VIET NAM QUARTERLY MACROECONOMIC REPORT

Quarter 2 and the first six months - 2019

Supported by:

Konrad Adenauer Stiftung

SUMMARY

- The Q2/2019 witnessed economic decelaration in many countries. IMF forecasted that the world economic growth would stay at only 3.3% in 2019. In addition, oil prices fluctuated unpredictably owning to disagreements from US and OPEC and rising political tensions in the Middle East.
- There are increasing concerns about China's economy as its low economic growth and considerably decreasing social investment. Besides, China's PMI and NMI are going down while growth-enhancing packages have no longer been effective as it were.
- Additionally, US and Europe have stopped the normalization of monetary policy due to worries of its growth-declining impacts. It is possible that Fed will lower interest rate in the next month, affecting significantly to the value of US dollar and its exchange rate. Meanwhile, Japanese governments have been attracting foreign workers to address their labour shortages.
- In Q2/2019, Viet Nam's economy grew at 6.71% (yoy), lower than that in Q1/2019 which was 6.79%. The growth in the agri-forestry-fishery, service and industrial sectors slowed down in the first half of 2019. The FDI sector played crucial roles in economic growth due to its major contribution to exports.
- Regarding to business activities, the number of temporarily ceased enterprises decreased significantly. In Q2/2019, there were 38,514 of newly established enterprises with 487.7 thousand million of registered capital, which was 30.8% (yoy) higher; and created 331.3 thousand of new jobs.
- Inflation in Q2/2019 increased to 2.65% (yoy) which was close to the inflation of 2.64% (yoy) for the first half of 2019 – the lowest levels in the three recent years. However, the inflation might increase in the near future due to the rise of food prices and education-related fees and fluctuations in energy prices.
- The exchange rate of VND/USD in commercial banks fluctuated widely while the central rate increased rapidly. The exchange rate of VND/USD in commercial banks increased considerably in May
- The Free Trade Agreement between EU and Vietnam created both challenges and opportunities towards Vietnam. Viet Nam has to improve labour conditions, environmental standards, intellectual property rights, etc. in order to meet EC’s requirements in the signed FTA.

THE WORLD ECONOMY

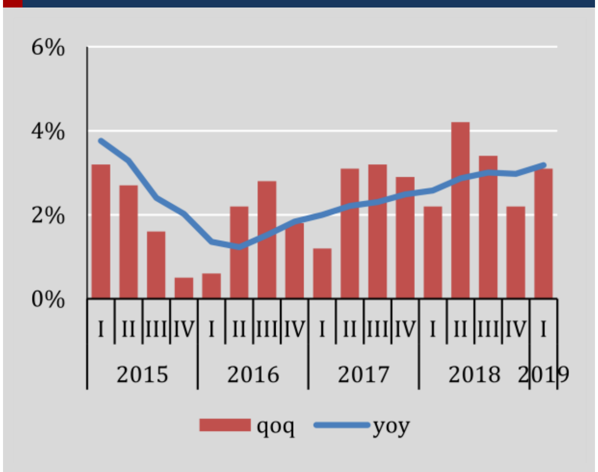
US Economy has confronted uncertainties.

The second estimate of the US Bureau of Economic Analysis (BEA) showed the economic growth rate in Q1/2019 was 3.1% (qoq) and 3.18% (yoy), owning to reducing trade deficits, increasing inventories and increasing local investment in infrastructure. The trade tension between US and China and the instability of the European economy are likely to slow down economic growth, even economic indicators still show that the US keeps on the right track.

US inflation is currently only at 1.79%, which is lower than the government's target of 2%. Core inflation dropped to 1.99% in May. This signals that Fed might cut interest rates in this July.

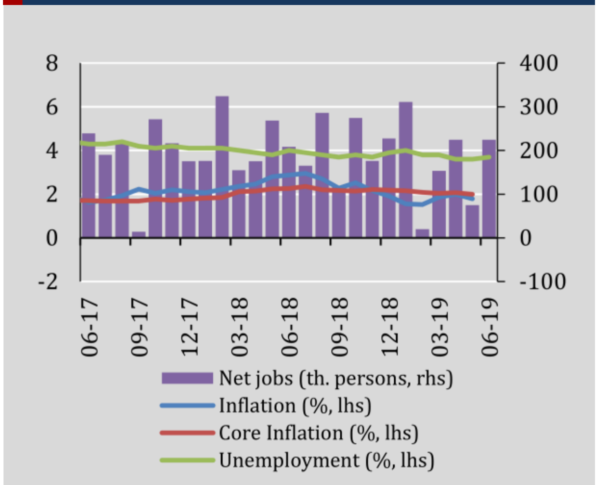
Key indicators related to production and services all followed an uptrend in the second quarter. In June, NMI reached

US Economic Growth (%)



Source: BEA, OECD

Inflation and unemployment rate (%, yoy)

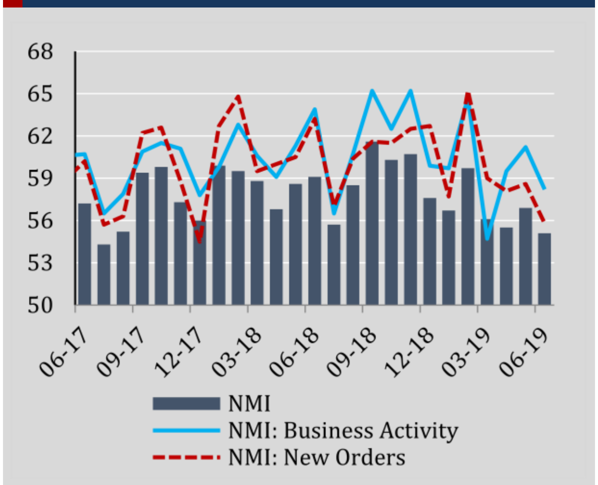


Source: BLS

55.1 points, at which NMI Business activities and New orders reached 58.2 and 55.8 respectively, lower than the firgures of last year.

The unemployment rate (adjusted seasonally) has fallen since the previous quarter, and standed at 3.7% in June. The number of new jobs was 224 thousand in June after a sharp decline in May to 75 thousand people. The labor market has

US non-manufacturing Index

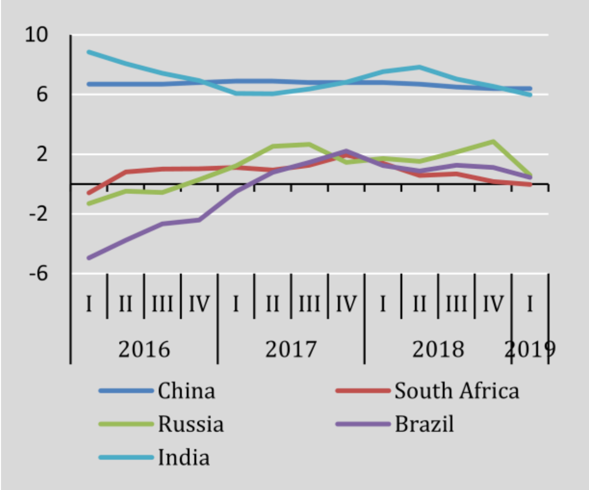


Source: ISM

been diminishing, but there are some improvements in wage issues. In order to enhance economic growth in the medium term, it is necessary to expand the skilled labor force.

Thanks to the imposition of new tariffs on Chinese exports, the US earned USD 4.9 billion in tariffs in May, which contributed to raise national budget to USD 44.9 billion in the first eight months, higher than that in the same period of fiscal year ago. However, it does not compensate to the loss of national budget. In the first eight months of the fiscal year, the US budget deficit was USD 738.6 billion, 38.8% higher than the level in the same period in last year. This is because the tax cut program along with increased government spending.

Economic Growth in Selected Advanced Countries (%, yoy)



Source: OECD

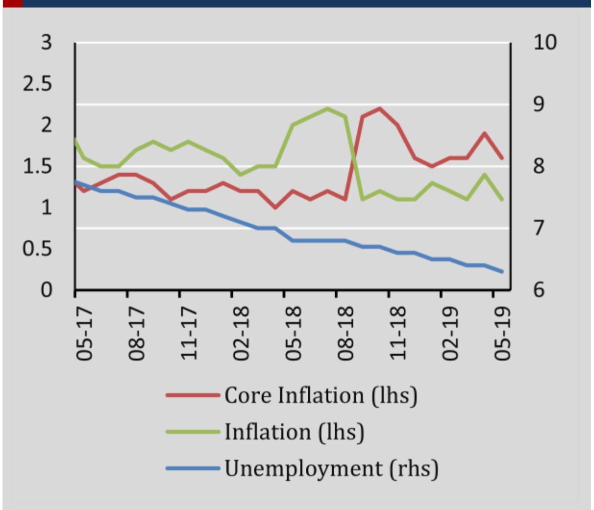
So, it is wondering that whether tariffs on Chinese goods hurt the US economy and whether tax reductions can be offset through increased revenue from economic growth (Laffer principle).

EU Economy expanded at a slower pace

European economy has weakened, reflecting by the slowest economic growth rate in the last three years. Specifically, the EU28 and EA18 regions grew respectively at 1.52% (yoy) and 1.17% (yoy). It can be seen that Brexit continues to have negative impacts on the economic growth of this region.

Employment situation in EU28 is improved in Q2/2019. The unemployment rate declined to only 6.3% in May. Total inflation and core inflation stopped at 1.6% and 1.1% respectively at the end of May. So far, this implies that inflation is controlled well. However, the salary growth was still slow,

Unemployment and Inflation in EU28 (%)



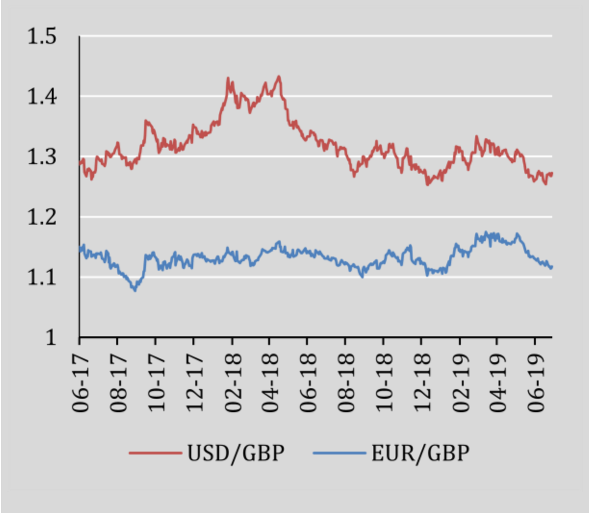
Source: OECD

although the labor market is considerably narrowed.

Compared to GBP, the Euro dropped sharply in value during the quarter, ending at 1.12 EUR/GBP, down nearly 4.6% from the beginning of the Quarter. The exchange rate of USD/GBP also decreased slightly to 1.27 USD/GBP, down more than 3.1%. The European Central Bank expects to keep the current interest rate unchanged until the first half of next year.

The UK economy grew quite well in the first quarter at 1.83% as both private and public sectors increased consumption, and 2,1% increased in total fixed capital. Brexit, despite reducing private investment, made businesses increase their consumption of goods in case they left the EU without any agreement. Therefore, at the meeting in May, the Bank of England (BoE) forecasted UK economic growth increased from 1.2% to 1.5%.

EUR/GBP and USD/GBP exchange rates



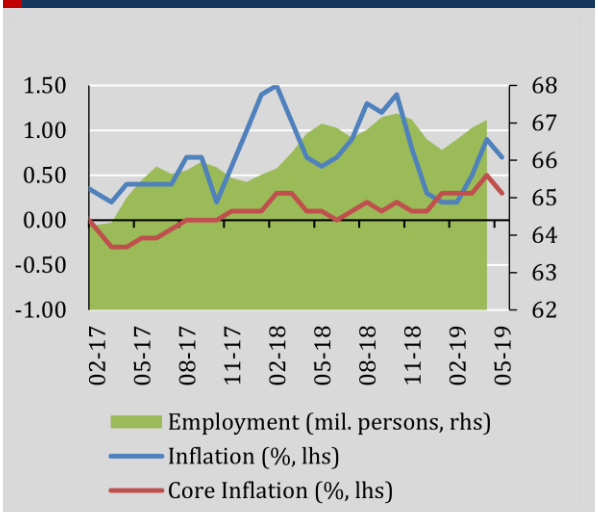
Source: BoE

Japanese economy has immersed in the shortage of labor

The OECD showed that Japan's economy in Q1/2019 reached 0.93% (yoy) due to a sharp increase in investment in housing and public investment. Industrial production and retail index increased slightly, rising to 105.2 and 103.3 in May, signaling the expansion of manufacturing and service sectors.

In the labor market, the ratio of total job vacancies to job applicants remained stable at 1.63%, suggesting that Japan is still facing a shortage of labor supply. Labor in the Japanese economy was at 67.080 million people in June, which was higher

Japan's Inflation and Employment



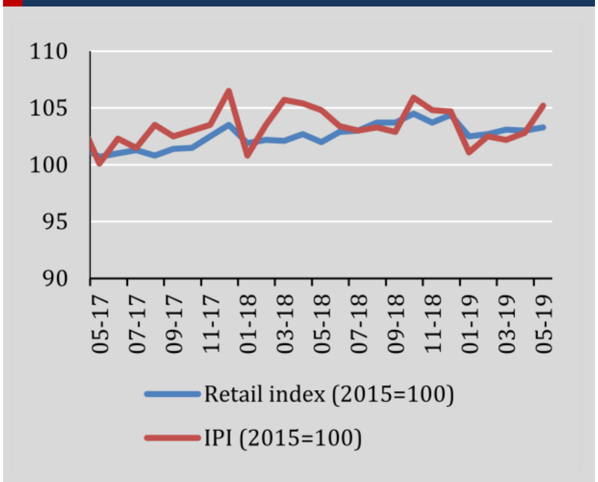
Source: Statistics Bureau of Japan

than figures in the previous months. This proved that the government's policies to attract more foreign workers began to have positive effects. Meanwhile, inflation increased again in the second quarter. Total inflation rose to 0.7% in May while core inflation was at 0.3%. 2% inflation target of Japan is difficult to achieve this year.

Japanese export growth has been partly reduced due to the decreased economic growth in their trade partners. At the same time, the domestic consumption also reduced, which made imports decline.

On July 4, Japan curbed exports of high-tech materials used in smartphone displays and chips to South Korea, which could slow down Korea's exports a few months, and then cause a decline in supplies in Korea's leading technology corporations importing 94% of the materials from Japan such as Samsung Electronics Co., SK Hynix Inc., LG Display. The cause of this trade tension is that Japan believes that South Korea has not given a reasonable solution to the issue of Korean people suing Japanese companies forcing them to work while Japan occupied the Korean Peninsula in First World War I.

Japan's Retail Sales and Industrial Production (seasonally adjusted)



Source: Japan Macro Advisors

Total Wage and Jobs-to-Applicants Ratio in Japan

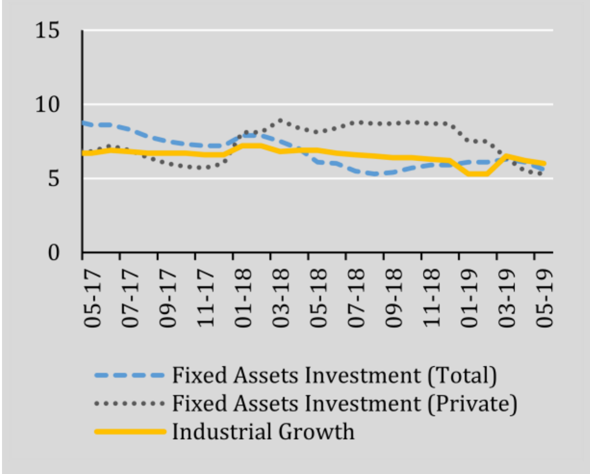
Source: Japan Macro Advisors

China’s economy grew slowly

China's economy in Q1/2019 grew at only 6.4%, but they are in the edge of considerably declined economic growth to below 6.3% due to worsen trade tension. Social investment fell sharply to 5.6% in May (from 6.3% in March) while private investment consecutively declined to 5.3% (compared to 6.4% in March). Industrial growth was only 6% in May, which was lower than March's at 6.5%. The PMI continued to fall below 50 points, for example 49.4 points in June. This implies that policies promoting the economy such as a USD 29 billion tax reduction package are effective in only short run. The non-manufacturing NMI index also declined in Q2/2019 at 54.2 points in June.

On the foreign exchange market, the exchange rate of CNY/USD fluctuated in Q2/2019 but is on the rise, at 6.86 CNY/USD at the end of June. In that context, foreign exchange reserves increased to USD 3,101 billion in June. This is due to the pricing effect and asset price changes.

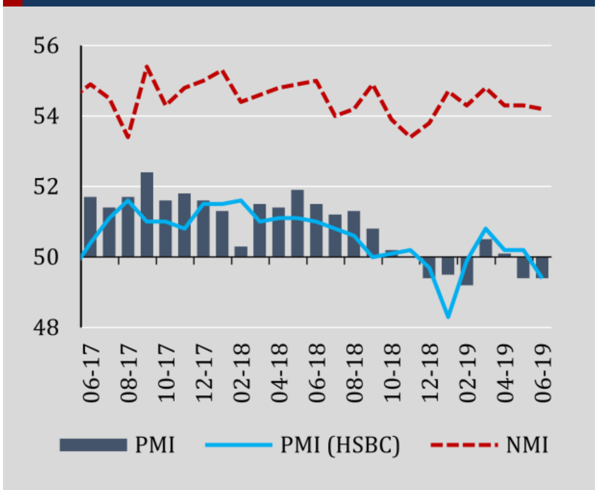
China’s Investment and Industrial Growth (%, yoy, ytd)



Source: NBS

Recently, in the G20 Summit in Osaka, China and US reached an agreement on ceasing to impose taxes and easing restrictions on Huawei to continue negotiations so as to resolve trade wars between the two countries lasting more than a year.

China’s PMI & NMI



Source: AASTOCKS

China’s Exchange Rate and FX Reserves

Source: FRED, PBoC

BRICS economies decelerated

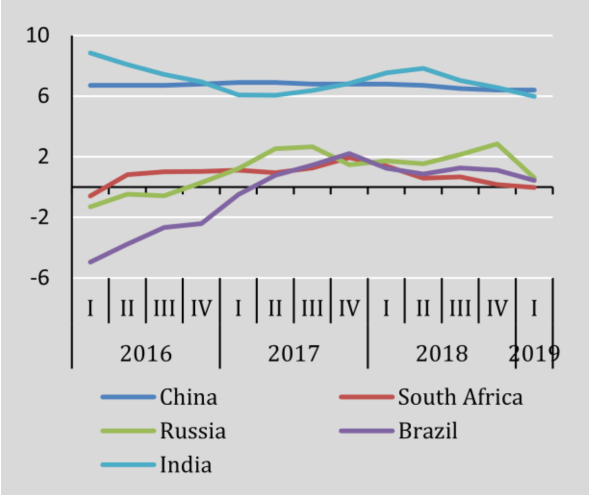
BRICS economies decelerated in Q1/2019. India growth was only 5.98% (yoy) - the lowest growth rate in the last five years, followed by Brazil with 0.45% (yoy) and South Africa with 0.04% (yoy).

In Q1/2019, India's growth rate was only 5.98% (yoy) due to a decrease in total investment and household spending. In the context of inflation below 4%, the Central Bank of India (RBI) decided to cut the interest rate for the third time to 5.75% - the lowest level in the past 9 years to support economic growth.

Similar to India, Brazil's total investment and consumption growth decreased, making economic growth decline to 0.45% (yoy).

South Africa's economy is still in the recession cycle since 2013 and is getting worse. The important reason is that Eskom cut energy used for production and mining, adversely affecting its production, especially, production and mining decelerated to 8.8%, and 10.8% respectively.

Economic Growth in BRICS (%, yoy)



Source: OECD

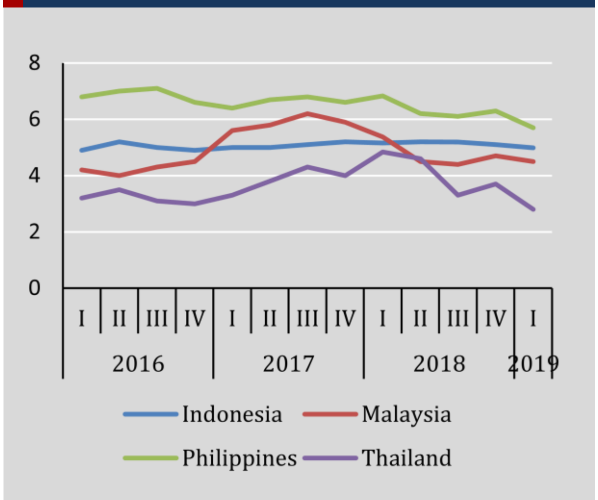
ASEAN Economy grew at slower pace

In the first quarter, the economic growth rate of the ASEAN-5 group (Indonesia, Malaysia, Philippines, Thailand and Vietnam) declined.

Due to the instable legal environment in Indonesia's election year, household consumption, government spending and total fixed investment declined in Q1/2019, making Indonesia's growth rate drop to only 4.99% (yoy).

In Q1/2019, the Philippines's economic growth declined sharply to 5.7% (yoy) - the lowest growth rate in the last three years. The delay in approving budget

Economic Growth in ASEAN-4 (%, yoy)



Source: CEIC

expenditures has led to a decline in government spending in the first quarter, combined with decreased exports to threat the growth of economy.

Thailand's economy declined in the first quarter, down to 2.8% (yoy), lower than the same period last year. The EU-Vietnam Free Trade Agreement (EVFTA) and the US-China trade war have had a negative impact on the country's export growth - the industry contributes 70% to GDP. So in the May meeting, Thailand Central Bank (BoT) decided to keep interest rates to promote growth.

Global Economic Prospect (%)

	WEO (4/2019)			GEP (6/2019)		
	2018e	*2019p*	*2020p*	*2018e*	*2019p*	*2020p*
World	**3,6**	**3,3 (-0,2)**	**3,6 (-0,1)**	**3,0**	**2,6 (-0,3)**	**2,7 (-0,1)**
Advanced economies	**2,2**	**1,8 (-0,1)**	**1,7 (0,0)**	**2,1**	**1,7 (-0,3)**	**1,5 (-0,1)**
US	2,9	2,3 (-0,2)	1,9 (0,1)	2,9	2,5 (0,0)	1,7 (0,0)
Euro area	1,8	1,3 (-0,3)	1,5(-0,2)	1,9	1,2 (-0,4)	1,4 (-0,1)
UK	1,4	1,2 (-0,3)	1,4 (-0,2)	1,3	1,4 (-0,1)	1,7 (0,0)
Japan	0,8	1,0 (-0,1)	0,5 (0,0)	0,8	0,8 (-0,1)	0,7 (0,0)
Emerging and developing economies	**4,5**	**4,4 (-0,1)**	**4,8 (-0,1)**	**4,3**	**4,0 (-0,3)**	**4,6 (0,0)**
Russia	2,3	1,6 (0,0)	1,7 (0,0)	2,3	1,2 (-0,3)	1,8 (0,0)
China	6,6	6,3 (0,1)	6,1 (-0,1)	6,6	6,2 (0,0)	6,1 (-0,1)
India	7,1	7,3 (-0,2)	7,5 (-0,2)	7,2	7,5 (0,0)	7,5 (0,0)
Brazil	1,1	2,1(-0,4)	2,5 (0,3)	1,1	1,5 (-0,7)	2,5 (0,1)
South Africa	0,8	1,2 (-0,2)	1,5 (-0,2)	0,8	1,1 (-0,2)	1,5 (-0,2)
ASEAN-5	**5,2**	**5,1 (0,0)**	**5,2 (0,0)**			
Indonesia	5,2	5,2	5,2	5,2	5,2 (0,0)	5,3 (0,0)
Malaysia	4,7	4,7	4,8	4,7	4,6(-0,1)	4,6 (0,0)
Philippines	6,2	6,5	6,6	6,2	6,4 (-0,1)	6,5 (-0,1)
Thailand	4,1	3,5	3,5	4,1	3,5 (-0,3)	3,6(-0,3)
Viet Nam	7,1	6,5	6,5	7,1	6,6 (0.0)	6,5 (0,0)
Laos	6,5	6,7	6,8	6,5	6,6 (0,0)	6,7 (0,0)
Cambodia	7,3	6,8	6,7	7,5	7,0 (0,2)	6,9 (0,1)
Myanmar	6,1	6,4	6,6	6,2	6,5 (0,0)	6,6 (0,0)

Note: ( ) shows differences from latest forecast; e stands for estimates; p stands for prediction

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

Comodity and asset markets

The world commodity market in Q2/2019 saw a price decline in most goods, while Vietnamese rice prices increased slightly.

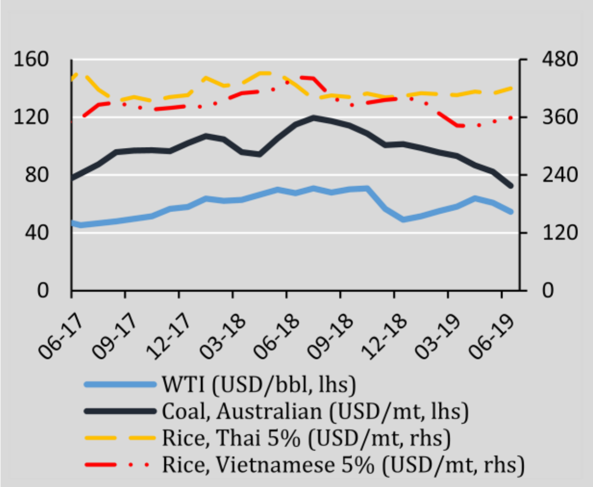
Crude oil prices continued to fluctuate in Q1/2019, ended at USD 54.7/barrel at the end of June and. Currently, OPEC and Russia have maintained an agreement to cut production by 1.2 million barrels per day for another nine months. The sudden surge of US taxes on Mexican goods. Increasing Gulf tensions (Middle East region) or flooding in the Midwest made oil transport from Cushing become more difficult, causing the fluctuations in crude oil prices to fluctuate in a way.

Australian coal prices consecutively declined to USD 72.5/ton in June.

Regards to food items, Thai rice rose sharply in June to USD 420/ton. Meanwhile, Vietnamese rice prices ended at USD 358.8/ton at the end of Q1/2019, lower than the same period last year. Because the major Vietnam's rice exporters such as China, Indonesia and Bangladesh all imported less, the price of Vietnamese rice was much lower than the same period last year though it has increased recently.

On the asset market, the dollar value has been more stable and went down to 127.32 at the end of Q2/2019. The forecast of cutting interest rate from Fed made the dollar value worsen.

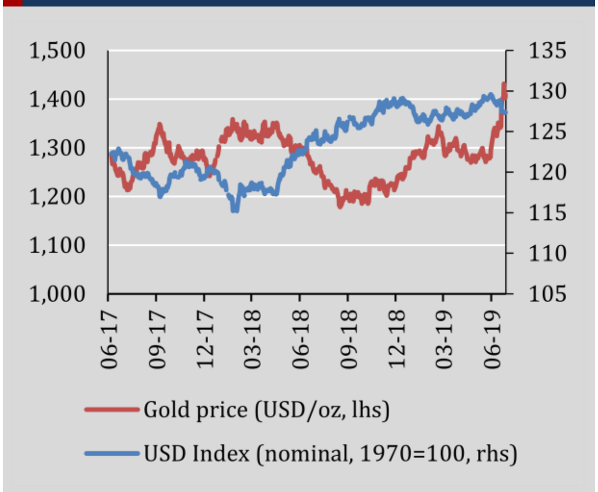
Commodity Prices



Source: The Pink Shee (WB)

World gold price have fluctuated unpredictably but are in the uptrend in Q2/2019, especially considerably increased to 1409 USD/oz in June due to worsen US dollar and expectation of the agreement reached by US and China in the G20 Summit.

Gold Price and USD Index

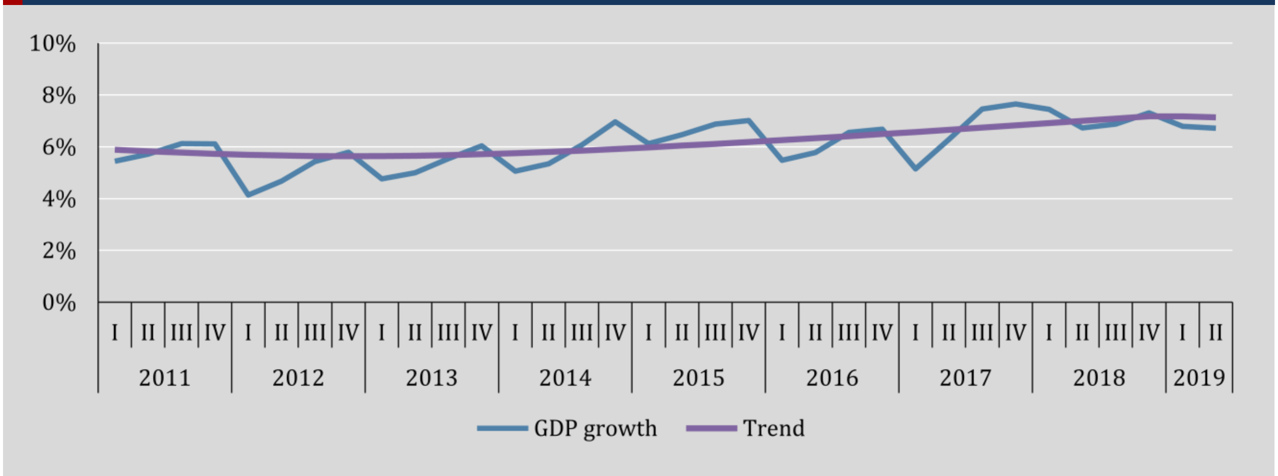


Source: FRED, www.gold.org

THE VIETNAMESE ECONOMY

Economic Growth

Viet Nam's Economic Growth (%, yoy)



Source: Calculation from GSO data

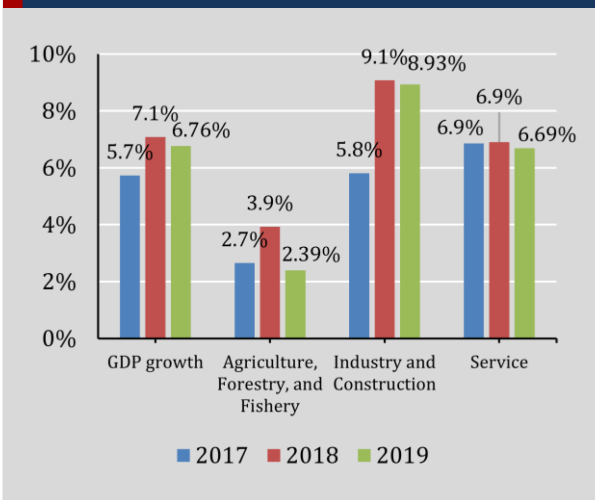
Growth in all three economic sectors decelerated in the first half of 2019

Vietnam's economic growth was 6.71% (yoy) in Q2/2019, and 6.76% (yoy) in the first six months – all above indicators were lower than those in the same period in 2018. Compared to figures in the 2018's first six months, all three economic sectors slowed down.

Firstly, the service sector grew at 6.69% (yoy), which was lower than the first six months of 2018, but the key industries remained stable growth. Wholesale and retail grew well to 8.09% (yoy), and has been important driving force contributing to 0.86 percentage points to the economic growth; financial, banking and insurance activities increased to 7.9% (yoy) and real estate business increased to 4.43% (yoy). The number of international visitors was nearly 8.5 million people, up 7.5% (yoy).

In particular, leading markets still offer increasing volume of tourists to Vietnam, including: Korea (21.3%), Japan (12.8%), Taiwan (27%). Meanwhile, the number of international visitors from China to Vietnam dominated by more than 2,483.3 thousand turns of people, but decreased by 3.3%, Cambodia offering

Economic Growth by Sector in Q1, 2017-2019 (%, yoy)



Source: GSO

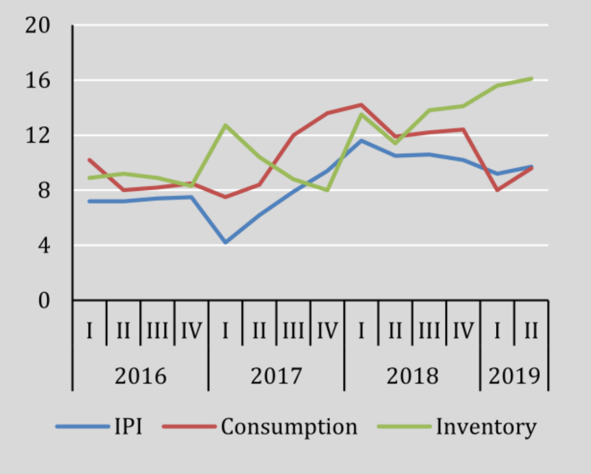
58.5 thousand turns of people, decreased 51%, Australia with 200.3 thousand, decreased by 0.3%, etc.

Secondly, the agri-forestry-fishery sector decelerated to 2.39% (yoy). Decreasing rice production in the winter-spring crop due to severe weather and the spreads of African hog cholera in a large-scale lead agricultural sector grow only 1.3% (yoy). Meanwhile, thanks to the US-China trade war, the demand for seafood in the US increased highly, so the fisheries sector grew well to 6.45% (yoy). However, under the pressure of removing the European Commission's yellow card, fishing output may be reduced in the end of year and greatly affect this industry's growth.

Thirdly, the industry and construction sector grew 8.93% (yoy) in first half of 2019, lower than the figure of 9.1% in the same period in 2018. Likewise, the processing and manufacturing industry, despite strongly grew 11.18% (yoy), and contributed 2.38 percentage points to the overall economy. Meanwhile, the mining industry grew steadily at 1.78% (yoy) thanks to high coal mining.

In the first 6 months, the index of industrial production (IPI) increased to 9.7% (yoy). The consumption index of the processing and manufacturing industry grew to 9.6% (yoy), but all were lower compared to the increase of those in 2018. The average inventory index has gone up highly to

Selected Industrial Indicators (%, ytd)



Source: GSO

16.1% (yoy) since 2018 - exceeding the 11.4% growth rate of the same period last year. This threat a risk of temporary stagnation in production and narrowing corporate capacity

According to the GSO, the structure of economic sector's contribution to GDP is moving towards market economy: the proportion of the state sector is decreasing to 27.67% in 2018, while the domination of the FDI and non-state sectors has reflected by 20.28% and 42.08% increase respectively in 2018. This fact raises two issues (i) the importance of the non-state sector along with the strong growth of the private sector in size and efficiency, and (ii) assessing the structure of national budget collection in correspond to their contribution to GDP.

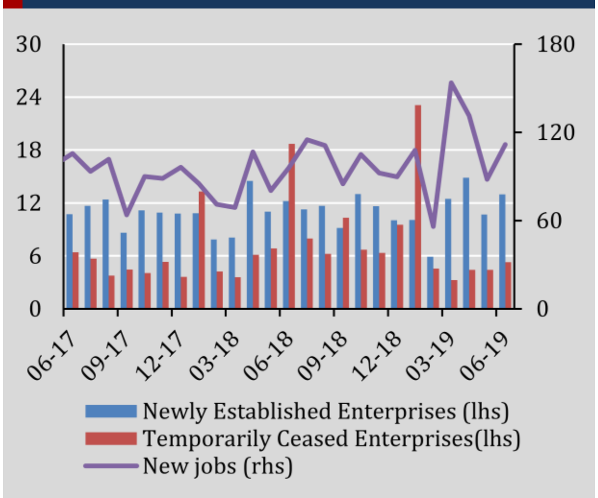
The number of new jobs increased but labour tends to move out of industry sector

In the context of low GDP growth, the Purchasing Managers' Index (PMI) in the first six months of 2019 reached 52 points, lower than the figure in the same period last year at 53.3 points.

Based on the survey in industrial enterprises in processing and manufacturing, there are only 45.2% of businesses surveyed rated the production and operation situation in Q2/2019 better than that in the first quarter. 16.5% of surveyed firms were in difficult situation. The number is higher than the forecast of 10.6%. This suggests that along with slowing economic growth, the number of businesses facing difficulties is increasing, although there are still 52% of businesses being optimistic in the next quarter.

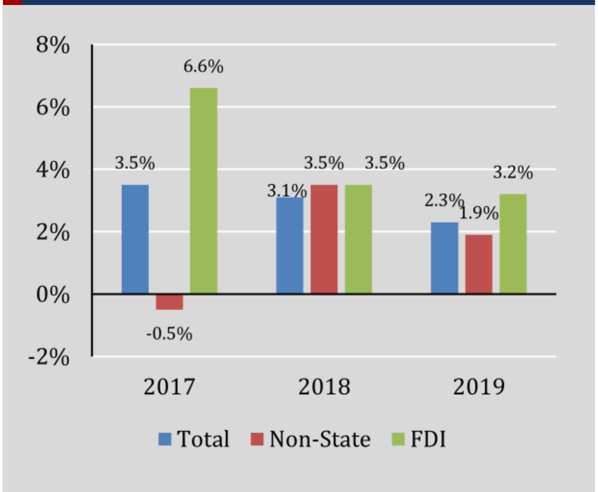
In Q2/2019, there were 38,514 newly registered enterprises with a total registered capital of 484.7 trillion VND, up 30.8% (yoy).

Business Operations (th. units, th. persons)



Source: GSO

Labor Growth in Industry Sector (%)

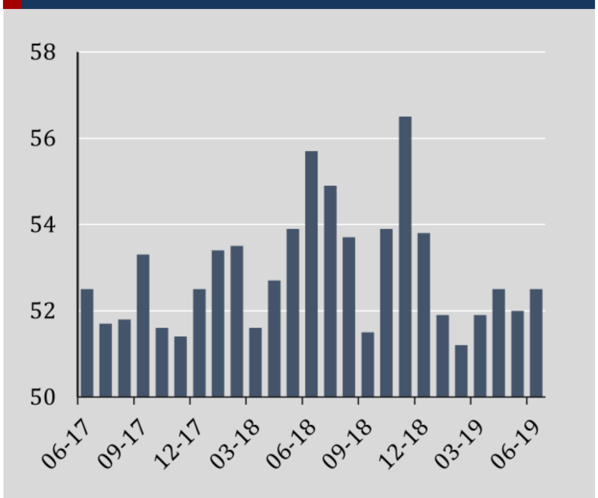


Source: GSO

The number of enterprises suspending from operations decreased sharply by 14,096 enterprises and 44.4% lower than the same period last year. In the first six months of 2019, only 44,996 enterprises temporarily stopped their operations and mainly were in wholesale and retail businesses, car repair, which accounted for 39.1% of enterprises.

With regards to labour force, the number of new jobs increased in Q2/2019.

Viet Nam's PMI



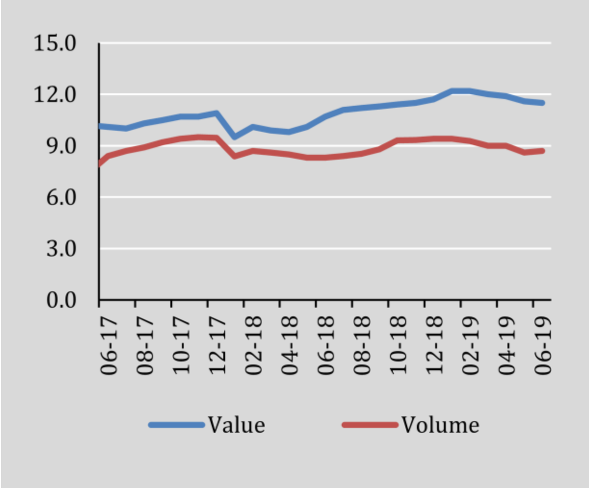
Source: Nikkei

650 thousand jobs were created in the first six months of the year. Labor tends to move outside the industrial sector, reflecting by the lowest growth rate of 2.3% in the last three years (2018: 3.1%; 2017: 3.5%). The number of workers in the FDI sector increased steadily at 3.2% after the jump in 2017, but accounted for less than 10% of the total labor force. This implies that industries in FDI sector might be technology-intensive group. Thus, it is not wise to utilize FDI sector to create employments. The proportion of labour force in the state sector diminished along with the shrinking of the production.

Retail and service activities are carried on well

Retail and service business activities in the first six months increased in value, although economic growth rate was lower than 2018. Total retail sales of goods and consumer service revenue reached VND 2,391,1 trillion, up 11.5% (yoy), if excluding 8.7% price increase so far in 2019 compared to figures in last year. In particular, retail sales of goods in the first 6 months were estimated at VND 1,823.6 trillion, accounting for 76.3% of total revenue and up 12.5% (yoy). This implies that consumer demand has been maintained at a high level. This is a good signal from the aggregate demand side.

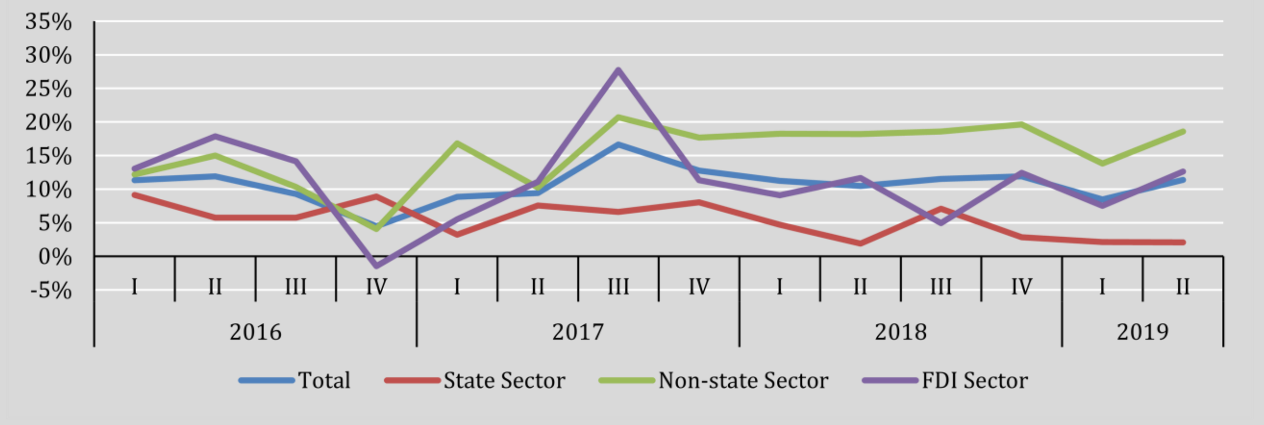
Retail Growth (%, ytd, yoy)



Source: GSO

FDI investment growth has been unstable since 2018

Total Social Investment (yoy), 2016-2019



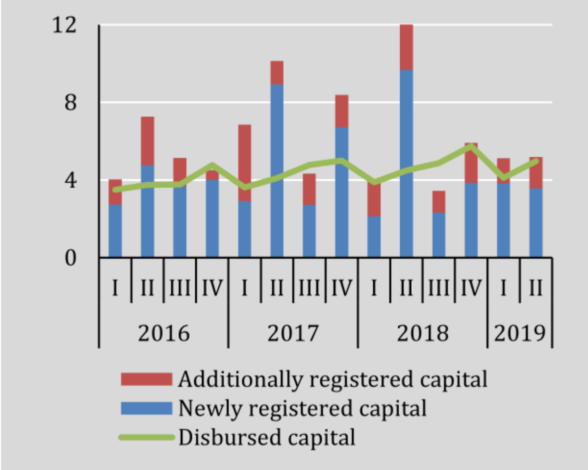
Source: Calculation from the GSO data

In the first six months of the year, total social investment capital reached VND 822.9 trillion, up 10.3% (yoy), and equal to 33.1% of GDP. In which, non-state economic sector accounted for the largest proportion of the total investment capital at 43.6% and its growth rate reached 16.4% (yoy). Investment capital from the state sector grew at the lowest rate, only about 3% (yoy).

Regarding to foreign investment flows, its growth has been unstable through the quarters since 2018. Although trade tension between US - China since 2018 is expected to increase capital inflows into Vietnam, facts do not reflect that. In the first six months, FDI investment increased by 9.7% - higher than the figure of 8.5% in the same period last year, but has not caught up with the growth pace of the non-state sector. By the end of June, there are 1,723 new licensed projects with USD 7,411.8 million, up 26.1% of registered capital in 2018.

Industry and manufacturing processing still attracted most FDI inflows with 73.4% of the total newly registered capital, and has been the main driver of Vietnam's economic growth. The following is the real estate industry with increasing newly registered

Foreign Direct Investment (bil. USD)



Source: MPI

capital, accounting for 10.8% of the total capital and 6.5% of the new registered capital. This signals that there is still a need to pay attention to the possibility of oversupply on real estate market or housing bubble.

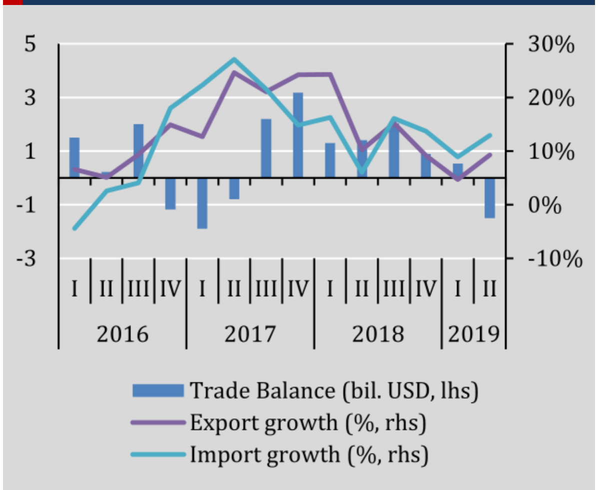
In the first six months of the year, China continues to be the largest investor with a total registered capital of USD 1,676.8 million. The following positions belonged to Korea (USD 1,239.2 million), Japan (USD 972 million), and Hong Kong (USD 920.8 million). The increasing US-China trade tensions and the CPTPP agreement makes China increasingly invest in Vietnam. Currently, the total new registered capital from China accounted for 22.6% of the total capital. However, if carefully selected, Chinese FDI enterprises have potential to bring about many old technology risks, environmental impacts, working conditions, etc. This will adversely affect Vietnam's institutional reform process in the process of signing new generation FTAs.

Vietnam experienced trade balance in the first half of 2019

The Q2/2019 experienced USD 1.5 billion deficit after seven consecutive quarters in surplus, in which the domestic sector has a deficit of USD 8.94 billion and the FDI sector (including crude oil) has a surplus of USD 7.49 billion.

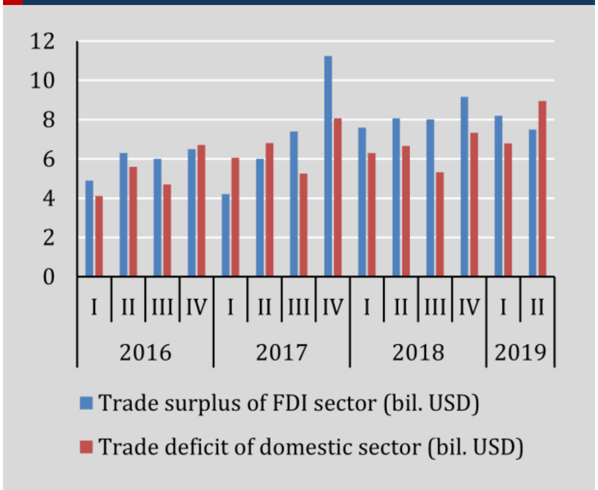
Exports turnover in Q2/2019 reached 63.8 billion USD, up 9.3% (yoy).
In particular, exports from FDI enterprises accounted for a major proportion of 44.3 billion USD (making up for 69.4% of total turnover). Exports from the domestic sector increased to USD 19.7 billion.

Trade Balance and Growth



Source: GSO

Trade Balance by Sector



Source: GSO

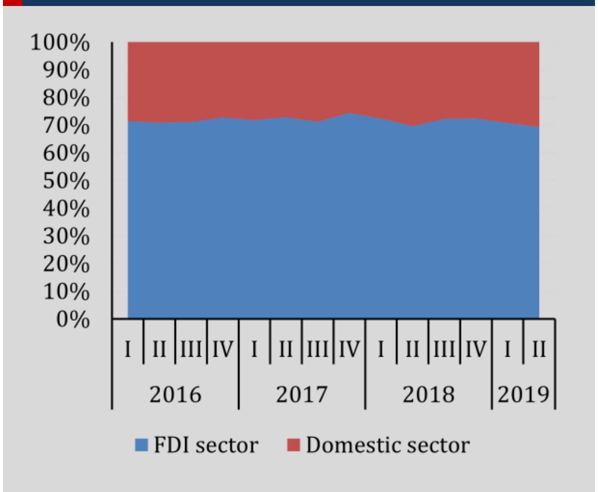
Total import turnover is estimated to reach USD 65.3 billion in Q2/2019, an increase of 12.18% (yoy). Specifically, imports of FDI sector accounted for USD 36.76 billion and the domestic sector was USD 28.54 billion. In particular, the imported goods include electronic products, computers and components; and machinery, equipment and spare parts. They are also heavily imported with turnovers of 12.5 billion USD and USD 9.3 billion respectively in Q2.

In the first six months of 2019, export turnover is estimated at USD 122.72 billion, up 7.3% over than the same period in 2018. Of which, the FDi sector (including oil crude) rose 5.9%, accounting for 70% (down 0.9 percentage points compared to the same period last year), the domestic economic sector increased by 10.8%. The list of the most exported products with high growth rates includes phones and components; electronics, computers and components; and textiles and garments. In particular, there are USD 2.08 billion of vegetables and fruits in the first six months of 2019, which is higher than the same period last year thanks to the impact of the US-China trade war.

Regarding the exports, in the first six months of 2018, the US continued to be the largest export market of Vietnam with a turnover of USD 27.5 billion, up 27.4% (yoy), followed by EU market with USD 20.6 billion, down 0.4%; China with USD 16.8 billion, up 1%; ASEAN market with USD 13.1 billion, up 6.7%, etc. The signing of the EVFTA agreement at the end of June is expected to offer more opportunities for Vietnam's export industry in the future.

Import turnover is estimated at USD 122.76 billion, up 10.5% (yoy), of which the domestic economic sector contributed USD 52.54 billion, up by 14.4% while foreign investment imported USD 70.22 billion, up 7.8%.

Exports by Sector



Source: GSO

EVFTA – opportunities and challenges

EU - Vietnam Free Trade Agreement (EVFTA) is a new generation FTA between Vietnam and 28 member countries, signed on June 30, 2019. This is a turning point after nine years of negotiations in order to create many opportunities and challenges for Vietnam.

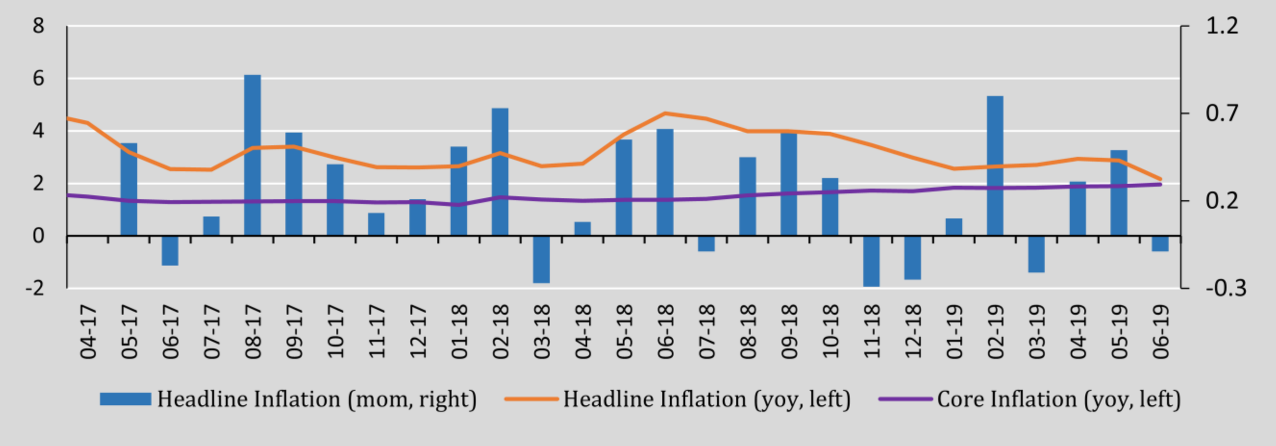
Firstly, the agreement opened up for Vietnam comprehensively penetrate to the EU - one of our two largest export markets. Through this FTA, all parties promise to cut 100% of tariff lines within seven years, but right after 2020, the tax rate of more than 85% of tariff lines will be zero - accounting for 70.3% of Vietnam's export turnover to the EU. Secondly, EVFTA is forecasted to contribute significantly to Vietnam's GDP growth by an average of 2.18 - 3.25% in the period of 2019 - 2023. Thirdly, the agreement is expected to improve competitiveness for domestic businesses and enhance access to high-tech products. In addition, policies related to environment, labor, rules of origin, etc. will also be improved to satisfy the requirements of a new generation FTA. This is both an opportunity but also a challenge for Vietnam.

Besides, Vietnam also faces many challenges. With regards to trade, along with the convenience to penetrate EU markets, in the exchange, EU goods are likely to access Vietnamese market, which leads to the increasing of competitiveness of Vietnamese goods on the domestic playground. This puts pressure on improving and ensuring the requirements for environmental quality, labor policies, etc, which definitely raises production costs in businesses, for example, Vietnam is struggling to remove the yellow card for seafood products before the EC examination in near future. In parallel, the issue of intellectual property - the eternal weakness of the economy needs to be thoroughly addressed. Institutional reforms along with enforcement guidelines should be actively implemented to meet EU requirements. By there, enterprises also need to understand and implement their rights and obligations in intellectual property to avoid unwanted consequences such as Trung Nguyen coffee and Vinataba cigarettes losing their brand names in international markets, etc.

In general, in order to receive great commercial benefits from EVFTA, Vietnam will have to go a long way in institutional reforms, competitiveness enhancement, etc. to meet EU requirements to validate EVFTA. The signing of the agreement is only the first step towards successful EVFTA.

Inflation is controlled but there are potential risks to increase again

Inflation (%)



Source: GSO

The average CPI in Q2/2019 increased to 2.65% (yoy) and 0.74% (qoq). CPI decreased slightly in April, May and June at respectively 2.93%, 2.88% and 2.16% (yoy). However, April and May still experienced high inflation compared to the previous months of 0.31% and 0.49% (mom) respectively. The main reason is the strong increase in petrol and electricity prices since March20th, which creates pressure on prices of other goods, especially transportations; housing and construction materials. However, in June 2019, CPI decreased to the lowest level since the beginning of the year, at 2.16% (yoy) and 0.09% (mom) due to two consecutive petrol price reductions on June 1st and June 17th causing gasoline and oil prices drop to 3.9%. In Q2/2019, the CPI of educational goods group increased sharply at 6.19% (yoy) because Vietnam Education Publishing House increased the price of textbooks from April. Housing and construction materials increased by 3.6%; and food and catering services increased by 3.38% due to the adjustment of gasoline prices, increased electricity prices and fluctuated meat prices due to the hog cholera.

In the first six months of 2019, the average CPI increased by 2.64% (yoy) - the lowest increase in the last three years. Inflation increased due to the following reasons: (i) Food prices rose sharply by 5.4% (yoy) because pork prices increased by 14.85% under the negative impact of African hog cholera; (ii) Electricity price adjustment at the end of Q1/2019 to 5.84%, putting pressure on many commodity groups; and (iii) Education sector's CPI increased sharply due to the increase in textbook prices and implementation of the roadmap to increase university and postgraduate tuition according to the Government's

Decree 86/2015 / ND-CP. However, the price of gasoline fell sharply by 3.55% (the overall CPI impact decreased by 0.15%) is a positive factor in curbing inflation.

Core inflation has increased since 2018, at 1.91% (yoy) in Q2/2019 and 1.87% (yoy) in the first six months of the year. This forecasts the price increase trend of commodity groups after eliminating fluctuations in energy and food prices.

In general, the economy will face many difficulties in controlling inflation in the second half of the year when the pressure of the cholera diminishes pork supply, gasoline prices fluctuate continuously and prices of goods and services education has always increased over 6% over the past two years.

Budget revenue in the first six months increased

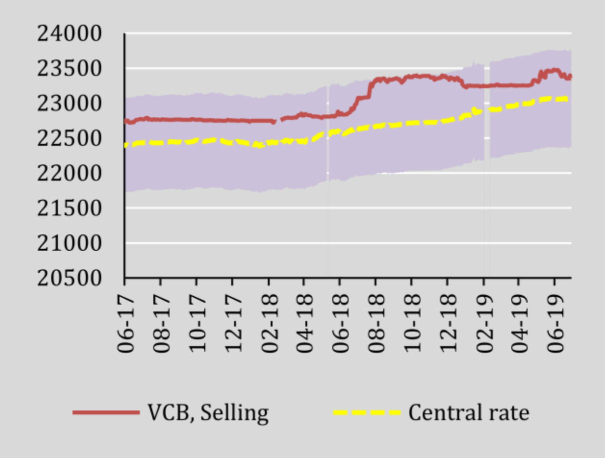
In the first six months of the year, the budget revenue was estimated at VND 597,786 billion, equal to 51.2% of the estimate, up to 12.5% (yoy) based on the Report of the General Department of Taxation. The central budget revenues in the first 6 months of 2019 were estimated at VND 272,000 billion, equal to 48% of the estimate, up to 19.7% (yoy). Local budget revenue was estimated at VND 325,786 billion, equal to 54.2% of the estimate, up to 7% (yoy). Many revenues and taxes have increased over the same period. Domestic revenue was estimated at VND 567,437 billion, equal to 50.5% of the estimated ordinance, increased by 13.2% (yoy), personal income tax increased by 17.1% (yoy); registration fee increased by 23% (yoy); etc.

The major contribution to the state budget revenue is the revenue from import and export activities. The state budget revenue of the General Department of Customs reached VND 175,522 billion, reached 58.4% of the estimate, reached 55.6% of the target, increased 19.4% compared to the same period in 2018. However, budget revenue sources is expected to gradually decrease over time under the impact of tariff reductions from FTAs, in particular reducing revenue from FTAs in 2019 is estimated at VND 13,820 billion.

The structure of tax collection from economic sectors still has many problems. Firstly, the revenue structure is not reasonable: the group of enterprises and non-state organizations, although accounting for only about 8% of the GDP structure, account for more than 36.35% (in 2018), the tax revenue from production and business. The burden from the lack of tax revenue of households (accounting for 1.85% of total revenue) is putting too much into private enterprises. Secondly, revenue from state-owned enterprises only reached 27.86% of total revenue, not commensurate with investment capital from the state (33.35%).

Regarding the state budget expenditure, the Ministry of Finance estimates that in 2019, it will spend 1,633,300 billion dong, 7.2% higher than 2018, of which recurrent expenditures account for 63.8%. At the same time, the Ministry of Finance also planned to spend VND 222 trillion, equivalent to 3.6% of GDP.

Nominal Exchange Rate (VND/USD)



Source: SBV, VCB

Asset market – Money and Financial market

VND/USD exchange rate at commercial banks fluctuated while central rate increased slightly

Continuing the upward trend since 2019, the central exchange rate also increased in Q2/ 2019, but, the increase was negligible. The central exchange rate on 29/6/2019 at 23,055 VND/USD, up 0.3% compared to the end of Q1/2019. In fact, from 2018 until now, although the State Bank has not officially stated but devalued the VND in a reasonable rate as recommended by VEPR, but, the change is lower and lower under pressure from international: the Q4/2018 experienced by 1.8% increase; the Q1/2019 underwent by 1% increase while the Q2/2019 only increased by 0.3%. It is forecasted that in the coming quarter, the exchange rate will fluctuate insignificantly due to the following reasons: (i) The Fed is likely to reduce interest rates in July; (ii) Asian currencies are considered to be underestimated against USD; and (iii) Vietnam's inclusion in a U.S. currency manipulation May 2019. Vietnam's currency surveillance is due to trade surpluses with the US and current account surpluses, so which puts the SBV under the pressure of flexible exchange rates, limiting monetary policy to create competitive advantage in trade

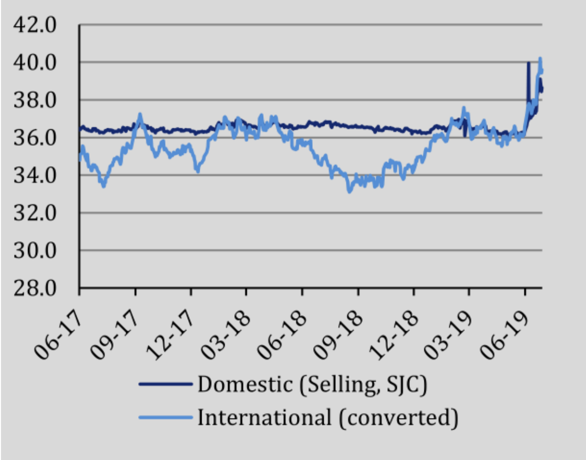
VND/USD exchange rate in commercial banks reached a peak in the period of 29/5/2019 - 4/6/2019 in Q2/2019. The rate fluctuated in the range of 23,465 - 23,480 VND/USD (according to the selling rate at Vietcombank). The main reason is uncertainty in strong currencies such as USD, CNY and JPY, concerns about increasing US-China trade tension and the continuous decline of CNY since the end of May. However, the VND/USD exchange rate at the end of Q2/2019 in commercial banks showed signs of dropping to 23,350 VND/USD due to expectations of lowering interest rates of the Fed.

At the end of Q1/2019, foreign exchange reserves exceeded over VND 65 billion. On the one hand, this is a good signal for the SBV to regulate monetary policy, and stabilize the exchange rate before international fluctuations. However, on the other hand, the strong intervention of the state in the monetary market may increase the risk of the US accusing Vietnam of manipulating money, affecting trade activities. In addition, the import turnover of Vietnam has increased over the quarters, Q2/2019 has reached 65.3 billion USD, so actually the level of foreign exchange reserves in Q1/2019 has only just over the safe level to regulate the exchange rate when necessary.

World gold price increased, domestic gold market price awakened

Unlike Q1/2019, in the next quarter, domestic gold price closely followed the fluctuations of the world gold price. Domestic and world gold prices have been relatively stable in the first two months of Q2/2019. Then, prices fluctuated around VND 36 million/tael. However, in June, the world and domestic gold prices suddenly increased. At the end of Q2/2019, gold price reached VND 39.5 million/tael - the highest level in the last six years. The main cause of the fluctuation is due to (i) increasing US-China trade tension, and US-Iran argument; (ii) USD and strong currencies are instable; (iii) investors withdrew from risky assets. Unresolved tensions in G-20 summit between US-China and new conflicts in Iran, along with the depreciation of the US dollar if Fed will reduce interest rates may make world and domestic gold prices continue to increase in the coming time.

Gold Price (mil. VND/tael)



Source: SJC, www.gold.org

Apartment market in Hanoi and Ho Chi Minh City faces supply decline

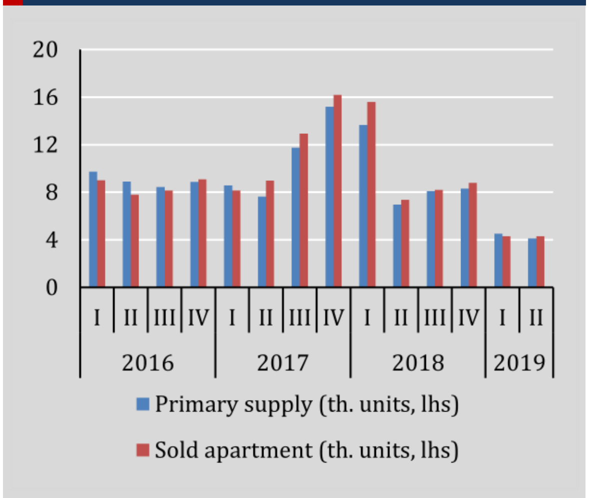
According to Jone Lang Laselle (Vietnam), in two big cities - Hanoi and Ho Chi Minh City, the supply of apartments decreased sharply in Q2/2019. In Hanoi, the number of apartments for sale and the volumen sold only reached 5,900 and 4,660 respectively, decreased by 27% (yoy) and 45% (yoy). The main reason is due to (i) declining demand and ability to supply apartments after a period of strong growth in both supply and demand for apartments, especially in Q1/2019, and (ii) interest rates has been high, the tight process in approving loans for housing investment makes people reduce the demand for houses based on loans. In general, apartment demand in Hanoi will be quite gloomy in the coming time due to the slowing economic situation, the risk of high inflation, and strong growth in Q1.
The supply of apartments is also not very optimistic because the tightened land fund and pressure from credit tightening in the real estate industry since Q1/2019.

In Ho Chi Minh City, the supply of apartments reached 4,100 units, consumed 4,300 units, decreased to 41% (yoy) and 41.6% (yoy). On the demand side, consumers demand flowed to townhouses/villas instead of high-end apartments for high profitability. On the supply side, investors face many difficulties, causing a decrease in the supply of apartments in the future, such as (i) the project approval procedures confront to more obstacles - the situation lasted from the beginning of the year, (ii) long land approval process and construction permit issuance due to the Government adjusting the supply in a sustainable way; (iii) high levels of real estate since the end of 2018 up to 1 billion USD, especially in the middle and high-end groups.

Hanoi's Apartment for Sale

Source: JLL

HCMC's Apartment for Sale



Source: JLL

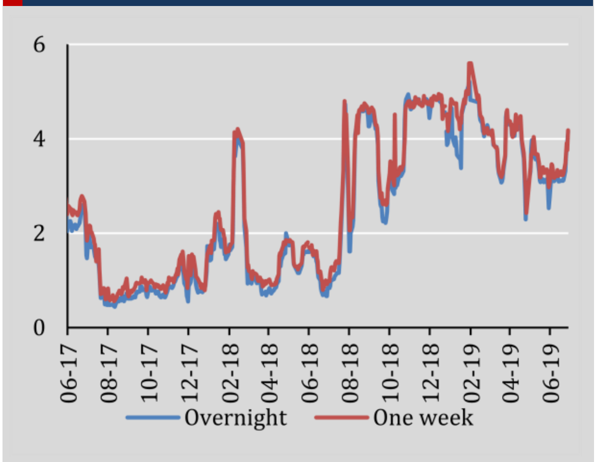
Capital and money markets

Interbank interest rates fluctuated slightly

In general, compared to the same period in 2018, interbank interest rates in Q2/2019 tended to increase. The requirement to increase the reserve ratio and fluctuation of deposit sources made the interbank interest rate higher than 4% at the beginning of Q2. However, only at the end of April, the interbank interest rate decreased to below 3% because SBV suddenly pushed a large amount into the banking system, causing the stuck of VND in commercial banks, but the interest rate quickly returned at high levels. At the end of Q2, due to the shortage of money supply, interbank interest rates continued to increase to 4.15%/year with overnight and 4.18%/year for one week term. Therefore, the SBV injected VND 47 trillion on the open market, VND 35 trillion via T-bills and VND 12 trillion via OMO. This move despite increased the liquidity of commercial banks, but potentially cause inflation risks, especially in the context of the economy facing many risks to push up the price index.

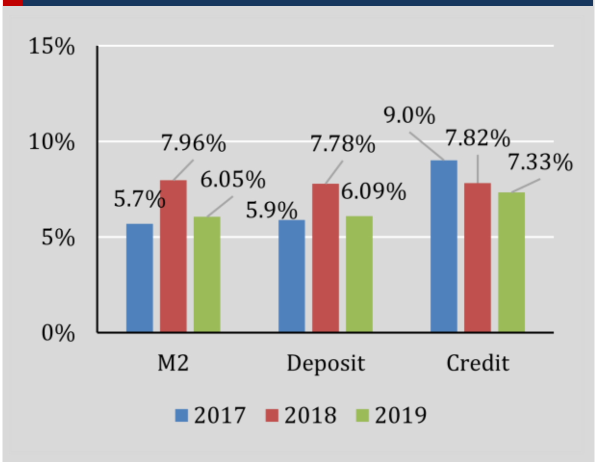
However, the growth of M2 money supply in Q2 was 6.05%, lower than in 2018 (7.96%) - this reduced the burden related to inflation. Credit growth was at 7.33%, the lowest in the last four years (2018: 7.82%; 2017: 9.01%; 2016: 8.21%). Similar to the previous quarters, credit was heavily accrued to the processing and manufacturing industries - the driving force of economic growth. In parallel, credit for agriculture and rural areas has received many priorities due to the impact of African hog choleta which has significant impacts on the livestock sector. As of the end of Q2/2019, outstanding loans to the livestock

Interbank Offered Rate (%)



Source: SBV

Growth of M2, Deposit, and Credit in Q1 2017-2019



Source: GSO

sector amounted to VND 51 trillion, of which VND 1.2 trillion was affected by epidemics.

Government bond market declined sharply, while corporate bonds developed

In Q2/2019, the State Treasury mobilized VND 35.6 trillion, lower than the plan of issuing over VND 80 trillion. Generally, the first six months of 2019, the SBV mobilized VND 105 trillion, equal to 70% of the plan. The result of winning Government Bonds was low because the State Treasury reduced the scale of bidding. The calling rate/issuing plan was only 0.6 times. Along with that, the progress of disbursement of slow public investment also made capital from Government Bonds remain in commercial banks.

Meanwhile, the corporate bond market witnessed many positive steps. In the first six months of 2019, the volume of issued corporate bonds reached VND 89,483 billion, up 134% compared to the same period of 2018. The outstanding debt of the corporate bond market reached about 10.22% of GDP in 2018 - exceed the target of achieving 7% of GDP by 2020 which the Government has set up. In the future, with the decline of credit growth and capital mobilization, the corporate bond market will continue to expand. In the second half of this year, there have been many issuance of private bonds in sectors such as securities, real estate and banks. The most issued banking sector - about VND 17,600 billion, in which VPBank issued VND 5,600 billion, 3-year term, fixed interest rate of 6.4 -6.9%/year.

The real estate group ranked second in the total value of bond issuance, with the deals of Phat Dat Real Estate Development JSC, Ho Chi Minh City Infrastructure Investment Joint Stock Company, JSC Dat Xanh Group, etc.

PROSPECT FOR POLICY NOTES AND THE ECONOMY IN 2019

The world economy was subject to a slowdown in growth in the second quarter of 2019. The drag on US – Sino trade dispute continues to put the two economies under significant uncertainties. The value of the CNY decreased, while the US dollar has been under fluctuation. The sluggish pace of growth overshadowed many European economies, worse still, the EUR dropped sharply against the USD and GBP. In contrast, Japanese economy steadily expanded in the second quarter, however, it could not address the substantial gap between human resource supply and demand. Besides, the ASEAN economy was also under disturbance as the growth rate Philippines, Indonesia, and Thailand simultaneously declined in the second quarter, which is an unfamiliar phenomenon for many years.

Also in this quarter, Vietnam's economic growth was 6.71% (yoy), which was lower than that in the Q1/2019 but higher than that of the Q2/2018. All three economic sectors experienced a weak growth in the first six months. However, the IPI and PMI index illustrated a significant increase, provoking optimistic outlook among the business world about the future. Moreover, the number of enterprises suspended from operations decreased, the labor force quickly increased and shifted into private and FDI sectors.

Growth-Inflation forecast 2019

With the growth rate of 6.71% in Q2, VEPR believed that the growth target of 6.6 - 6.8% in 2019 set by the National Assembly is possible. However, due to the US- China trade war, the conflicts between Korea and Japan affecting significantly to global value chains, the future of Vietnam's economy in 2019 is in the edge of uncertainties in front of world market shocks. SBV has to flexibly, objectively and market-based manage the exchange rate to mitigate the external shocks.

The average inflation rate in the second quarter was at a moderate level of 2.65%, but is on an increasing trend. The impact of the recent increase in electricity and petrol prices to CPI may last 2 to 6 months. Therefore, in order to achieve inflation target below 4%, SBV needs to be cautious with its monetary policies.

In that context, we forecasted growth and inflation in 2019 as follows:

Growth- Inflation in 2019 (%, yoy)

	Economic Growth	Inflation
Q1	6,79	2,63
Q2	6,71	2,65
Q3	7,06	3,38
Q4	7,17	4,21
2019	6,96	

Source: VEPR

With respect to the demand side, retail and service business activities were lucrative. The growth in the total investment capital slightly decreased due to the stagnation of the public sector. S of the first half of 2019, China, once again, was the largest foreign investor with the total registered capital of USD 953.6 million. This surging in the China's FDI flows into Viet Nam was fueled as the US – China trade dispute is getting tougher. Meanwhile, the trade balance in the first six months remained in equilibrium.

Inflation in the first six months of the year was successfully controlled at a low level, however, there are still many latent factors that might escalate the inflation in the near future. Considering that the price of educational items consistently increased; food prices accelerate as the African swine flu crushed into Viet Nam and fuel prices were volatile.

The pressure from the process of monetary normalization in major economies worldwide has decreased. Accordingly, SBV could alleviate pressure on the exchange rate and interest rate management. The research team believe that these two fundamental indicators will not have much fluctuation in 2019 and may be within the target.

Indeed, as Viet Nam was on the US list of currency manipulation published in May, 2019 that SBV has to flexibly, objectively and market-based manage the exchange rate to mitigate the external shocks. Thereby, at the moment, any attempt to depress the value of the VND in order to support trading activities will be a fateful decision.

The correlation between economic sectors has been gradually changing. The non-state sector has been increasingly expanded and made major contribution to government revenue and create many jobs, meanwhile the state sector has shown many weaknesses. Therefore, Vietnamese government should implement policies to encourage the non-state business sector by further eliminating barriers, improving the accessibility to source of capital, information, technology, transparency and tax justice, etc. Additionally, the equitization of state-owned enterprises, which is always the primary goal to improve economic performance, should be decisively facilitated. Moreover, it is essential to reevaluate the position of the FDI sector in encouraging the economic growth; deeper combine the prioritization foreign capital inflows and high technology transfer to improve the labor quality rather than focusing solely on the number of FDI projects. Finally, the participation of Viet Nam in new generation FTAs also exerts pressure on the State to introduce a framework for assessing and controlling the quality of FDI inflows

Interest rate stabilization should be the top priority in order that Viet Nam can sustain favorable conditions for enterprises to access to the capital market, especially in the context of declining deposit and credit growth. In addition, lowering leverage and strengthening the banking system should also be taken into account. Not to mention, the shift of FDI inflows to Viet Nam as a strategic movement of foreign investors to take the advantages of crucial signed trading agreement such as CPTPP and EVFTA and to hedge the risks associated with the US - China trade tensions is another point of interest this year. In the first six months, China were constantly the largest foreign investor in Vietnam. The inflow of capital from China, on the one hand, might exert positive impact on employment and economic growth. On the other hands, it entails environmental risks, management of foreign workers and other problems. Especially under the context that Vietnam is proactively improving institution, environmental standards, labor law, etc. to meet EVFTA requirements. Thereby, it is time for Vietnam to review preferential policies on tax or land for FDI in order to create a more equal environment to do business among different type of ownership as well as ensure the quality of FDI inflows.

Finally, as recommended in the previous reports, in the long term, Viet Nam has to step by step build up a fiscal buffer by streamlining the state apparatus and cutting down on regular spending. Shortly, fiscal buffer emerged as a critical policy objective because a tremendous amount of sustainable source of government revenue will be degraded as Viet Nam has to remove tariff when participating in FTAs. However, despite the new challenges in sustaining the state budget revenue, the government expenditures communicated no signs of decreasing in the near future. Once the problem of high budget deficit and accelerating public debt has not been resolved, the attained growth rate or inflation are persistently based on an insecure foundation.

Note: Long-term and structural policies will be discussed in other policy reports of VEPR.

Danh mục từ viết tắt

BoJ	Bank of Japan
BoE	Bank of England
BSC	BIDV Securities Company
CBRE	CB Richard Ellis Viet Nam
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
JLL	Joneslanglasalle
LHS	left hand side
IMF	International Monetary Fund
MOF	Ministry of Finance
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 Viet Nam
UN	United Nations
USD	the United State dollar
VAMC	Viet Nam Asset Management Company
VCB	Viet Nam Bank of Foreign Trade
VND	Viet Nam Dong
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: Nguyễn Đức Thành, Phạm Thế Anh, Bùi Hà Linh, Hà Thị Dịu (VEPR Macroeconomic Research Team).

This document has been prepared and is being distributed by Viet Nam Institute for Economic and Policy Research (VEPR) and is intended solely for the customers of VEPR and is not for publication to other persons, whether through the press or other means. Advice in this document is general and should not be construed as personal advice.

Additional disclosures

This report is dated as July 11, 2019. All data included in this report are dated June 28, 2019 unless otherwise indicated in the report.

VEPR has procedures in place to identify and manage any potential conflicts of interest that arise in connection with the authors. Any confidential and/or sensitive information is handled in an appropriate manner. All contributions and exchange please send to: Viet Nam Institute for Economic and Policy Research, Room 707, E4 Building, 144 Xuan Thuy Street, Cau Giay district, Ha Noi. Email: info@vepr.org.vn

VEPR

☐ MORE WORKING PAPERS

VMM19Q1 Viet Nam Quarterly Macroeconomic Report, Quarter 1 - 2019

VMM18Q4 Viet Nam Quarterly Macroeconomic Report, Quarter 4 - 2018

VMM18Q3 Viet Nam Quarterly Macroeconomic Report, Quarter 3 - 2018

PD-07: Evaluation of the Law on Public Debt Management of Vietnam and some Policy Implications

PD-06: Minimum Wages in Viet Nam: Preliminary Observations

PD-05: A brief on impacts of Brexit on the World Economy and Vietnamese Economy

WP-18: Development characteristics of SME sector in Vietnam: Evidence from the Vietnam Enterprise Census 2006-2015

WP-17: The 19th National Congress of the Communist Party of China: Preparation for a New Era

CONTACT US

Viet Nam Institute for Economic and Policy Research
University of Economics and Business, Viet Nam National University, Ha Noi
Address: Room 707, E4 Building
144 Xuan Thuy strt, Cau Giay dist
Ha Noi, Viet Nam
Tel: (84-24) 3 754 7506 - 704/714
Fax: (84-24) 3 754 9921
Email: info@vepr.org.vn
Website: www.vepr.org.vn