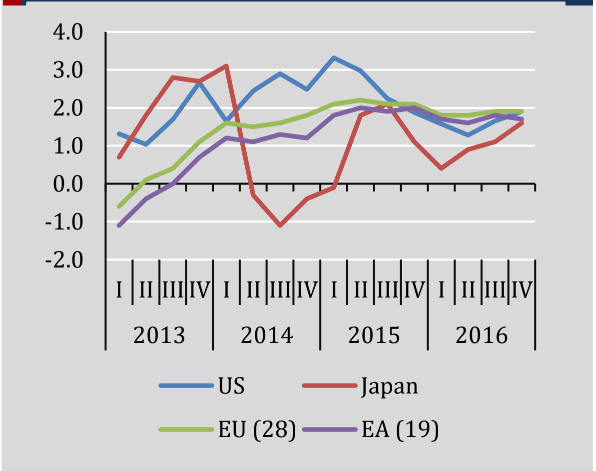
Improved growth rate in Europe despite uncertainties

The Europe economy has maintained a sustainable growth rate since the second half of 2016. GDP in the EU28 grew by 0.4% and 0.5% respectively in Q3 and Q4. Therefore, the general average growth rate of this region reached 1.9% in 2016. Moreover, indicators about price and jobs were slightly improved in Q1/2017. Nonetheless, the Europe is being confronted with many internal instabilities.

Headline inflation rate in the first two months rose remarkably to nearly reach the ECB's target level of 2%. However, such recovery in prices mainly resulted from groups of non-food and non-energy commodities while core inflation rate only climbed by 0.1 percentage point to 0.9% (yoy) in January and February. Meanwhile, unemployment rate continued to drop 0.1 percentage point per month, reaching 8.1% in January.

In the end of March, the Prime Minister of the UK officially sent a letter to the European Commission to launch the negotiation to leave the EU. Accordingly, the UK and EU will have two years to

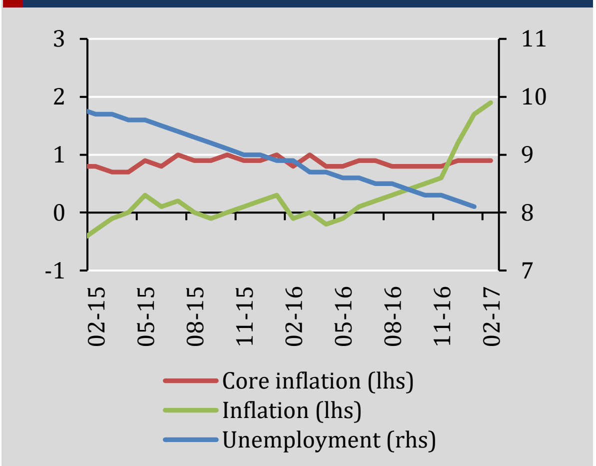
Economic Growth Rate in Selected Advanced Countries (%, yoy)



Source: CEIC, OECD

negotiate agreements after the UK officially leaves the EU. The agreements will include major issues, namely citizen rights of the EU residents in the UK and vice versa, financial commitment of the UK when this country was still a member country of the EU, border issues and international commitments signed by the UK as an EU member country. In order for Brexit to succeed, agreements between the two parties should be approved by the UK, the

Inflation and Unemployment in EU28, %



Source: CEIC

EU paliament as well as at least 20/27 EU member countries. In case none of these agreements were approved, a 'hard brexit' will happen.

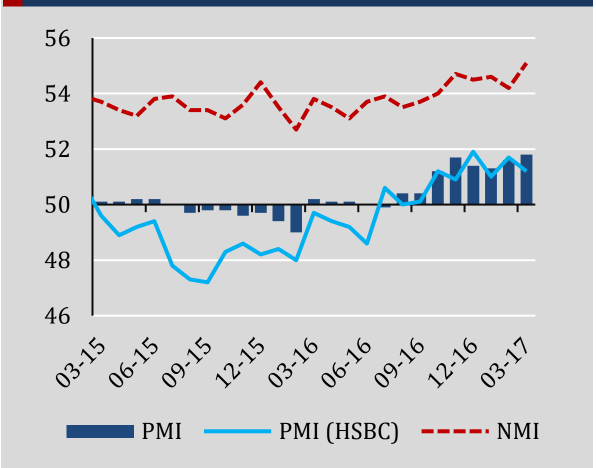
It is noteworthy that, in the coming time, some major members of the EU will conduct new Prime Minister elections. In France, Mrs. Marine Le Pen is a holder of extreme right-wing views advocating anti-immigration and anti-EU and recorded as the leading candidate in many recent surveys. Currently, about 25-27% votes are for Le Pen, which is the highest proportion of the five candidates up to now. The winning of Le Pen will come as a blow to the EU as well as the future of this union. In addition, the upcoming election in Germany in Q3 will partly shape the future of the EU when immigration policies of Mrs. Merkel are opposed by this country's people.

Cautious growth targets in China

Chinese economic growth rate in Q4/2016 was 6.8% (yoy), higher than researchers' expectation. In 2017, many indicators revealed a recovery of the second largest economy. Nonetheless, to maintain a proactive fiscal policy and a cautious monetary policy, Chinese policy-makers lowered its target growth rate again to 6.5% for 2017.

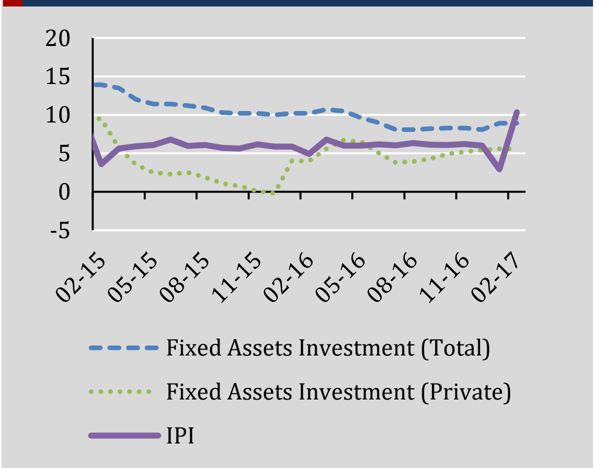
In Q1, Purchasing Managers' Index – PMI calculated by both the National Bureau of Statistics of China (NBS) and HSBC remained stable at above 50 points, which demonstrates an expansion in manufacturing. Specifically, PMI calculated by the National Bureau of Statistics of China (NBS) reached 51.6 points on average, higher than 51.4 points of Q4/2016. Meanwhile, Non-Manufacturing Index – NMI for non-manufacturing sector approached 54.6 – 54.2 – 55.1 points respectively in the first three months.

China PMI



Source: HSBC, NBSC

Fixed Capital Growth & IPI (%, yoy, ytd)

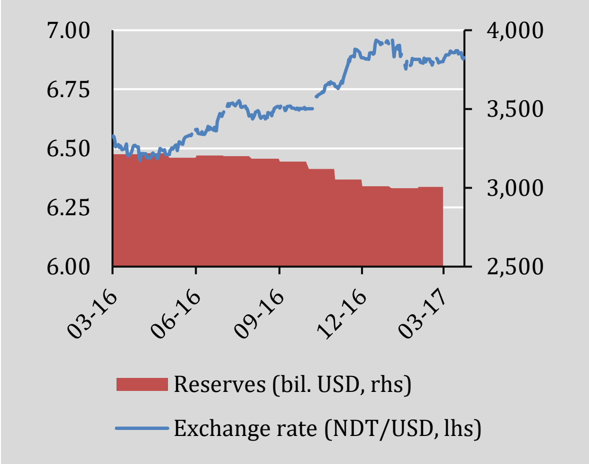


Source: CEIC

The recovery in the manufacturing sector can be seen clearly in the industrial production index (IPI) as well as the growth of fixed capital in the first two months. Accordingly, the IPI in February rose by 10.2% while fixed capital climbed by 5.6% compared to the same period of the previous year. Such increase has been recorded as the highest since mid-2016.

In the forex market, the CNY fluctuated strongly due to events in the US. After Fed's decision to raise interest rate at the end of 2016, the CNY continuously depreciated to approximately 7.0 CNY/USD. Nonetheless, as the USD got weaker against most other major currencies, the CNY stayed around 6.85 CNY/USD before slightly depreciating due to Fed's second interest rate hike after the end of 2016. For the whole Q1, the CNY appreciated by 0.85% compared to the end of 2016 with the margin of ±0.9%. Foreign currency reserves of China witnessed few fluctuations in Q1, staying at 3,000 billion USD and slightly down compared to December/2016.

China Exchange Rate and Reserves



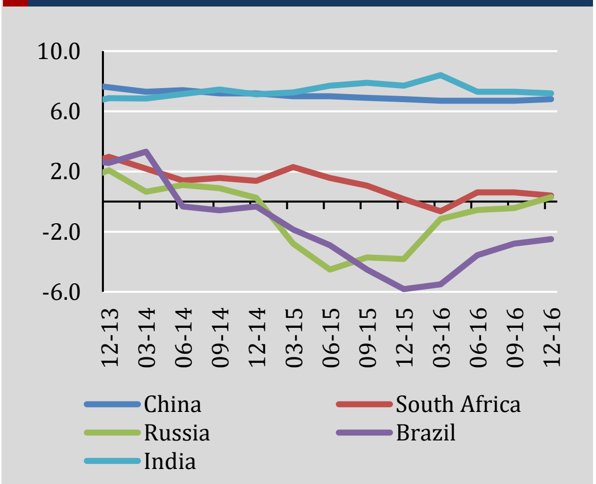
Source: FRED, CEIC

Further differentiation in BRICS

After two years of crisis, two BRICS members namely Russia and Brazil has started to recover since the end of 2016. Economic growth in these two countries has been improved significantly compared to the reduction of more than 4% in 2015. Especially, that crude oil price rose contributed to a positive growth rate of 0.4% of Russia (yoy) for the first time since 2014. In Brazil, since political instability ceased, economic growth rate was forecast to reach 0-0.5% in 2017 and 1.8% in 2018.

Meanwhile, in India, a slowdown was seen due to a temporary shrink in liquidity. India's surprising demonetization of high-value notes significantly affected domestic economic activities. Economic growth rate

Economic Growth in BRICS (%, yoy)



Source: OECD, CEIC

was 7.2% in Q4/2014 and 7.0% (yoy) for the whole year, lower than the previous forecast. Nonetheless, it is believed to be short-term impact, the government's movement of administrative procedure renovation as well as changes in taxation will boost the economy in the coming time.

Positive prospect in ASEAN

ASEAN ended 2016 with a growth rate of 4.6%, up 0.1 percentage point compared to the previous year. In 2017, with more favorable conditions, ASEAN is believed to improve its growth rate. Some international institutions such as ADB, IMF or WB all forecast that ASEAN or ASEAN5 growth rate will be increased by 0.1-0.3 percentage point in the next two years.

Mild weather in Q1 create favorable condition for the agricultural sector to recover considerably compared to 2016. Meanwhile, industry and exports bounced back thanks to the world commodity price.

Nevertheless, inflation may return in ASEAN. According to ADB forecast, average inflation rate of ASEAN will climb from 2.1% in 2016 to 3.3% in 2017.

World Economic Outlook (%)

	WEO (1/2017)			GEP (1/2017)		
	2016e	*2017p*	*2018p*	*2016e*	*2017p*	*2018p*
World	**3.1**	**3.4 (0.0)**	**3.6 (0.0)**	**2.3**	**2.7 (-0.1)**	**2.9 (-0.1)**
Advanced Economies	**1.6**	**1.9 (+0.1)**	**2.0 (+0.2)**	**1.6**	**1.8 (-0.1)**	**1.8 (-0.1)**
United States	1.6	2.3 (+0.1)	2.5 (+0.4)	1.6	2.2 (0.0)	2.1 (0.0)
Japan	0.9	0.8 (+0.2)	0.5 (0.0)	1.0	0.9 (+0.4)	0.8 (+0.1)
United Kingdom	2.0	1.5 (+0.4)	1.4 (-0.3)			
Euro Area	1.7	1.6 (+0.1)	1.6 (0.0)	1.6	1.5 (-0.1)	1.4 (-0.1)
Emerging Market and Developing Economies	**4.1**	**4.5 (-0.1)**	**4.8 (0.0)**	**3.4**	**4.2 (-0.1)**	**4.6 (0.0)**
Brazil	-3.5	-0.2 (-0.3)	1.5 (0.0)	-3.4	0.5 (0.7)	1.8 (+1.0)
Russia	-0.6	1.1 (0.0)	1.2 (0.0)	-0.6	1.5 (0.1)	1.7 (-0.1)
India	6.6	7.2 (-0.4)	7.7 (0.0)	7.0	7.6 (-0.1)	7.8 (+0.1)
China	6.7	6.5 (+0.3)	6.0 (0.0)	6.7	6.5 (0.0)	6.3 (0.0)
ASEAN-5	**4.8**	**4.9 (-0.2)**	**5.2 (0.0)**			
Indonesia	4.9	5.3 (0.0)	5.5 (0.0)	5.1	5.3 (0.0)	5.5 (0.0)
Malaysia	4.3	4.6 (0.0)	4.7 (0.0)	4.2	4.3 (-0.2)	4.5 (-0.2)
Philippines	6.4	6.7 (0.0)	6.8 (0.0)	6.8	6.9 (+0.7)	7.0 (+0.8)
Thailand	3.2	3.3 (0.0)	3.1 (0.0)	3.1	3.2 (+0.5)	3.3 (+0.3)
Viet Nam	6.1	6.2 (0.0)	6.2 (0.0)	6.0	6.3 (0.0)	6.3 (0.0)

Note: The differences from the latest forecast are shown in parentheses

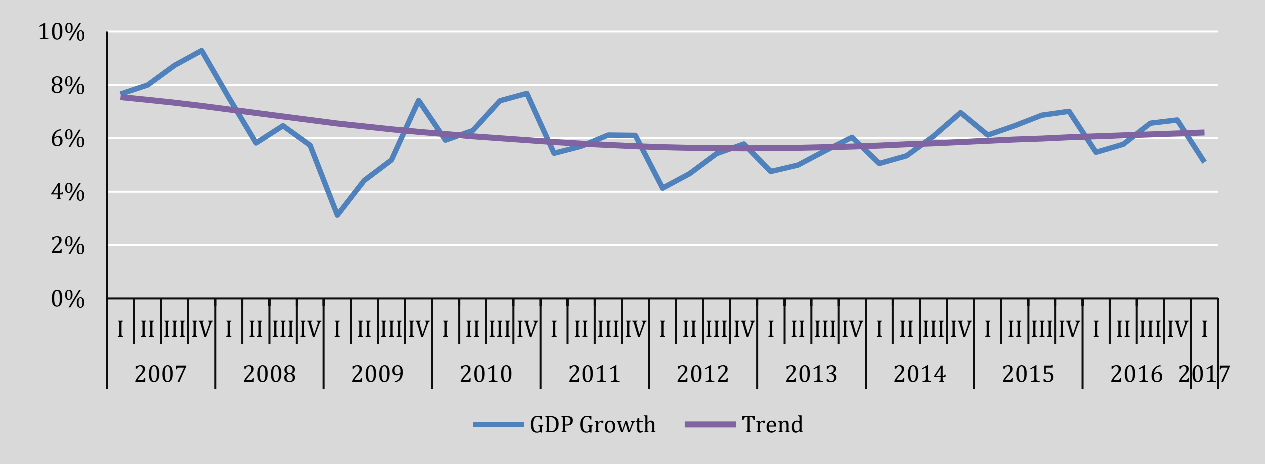
Source: World Economic Outlook (IMF), Global Economic Prospects (WB)

VIETNAMESE ECONOMY

Growth – Inflation

Decline in industrial growth

Viet Nam Economic Growth (%, yoy)



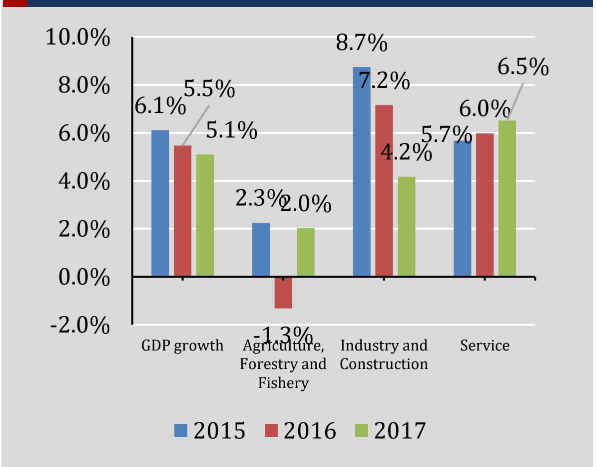
Source: Calculated from GSO data

After two quarters of recovery, Vietnamese economy grew at merely 5.1% (yoy) in Q1, the lowest rate since the last three years (Q1/2015: 6.12%; Q1/2016: 5.48%).

Notably, decline in Q1 mainly came from the industry. Of which, manufacturing grew 8.30% (lower than the 2015 and 2016 level of 9.70% and 8.94%, respectively). The mining sector plummeted, reducing 0.76 percentage point of general growth rate in Q1. The industry increased by only 3.85% over the same period last year, the lowest level since 2011. Construction rose 6.10%, contributing 0.30 percentage point to the general growth.

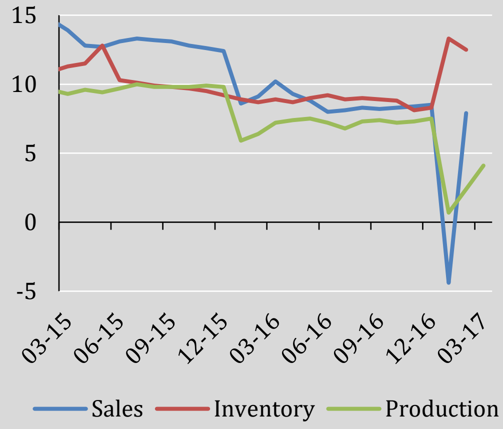
The agriculture, forestry, and fishery showed positive changes after a year of reduction. This sector rose 2.03% (yoy), roughly equal to the growth rate of the previous years. Of which, the agricultural sector showed positive signs with an increase of 1.38% over the same period last year (Q1/2016: -2.69%), forestry sector increased 4.94%, and the fishery sector increased by 3.50%.

Economic Growth in Q1 by sector



Source: GSO

Selected Industrial Indicators (ytd, %)



Source: GSO

Service remained stable and grew at 6.52% (yoy), higher than the same period of two previous years.

Industrial indicators also revealed a dull picture of the industry in Q1. Manufacturing and consumption indices plummeted while inventory expanded strongly in the first two months. IPI in the first three months rose by 0.7% - 2.4% - 4.1% (yoy, ytd) respectively, being the lowest rates recently. Specifically, IPI of the manufacturing sector in Q1 only increased by 8.3% (yoy) compared to the rate of 9.4% of the same period in 2016.

Sale index even decreased by 4.4% in January before recovering to 7.9% (yoy, ytd) in February. Meanwhile, inventory index reached 13.3% and 12.5% (yoy) in the first two months. It reflects the effects of Tet holiday, while industrial manufacture and sale strongly shrank.

The VEPI (Viet Nam Economic Performance Index) was calculated by VEPR, based on

Index of Economic Freedom and Vietnamese Economy

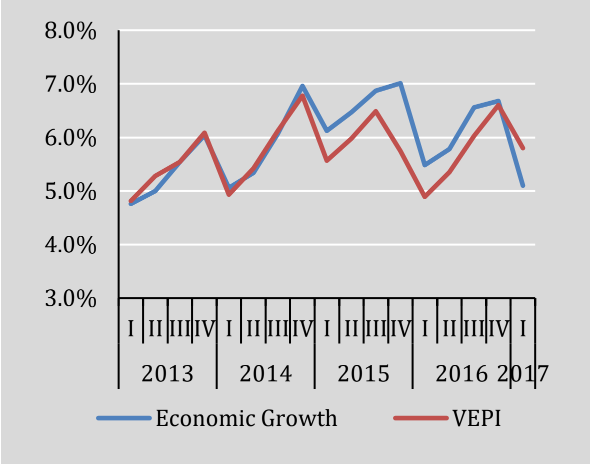
Index of Economic Freedom, IEF, created by The Heritage Foundation aims at measuring economic freedom policy in a country in four aspects: (i) Rule of law; (ii) Government size; (iii) Regulatory efficiency; and (iv) Open markets.

The Heritage Foundation's report shows that Viet Nam is on the list of countries with low economic freedom, ranked 148-131-147 respectively in the three years from 2015 to 2017. Nonetheless, Viet Nam is still considered as one of the countries with highest growth in index of economic freedom. Especially, the index of property rights of Viet Nam showed remarkable rise from 15 points to 49.7 points in 2017. Two components of *Regulatory efficiency* (Business Freedom, Labor Freedom and Monetary Freedom) and *Government size* (Government Spending, Tax Burden and Fiscal health) have increased remarkably in recent years to reach the average level compared to other countries. In terms of *Open Markets*, Viet Nam has continuously opened commercially, been deeply integrated into the global market recently. Nevertheless, the capital and financial markets have not followed this trend. In 2017, Trade Freedom of Viet Nam reached 83.1 points while Investment Freedom and Financial Freedom were 25 and 40 points respectively.

It should be noticed that the moving down in ranking of Viet Nam in 2017 is due to the fact that the Heritage Foundation added two new components of *Judicial effectiveness* and *Fiscal Health*. Meanwhile, these components only reached 32 and 21.1 points respectively. Therefore, IEF of Viet Nam dropped from 54 points in 2016 to 52.4 points in 2017 (57.6 points if these two components are excluded).

data on production of commercial electricity, exports and imports, railway transport volume, credit growth and PMI manufacturing. VEPI also revealed a decline in economic growth. Nonetheless, VEPI still reached 5.8%, higher than the same period of the previous year. Imports surged while credit growth has remained high since Q4/2016, which brings positive results of VEPI.

Viet Nam Economic Performance Index



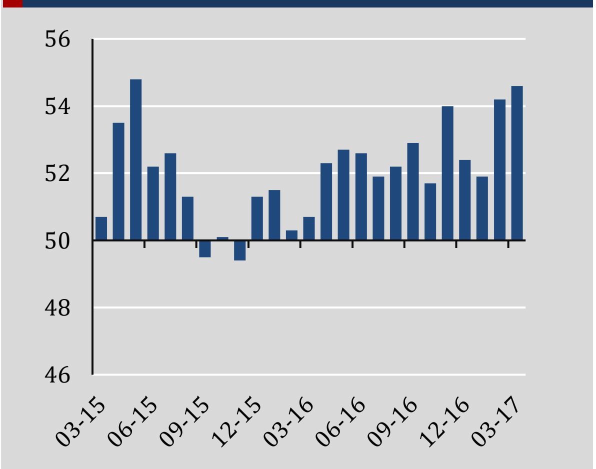
Source: VEPR

Seasonality in enterprises' activities

Despite a decline in growth, Purchasing Managers' Index (PMI) of the manufacturing sector remained optimistic. After slipping to 51.9 points in January, PMI Viet Nam quickly recovered to reach more than 54 points in the next two months, which was the highest increase since May 2015.

Nevertheless, it should be noticed that PMI of Viet Nam is calculated based on the surveyed data of 400 manufacturing

Viet Nam PMI



Source: HSBC, Nikkei

enterprises. Therefore, such acceleration in PMI only demonstrates optimism about the business environment of only manufacturing enterprises, not all enterprises in the economy.

Meanwhile, the survey on the business trend of manufacturing enterprises conducted by the GSO revealed a clearly downward trend. Of all surveyed enterprises, only 33.7% considered the production and business situation in Q1 to be better than the previous one, higher than the same figure of Q1/2016 (29.2%) yet far lower than the previous quarter (41.2%). Meanwhile, about 24.5% acknowledged a more difficult business situation. Of all component indices, Production level, New orders and Inventories witnessed the most significant decline.

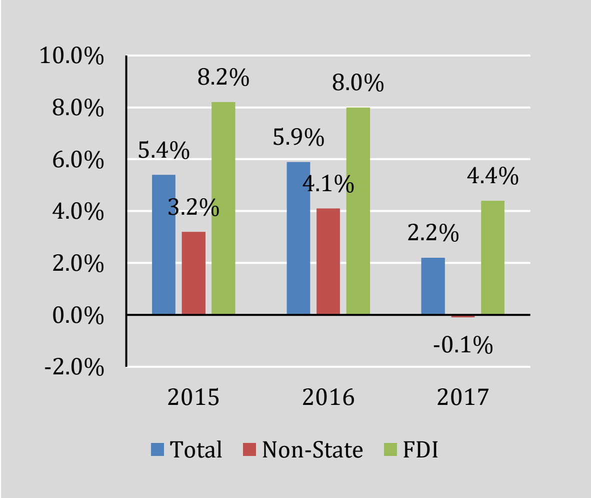
Along with the declining trend in industry, employment situation also got worse in Q1. Labor growth rate on 1st March 2017 was 2.2%, the lowest rate in many recent years. Of which, employees in the mining sector slipped by 4.8% (yoy) while the figure for manufacturing increased by merely 2.7% (yoy). Decrease in labor growth rate was seen in all three sectors in Q1. Notably, the non-state sector even decreased by 0.1% compared to the same period last year.

Despite many difficulties, business registration remained relatively stable in Q1. There were 26,478 newly established enterprises nationwide, up 11.4% compared to the same period in 2016. Of which, the highest growth rate of newly registered enterprises were seen in real estate (55%), education and training (28%), and finance, banking and insurance (26.3%). Not only the number of enterprises but also the amount of newly registered capital of these three areas witnessed remarkable growth rates, at 31.1%, 79.7% and 50.1%, respectively.

In the manufacturing sector, while newly registered enterprises increased by a lower rate than the same period of previous years (11.4%), newly registered capital in this sector showed remarkable increase, at 75.6% compared to the same period of the previous year, much higher than the national average level.

The number of enterprises that temporarily ceased operations slightly increased while both registered capital and new employees increased notably compared to the same period last year. The number of enterprises that temporarily ceased operations rose by 3% (yoy) to reach 20,636. New employees were 291.6 thousand, which was lower than the previous quarter yet 17.7% higher compared to Q1/2016.

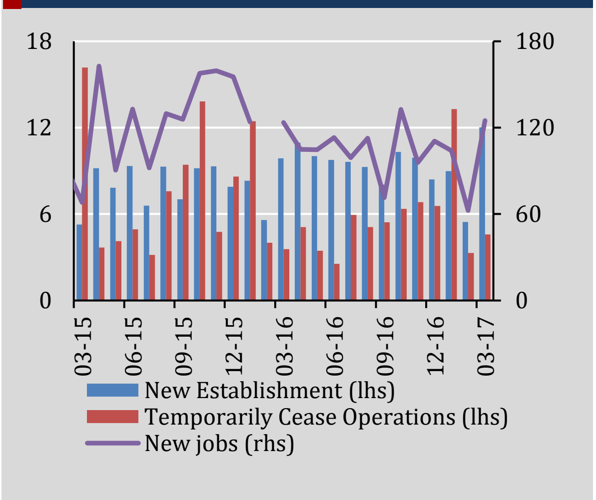
Labor Growth in Industry Sector Q1



Source: GSO

In such circumstance, the government continued to issue Resolution No. 19-2017/NQ-CP on improving business environment and enhancing the national competitiveness. Different from previous years, Resolution No. 19-2017 adds more targets based on four groups of

Operation of Enterprise (th. unit, th. people)



Source: MoIT, CEIC

international indices: (i) WB's Business environment; (ii) the World Economic Forum's Global competitiveness; (iii) the World Intellectual Property Organization's Innovation capacities of; and (iv) the United Nations's E-government. Moreover, Resolution No. 19-2017 also raises the business environment target to the average level of ASEAN4. With nearly 250 specific targets, 260 organizing tasks and 181 collaborating tasks, we believe that Resolution No. 19 proposes highly ambitious targets. Hence, from our perspective, the government should be highly determined as well as closely supervise ministries, departments and provinces in implementing the Resolution to assure favorable conditions for enterprises.

A slowdown in inflation rate

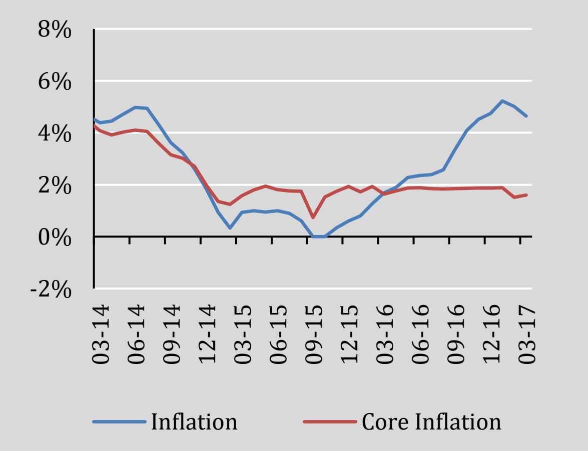
After two periods of continuous increasing, there are signs of cooling down in inflation rate in Q1/2017. Specifically, consumer price index after going up to 5.22% (yoy) at the end of January slipped to 4.65% (yoy) and 1.6% (yoy) in February and March respectively. It clearly reflects the slowdown in consumption in Q1. Prices of *Beverage and tobacco* and *Garment, hats and footwear* even decreased slightly compared to previous months. Food and foodstuff price index plummeted even in the Tet holiday. It could result from the considerable reduction in demand for pork in the Chinese market.

Meanwhile, that the gap between inflation rate and core inflation rate still remained high showed that prices of goods managed by the state still surged. Health service prices were adjusted in 13 municipalities and provinces in March, increasing by 48.7% compared to the same period of the previous year and contributing 0.38 percentage point to the increase of CPI.

Education service prices at the end of March rose by 11.8% (yoy) due to the two adjustments in six provinces in January and in Thanh Hoa province in March, according to Decree No. 86/2015/ND-CP on 02/10/2015 of the government.

Energy price continued its recovering trend, posing pressure on the price adjustment of this type of goods. Price index of transportation group accelerated after the price adjustment of oil and petrol

Inflation and Core Inflation (%, yoy)



Source: GSO, IFS

in Q1. By the end of March, CPI of the transportation group grew by 14.6% compared to the same period of the previous year, only lower than the increase of health service prices.

Since the implementation of Joint Circulation No. 37/2015/TTLT-BYT-BTC, 63 provinces and municipalities have finished Step 1 (adjusting prices including direct costs and special allowances) and about 36 out of 63 provinces and municipalities have fulfilled Step 2 (including salary cost). The remaining adjustments will be done this year.

Therefore, despite signs of cooling down in Q1, we believe that there is still a lot of pressure on domestic inflation, especially when the economic growth rate is much lower than the target set by the National Assembly. Inflation rate in the coming months seem to be unable to get below 4% when consumption demand bounces back, the world commodity price continues to recover and prices of public services still need to be adjusted as planned. Hence, we believe that the administrators should closely observe the variation of price in the coming months.

Macroeconomic balances

Imports surged, rebounding trade deficit

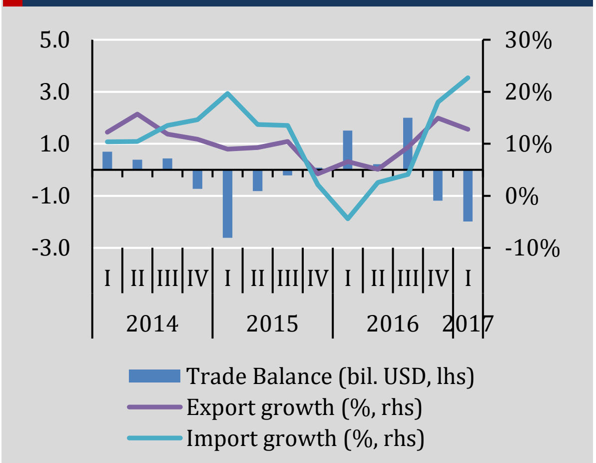
Following the trend at the end of 2016, trade in Q1 recovered steadily. Exports growth rate nearly reached the average growth rate of the period 2012-2014 while surging imports caused trade deficit in Q1.

Export turnover in Q1 was estimated at 43.7 billion USD, 12.8% higher than Q1/2015. Nonetheless, when the price factor was excluded, exports grew by 6.7% (yoy), much lower than the same period of previous years (2015: 10.9%; 2016: 9.3%).

Imports in Q1 grew quickly at 22.7% (yoy), the highest rate since 2012, to reach 45.7 billion USD. Different from exports, imports grew in both quantity and value. Accordingly, imports excluding price factor in Q1 grew at 19.9% (yoy), higher than the rate in 2016 (4.4%) and roughly equal to the rate in 2015 (19.4%).

Therefore, it can be concluded that the recovery in exports of Viet Nam is mainly based on the price factor, not on the value.

Trade Balance and Growth



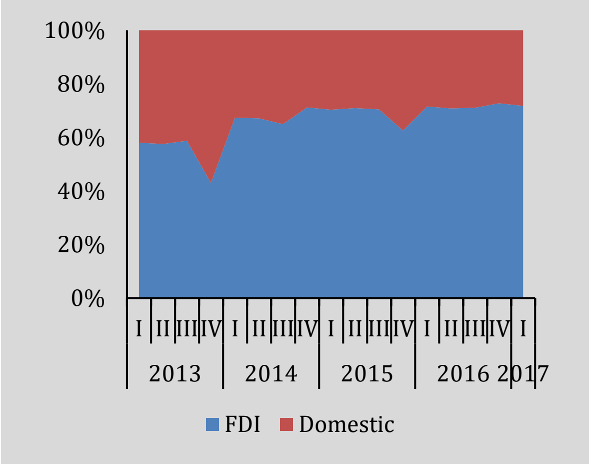
Source: CEIC, GSO

Meanwhile, import demand surged, causing trade deficit. For the whole quarter, trade deficit was 2 billion USD, surpassing the level of 1.2 billion USD in the previous quarter.

By types of goods, excluding the group of phones of all kinds and electronic components (7.4 billion USD, down 10.7% yoy), exports of almost all major items rose remarkably over the same period in 2016. Of which, export turnover of textile was 5.6 billion USD (increased 10.2%), exports of electronics, computers and components was 5.3 billion USD (increased 42.3%), that of footwear was 3.1 billion USD (increased 10.5%) and that of agricultural products reached approximately 4.8 billion USD (increased 11.8%). In conclusion, the reduction in export growth mostly came from the group of phones of all kinds and electronic components.

Meanwhile, imports surged in almost all types of items. Import turnover of machinery, equipment and spare parts reached 7.6 billion USD (up 28.3%, yoy), of phones of all kinds and electronic components was 2.9 billion USD (increased 20.7% yoy) and that of plasticizer was 1.7 billion USD (increased 33.2%, yoy). Imports of the group of materials were 42 billion USD, accounting for 92% of the total import turnover and being 22.7% higher than the same period in 2016.

Trade Structure by Sectors



Source: Calculated from GSO data

By partners, the US and EU still remained the two largest importers of Viet Nam, with 8.7 and 7.9 billion USD respectively. Nonetheless, export turnover to China and the ASEAN accelerated, which were the main driving forces for export growth in Q1. Export turnover of the two markets was 6.0 and 4.9 billion USD, increased 43.3% and 21.8% respectively compared to the same period of the previous year.

By import markets, Korea continuously replaced China with import turnover from Korea reaching 9.3 billion USD, accounting for 20.3% of the total import turnover (increased 2.3 percentage points). In the meantime, import turnover from China reached 11.9 billion USD, accounting for 26% of the total import turnover (decreased 2.0 percentage points).

Shift in structure of revenue plan due to pressures from the new context

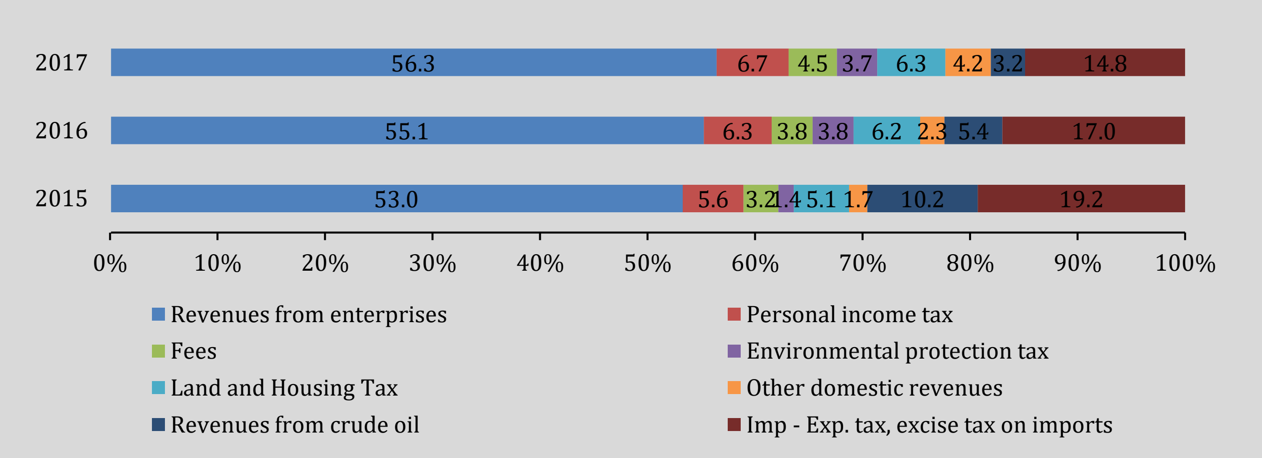
Since the end of 2014, the world crude oil price has plunged while there have been many difficulties in the import activity; as a result, it is necessary that the government adjust its plan of budget revenue. Accordingly, the estimated ratio of domestic revenue has risen quickly for the past two years. The estimated ratio increased from 70.1% in 2015 to 77.4% and 81.7% respectively in 2016 and 2017. Of which, some minor items of revenue increased considerably including revenues from charges and fees (mainly registration fees, increasing from 1.7% to 2.2%), environment tax (increasing from 1.4% to 3.7%), revenues from houses and land (mainly from land use fee, increasing from 4.3% to 5.3%).

Meanwhile, estimated revenues from crude oil and exports and imports showed a clear downward trend. Estimated revenues from crude oil in 2017 was 38.3 trillion dong, accounting for 3.2% of the total revenues and lower than the level of 10.2% in 2015 and 5.4% in 2016. Estimated revenues from imports and exports was unchanged in terms of absolute value, at 175 – 180 trillion dong, yet decreased remarkably in terms of proportion in the total estimated revenues.

The total revenues in Q1 was estimated at 280.9 trillion dong, equal to about 23.2% of the estimated value. Of which, some revenue sources with high proportions were revenues from land use fee (22.6 trillion dong, about 25.5% of the estimated value), personal income tax (24.6 trillion dong, about 30.3% of the estimated value), crude oil (11.1 trillion dong, about 28.9% of the estimation).

Notably, revenues from lottery was considered as a revenue source of the state budget according to Law on State Budget

Structure of State Budget Revenue planned by year (%)



Source: Calculated from State Budge Plan, MoF

2015. In Q1, revenues from lottery was estimated at 10.0 trillion dong, equal to 41.5% of the estimation for the whole year.

The total expenditure in Q1 was estimated at 284.96 trillion dong, equal to 16.5% of the estimation. Of which, current expenditures was 211.2 trillion dong, equal to 23.6% of the estimation and accounting for 74.1% of the total expenditure. Investment and development expenditures was considered low with the absolute value of 44.2 trillion dong, equal to 12.4% of the estimation. One reason is the slow allocation of public investment. We believe that it is also the main reason for the low growth of social investment in Q1.

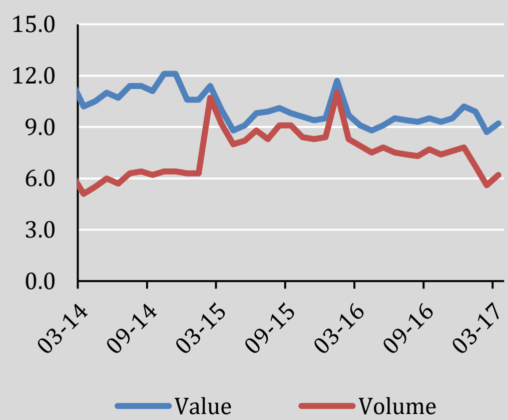
Consumption decreased, investment somewhat improved

In contrast to previous years, consumption in Q1 declined even in the Tet holiday. The total retail sales of consumer goods and services in the first quarter of 2017 were estimated at 921.1 trillion dong, 9.2% higher than the same period last year. Excluding the price factor, the growth rate of retail sales was a mere of 6.2%, lower than the same period of previous years (2015: 9.2%, 2016: 7.9%). Of which, some goods with high growth rates were food (10.4%); accommodation and food services (12.4%).

In the meantime, total social investment only slightly recovered compared to the end of 2016. Total investment was 297.8 trillion dong, equal to 108.8% compared to the same period in 2016 (lower than the level of 109.7% in 2015 and 110.7% in 2016). Of which, this improvement mainly came from the private sector with capital of 117.4 trillion dong, equal to 116.8% compared to the same period in 2016 (Q1/2016: 111.5%; Q4/2016: 104.1%).

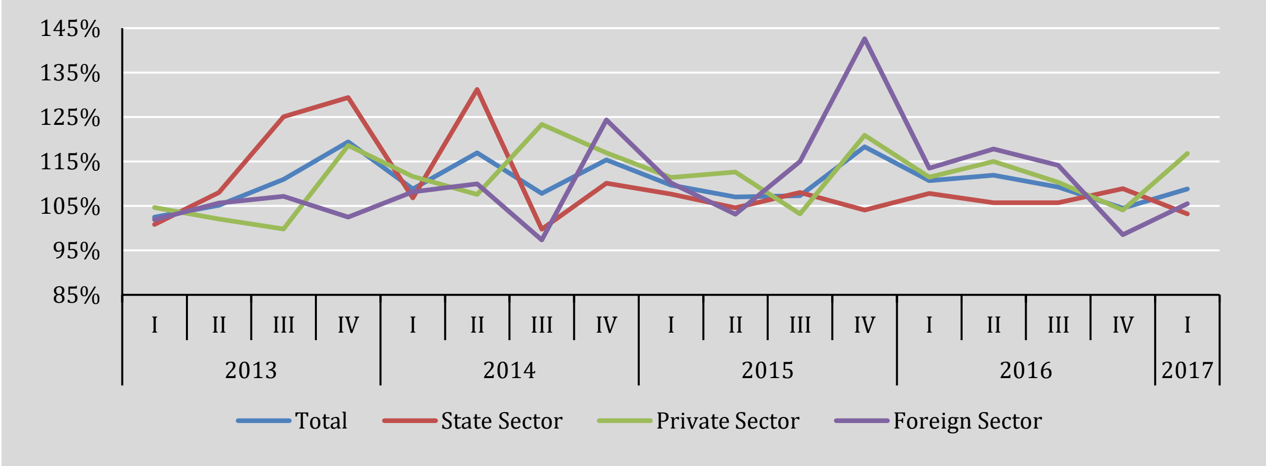
In contrast, both the public and foreign sector witnessed reduction in investment. Investment of the public sector only increased by 3.2% in terms of nominal value over Q1/2015, after a surge in 2016. Meanwhile, that of the FDI sector only increased by 5.5% yoy to reach 80.5 trillion dong, while the figures for 2015 and 2016 were 17%/quarter and 11%/quarter. It also reflected the slight reduction of FDI inflow into Viet Nam in 2016.

Retail Growth (%, yoy, ytd)



Source: GSO

Viet Nam's Investment by Sector (Compared to Corresponding Period of the Previous Year)



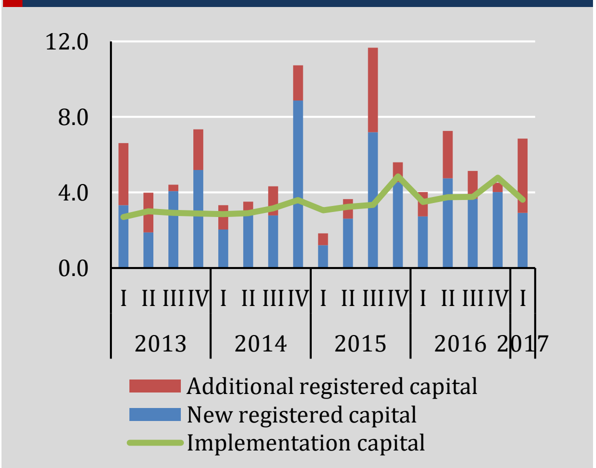
Source: Calculated from GSO data

Besides, the disbursement rate for FDI also slowed down in Q1, with realized FDI reaching 3.62 billion USD and increasing by only 3.4% compared to the same period of previous years (much lower than the average quarterly level of 10% in 2015). Newly registered capital has followed the downward trend since the early 2016. In Q1, there were 493 new registered projects with the total registered capital of 2.92 billion USD. It somehow reflected the impacts of the US withdrawal from TPP while other new-generation FTAs witnessed no new progress.

Nevertheless, the surged additional registered capital helped the total registered FDI in Q1 reach 7.7 billion USD, equal to 177% compared to the same period in 2015. Of which, investment in manufacturing made up the majority of the total with 84.9%, equal to 6.55 billion USD (Q1/2015: 72.2%; 2015: 64.6%). Real estate was ranked second with 13 newly registered projects and five additional registered projects. Registered FDI in this area was merely 0.34 billion USD and accounted for 4.5% of the total registered capital in Q1.

By partners, Korea remained its first position among foreign investors in Viet Nam. In Q1, Samsung Display Viet Nam project added 2.5 billion USD in Bac Ninh province, increasing the total registered capital of Korea to 3.7 billion USD, equal to 48.6% of the total capital. This is also the

FDI (bil. USD)



Source: MPI

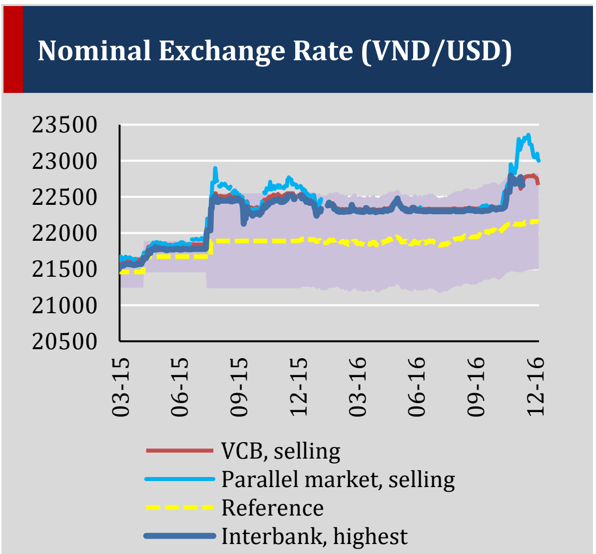
main reason for the surge in additionally registered FDI in Q1. Notably, China surpassed other investors such as Japan, Taiwan and Hong Kong to rank third in Viet Nam in Q1. Accordingly, there were 66 new and additional registered projects of China into Viet Nam, with the total registered capital being 0.82 billion USD. To sum up, in the first three months, the amount of FDI from China has been roughly half of the total registered capital of this country in the whole year 2016 (1.88 billion USD).

The financial and monetary markets

The forex market became steady again

In Q1, the exchange rate followed fluctuations in the world market. Both average interbank exchange rate and the spot exchange rate in commercial banks fluctuated in the first two months before becoming stable in the latter half of March.

Accordingly, the exchange rate was strongly affected by important events in the US, namely the official inauguration of President Donald Trump and Fed's interest rate hike. The trading band of the average interbank exchange rate and the spot exchange rate of Vietcombank was ±0.6%.



Source: VEPR

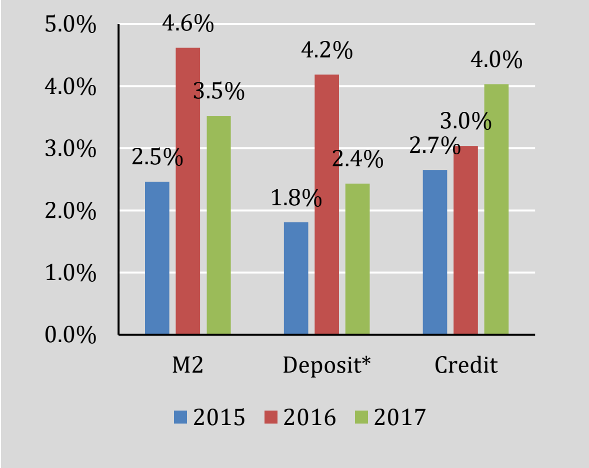
Meanwhile, the application of new exchange rate regime of the SBV, which bases on a basket of eight reference currencies, made central exchange rate no longer highly depend on the fluctuation of the US dollar, resulting in contrast trends between the central exchange rate and the market exchange rate. In Q1, the reference rate has followed an upward trend since 2016 but the trading band was merely ±0.3%. At the end of Q1, the central exchange rate announced by the SBV was 22,154 VND/USD, 0.53% higher than the end of Q4/2016.

We believe that the SBV can actively controls the forex market to fulfil the target of stabilizing exchange rate in the second half of March. All the average interbank exchange rate, the sell exchange rate of Vietcombank, and the free-market exchange rate fluctuated around 22,770-22,790 VND/USD, lower than the celling rate.

Monetary policy and interest rate

In Q1, the SBV continued a cautious monetary policy. According to the SBV's Report, total liquidity in the first three months increased by 3.52% compared to the end of 2016 while slightly decrease compared to the same period in 2016. It somewhat resulted in a slight reduction in the core inflation rate in Q1 compared to 2016. Meanwhile, credit in Q1 recorded the highest growth rate at 4.0% compared to the end of 2016, which reflects an increase in the capital absorption capacity of enterprises.

Growth of M2, Deposit, and Credit Q1, 2015-2017



**: data updated as of 20/3/2017*

Source: SBV, CEIC, GSO

Nevertheless, deposit grew at a lower rate, creating a gap between deposit and credit. By the end of 20/3/2017, credit growth rate was 2.43% (the same period in 2016: 2.26%; Q1/2016: 4.2%). It may be the reason for the disorder in the interbank market. Interbank interest rate rose again to reach the average level of the first half of the year, varying around 2-5%.

Interbank Offered Rate (%)

Source: CEIC

Deposit interest rate in Q1 slightly fluctuated, mainly in medium- and long-term deposit in small commercial banks. Accordingly to Circulation No. 06/2016/TT-NHNN, the maximum rate of using short-term capital for medium- and long-term lending has been lowered to 50% since the early 2017. It put pressure on the restructuring of deposit sources, especially for small commercial banks.

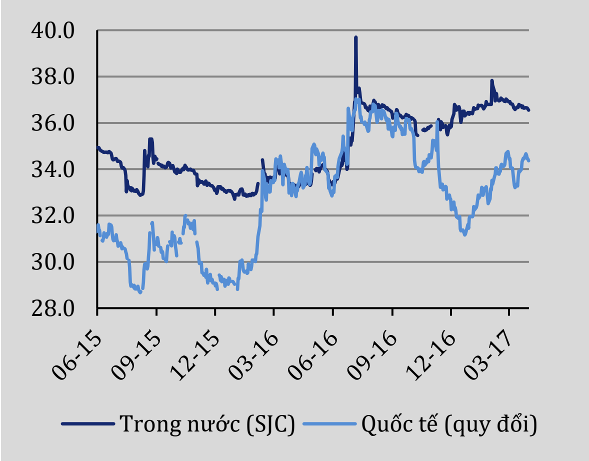
However, such phenomenon only happened in small commercial banks, with medium- and long-term deposit. Meanwhile, short-term deposit sources remained steady in Q1. Deposit interest rate with term of less than six months regularly stayed around 4.8-5.4%.

The assest market

Weak connection between the international and domestic gold price

While the world gold price continuously increased in Q1, the domestic one remained steady and became unaffected by the world events. It only surged in the early February, after the Tet holiday when demand for gold climbed. In the entire Q1, the gold price fluctuated around 36.4-37.8 million dong/tael, equal to the trading band of ±2.0% (lower than the world trading band of ±4.4%). By the end of March, the domestic gold price reached 36.5 million dong/tael, increased 0.25% compared to the end of 2016. Meanwhile, the world gold price was about 34.4 million dong/tael,

Gold Price (mil. VND/tael)



Source: SJC, Fxpro

increased 7.5%. Such contrast movement narrowed the gap between the world and domestic market to 2.1 million dong/tael, compared to the level of 5 million dong/tael in Q4/2016.

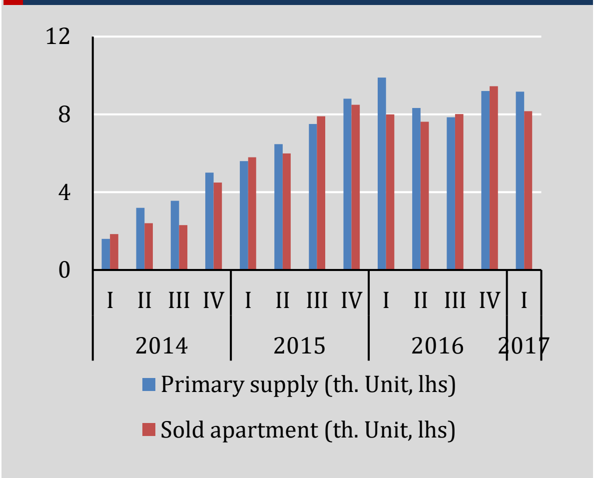
The real estate market: an acceleration in mid-end and high-end segments

The real estate market in Q1 was relatively quiet in both Hanoi and Ho Chi Minh markets. The number of new launches and successful transactions declined compared to both the previous quarter and the same period in 2016. Nonetheless, the number of transactions in the mid-end and high-end segments was on the rise.

In the Hanoi market, the total supply of new launches in Q1 was 9,174, decreased 0.3% qoq and 7.3% yoy, according to JLL Viet Nam report. Accordingly, the number of successful transactions in Hanoi was 8,172, increased 2.2% yoy yet decreased 13.5% qoq. In Ho Chi Minh market, the total supply of new launches and the number of successful transactions were 8,565 units (decreased 3.5% qoq and 11.9% yoy) and 8,140 units (decreased 10.5% qoq and 9.6% yoy).

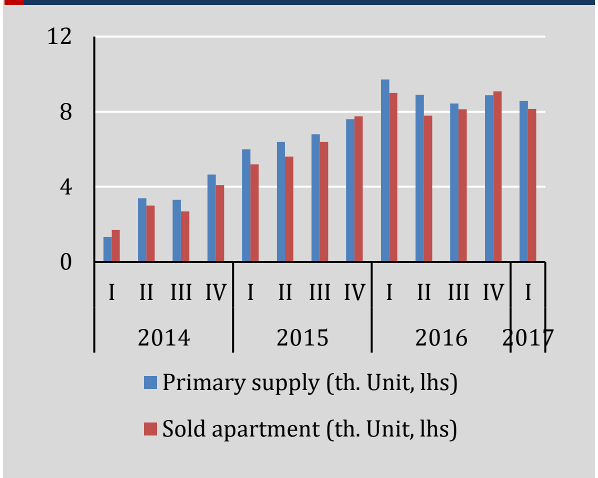
However, the proportion of mid-end and high-end transactions witnessed significant rise in Q1. In Hanoi, the number of apartments with prices of above 1,800 USD/m2 accounted for 37%. Moreover, JLL data also demonstrated that the number of successful transactions in the mid-end and high-end segments made up 30%, triple that of 2016. Similarly, Ho Chi Minh market witnessed the proportion of successful

Hanoi Apartment for Sale



Source: JLL Viet Nam

HCMC Apartment for Sale



Source: JLL Viet Nam

transactions of apartments in the mid-end and high-end segments (with prices higher than 1,200 USD/m2) at 58% of the total transactions. The report of the Viet Nam National Real Estate Association in February also pointed out a clear reduction in the number of transactions in the first two months compared to the end of 2016 and the concentration on the mid-end and high-end segments.

So far, real estate has been considered the area attracting major attention of new investors, both domestic and international ones. According to the data of the National Business Registration Agency, Ministry of Planning and Investment, there were 924 newly established enterprises in real estate area in Q1, 55% higher than the same period of 2016. This is also the area with the highest number of newly established enterprises in Q1. In terms of foreign investment, the number of capital registered in the real estate area was 343.7 billion USD, decreased in terms of proportion in the total FDI, yet increased 43.3% compared to the same period in 2016.

POLICY IMPLICATIONS

Since the end of 2016, recovery has been seen in many large economies in the world. The US, EU and Japan economies experienced improvements in economic growth. Nonetheless, uncertainties in the trade policies of the US President Donald Trump or the prevalence of the extreme right-wing view in the EU may pose new difficulties for the export markets of Viet Nam in the coming time.

Domestically, most industries showed abnormal decline; therefore, economic growth fell short of its target. GDP of Viet Nam increasingly depends on the FDI sector, especially some large enterprises such as Samsung. Similarly, trade grew remarkably yet exports did not improve in terms of quantity. Especially, the proportion of domestic sector exports declined to 28%. This reflects the disadvantages of the domestic sector in the context of global integration.

In terms of investment, the private sector showed positive signs while the disbursement rate of public investment as well as FDI decreased. For the public sector, budget constraints may be the main reason. Meanwhile, the slowdown in foreign investment may result from the TPP cancellation.

In such a changing environment, Vietnamese economy is confronted by many constraints for growth. VEPR estimated that the growth rate would be 5.7% (yoy) in Q2 and 6.1% for the whole year 2017, significantly lower from the target of 6.7% set by the government.

In terms of structure, industrial growth is often low in Q1 due to the Tet holiday. Nonetheless, such low growth in Q1 is alarming, especially when most of the major industries showed declines in growth. Industry and consumption indices have recorded the lowest growth rate for the past five years while inventory increased significantly. If the main reason for such decline is the seasonality of Samsung's manufacturing and export activities, it clearly shows the dependence of Vietnamese economy on a small number of multinational companies as well as industries. Meanwhile, the domestic industry becomes less competitive and tends to shrink, demonstrating the failure of international integration.

The FDI capital inflows in Viet Nam showed signs of decline through the amount of realized capital as well as new registered capital. It can be said that the advantages in attracting investment thanks to the TPP has faded, which becomes clear disadvantages in the context of joining AEC. It means that raising the competitiveness of the economy is inevitable and should be implemented, not just proposed as a policy.

Forecast on Growth – Inflation 2017

With a low economic growth rate in Q1, VEPR research group believe that the target growth rate of 6.7% for the whole year will be ambitious. We estimated that the economic growth rate for Q2 and for 2017 would be 5.7% and 6.1% respectively. It is 0.3 percentage point lower than our forecast on the previous report. Moreover, with a cautious monetary policy in Q1 and the upcoming quarters, inflation rate for the whole year may be lower than 5%. It is highly possible that the real inflation rate may surpass the forecast due to impacts of the adjustments to the national public service prices and the uncertainty of the world price level.

Forecast on growth – inflation 2017 (%, yoy)

	Growth rate	Inflation rate
Q1	5.10	4.65
Q2	5.7	4.5
Q3	6.5	4.2
Q4	6.6	4.3
2017	6.1	

Source: VEPR

Inflation seemed to cool down in Q1, which are signs of a more stable macroeconomic environment in 2017. Nonetheless, the large gap between headline inflation rate and core inflation rate contains latent threats of the comeback of inflation. The world commodity prices are in the process of recovery and public service prices need to be adjusted; hence, administrators need to be cautious to reach the inflation target. The adjustment to prices of health and education services need to follow the plan to stabilize the price level in the market. Although it may cause difficulties in controlling inflation in the short term, it will be a steady foundation in the long term.

In the long term, it is high time Viet Nam reconsidered the sources of economic growth due to changes in international integration. Short-term mindset in coping with the decline of economic growth such as capital raising, acceleration in the disbursement process of public construction projects, increase in crude oil output, etc. may not bring expected results. The government should focus on upgrading the educational and vocational system to enhance the human resource quality; conducting institutional and administrative reforms to raise the quality of business environment; equitizing SOEs for a sound market-based economy. Finally, reforming the state apparatus and the government to enhance the quality of public services and the efficiency of the state administrative cost is inevitable since budget deficit and public debt will surely cause socio-economic instabilities in the coming time.

Abbreviations

BoJ	Bank of Japan
BoE	Bank of England
BSC	BIDV Securities Company
CNY	Chinese Yuan
ECB	European Central Bank
FDI	Foreign Direct Investment
FED	Federal Reserve
FIE	Foreign invested enterprises
FMCG	Fast Moving Consumption Goods
GDP	Gross Domestic Product
GSO	General Statistics Office
HSCB	Hong Kong Shanghai Commercial Bank
LHS	left hand side
IMF	International Monetary Fund
MOLISA	Ministry of Labor, Invalid and Social Affairs
MOIT	Ministry of Industry and Trade
mom	month-on-month
MPI	Ministry of Planning and Investment
OECD	Organization for Economic Co-operation and Development
PMI	Purchasing Manager Index
qoq	quarter-on-quarter
RHS	right hand side
SBV	State Bank of Vietnam
UN	United Nations
USD	the United State dollar
VAMC	Vietnam Asset Management Company
VCB	Vietnam Bank of Foreign Trade
VND	Vietnamese currency
WB	World Bank
yoy	year-on-year
ytd	year-to-date

Disclosure appendix

Author's Certification

The following author who are primarily responsible for this report, certify that the opinion on the subject or issues and/or any other views or forecasts expressed herein accurately reflect their personal views and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendations or views contained in this research report: VEPR Macroeconomic Research Team.

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Additional disclosures

This report is dated as May 5th, 2017. All data included in this report are dated March 31th, 2017 unless otherwise indicated in the report.

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