INDOCHINA CAPITAL
Investing in Vietnam's Future

MONTHLY NEWSLETTER

DECEMBER 2016

MACROECONOMIC UPDATE

	2015 Actual	2016 Actual	2017 Govt Target
GDP Growth Rate *(YoY)*	6.68%	6.21%	6.7%
CPI *(YoY change)*	0.63%	4.74%	4.0%
Trade Balance *(USD billion)*	($3.55)	$2.68	($6.58)
Exchange Rates *(USD/VND)*	22,530	22,810	
Disbursed FDI *(USD billion)*	14.50	15.80	
PMI Manufacturing Index	51.30	52.40	
Credit Growth *(YTD YoY)*	17.17%	18.71%	18.00%
Deposit Rate *(in VND terms)*	5.50%	5.50%	
Retail Sales Growth *(Nominal Terms)*	9.50%	10.20%	
VNIndex	579.03	664.87	

Source: GSO

2016 turned out to be a more difficult year for the Vietnam's economy than policy makers expected. The slow pace of the global economic recovery, low commodity prices, and the El Nino impact on the agricultural sector resulted in GDP growth of 6.21%, nearly 0.5% lower than the original target of 6.70%. However, continued resilient FDI inflows, a solid manufacturing sector and robust domestic consumption point to increased economic expansion in 2017.

- **GDP growth waned after reaching an 8-year high of 6.68% in 2015.**
  - The slower growth resulted from a combination of
    - (i) modest growth in the agriculture, forestry and fishery sectors of 1.36% YoY which is the lowest level since 2011 (2015: 2.41% YoY). Ravaged by El Nino, these sectors reported negative growth during 1H 2016 and only started to recover towards the end of the year; and
    - (ii) a decline in mining output of 4.00% YoY as a result of low commodity prices (2015: +6.5% YoY).
  - Within the industrial and construction sectors, only the mining sector lodged negative growth. The power sector and the construction sector both registered double digit growth of 11.60% and 10.00% YoY, respectively (2015: 11.40% and 10.82% YoY, respectively). The manufacturing sector posted the fastest growth of 11.90% YoY (2015: 10.60% YoY). It is worth noting that Vietnam's PMI has stayed in expansionary territory for 13 consecutive months, indicating more resilient growth than most other ASEAN countries'.
  - The service sector's overall growth accelerated from 6.33% YoY to 6.98% YoY. Despite a mild deceleration in wholesale and retail sectors from +9.06% YoY in 2015 to +8.28% YoY, other sub-sectors accelerated. Real estate reported the highest improvement with growth of 4.00% YoY (2015: 2.96% YoY).
  - In terms of 2016 GDP contribution, the agriculture, forestry and fishery sectors accounted for 16.32% of total GDP, the industrial and construction sector 32.72%, the service sectors 40.92%, taxes less subsidies 10.04%. The respective proportions in 2015 were 17.00%, 33.25%, 39.73% and 10.02%.
  - The Government targets GDP growth for 2017 at 6.7%.
- **Credit growth was 18.71% YoY, stronger than 2015's of 17.17% YoY.**
  - Short-term deposit rates ranged from 5.0% - 6.5% pa while longer-term rates were from 6.5% - 7.2% pa. Short-term lending rates ranged from 6.0 – 9.0% pa while longer-term rates were from 9.3% - 11.0% pa. Average rates were reported to have reduced by 50 bps – 100 bps. Deposit rates are expected to go up in 2017 as inflation kicks in. Yet, the government expects to keep lending rates at the current levels to support economic growth.
  - Target credit growth for 2017 is 18.00%.
- **Inflation for 2016 reached 4.74%, bottoming out from the multi-year low level in 2015 of 0.63%.**
  - CPI was mainly driven by the release of subsidies for public healthcare services and public educational services. This has caused healthcare prices to go up by 77.57% YoY and educational costs 12.5% YoY, resulting in CPI increase of 2.70% and 0.58%, respectively.
  - Target inflation for 2017 is 4.0%.
- **2016 trade surplus came in at a record high at USD2.68 billion vs. 2015's deficit of USD3.55 billion.**
  - Export growth reached 8.6% YoY, faster than 2015's 7.9%. Excluding price changes, export growth would be 10.6% YoY.
  - Import registered growth of 4.6% YoY vs 2015's growth of 12.0%. Excluding price changes, import growth would be 10.5% YoY.
  - The trade balance is expected to record a deficit of USD6.58 billion in 2017. This probably reflects concerns on the potential slowing of Samsung's exports of smart phones which partially accounted for the trade deficit of USD988 million realized in the last quarter of 2016.
- **Disbursed FDI reached a new high of USD15.8 billion, surpassing its previous peak of USD14.5 billion set in 2015.** Newly registered FDI was reported at USD20.9 billion, down 6.7% YoY as a result of a high base effect (2015 registered FDI was a record high since 2008). 65% of the newly registered FDI targeted the manufacturing sector.

- **Strong FDI inflows, a trade surplus and high FX reserves successfully alleviated much of the depreciation pressure on the VND during the year 2016.** The VND only lost 1.24% against the USD last year. However, we expect the USD interest rate hikes will intensify depreciation pressure on the VND in the coming time. The situation could be aggravated by declining remittances and a potential trade deficit in 2017.

- **Below are macro-political highlights for 2016:**
  - A new Politburo was formed after the 12th Party Congress in January. Even though there were no significant changes in policies, the new Government has taken some notable actions:
    - The newly appointed leadership focused its efforts on cleaning up the system, resulting in investigations of economic transactions and SOE failures. Some of the largest companies were involved, including listed companies. This has resulted in increasing volatility in the stock market.
    - They also sped up divestments of SOEs, starting with the auction of Vinamilk's shares and forced listing of Sabeco, Airport Corporation of Vietnam (AVC), Vocarimex, Seaprodex, Power Construction 1, and many other smaller equitized SOEs. This flooded the Vietnam stock market with new supply in the last quarter of the year and has re-directed local investors' interest from the listed market into the OTC market.
    - One of the driving forces behind the Government's resolution to push forward SOE divestments was public debt reaching its ceiling level of 65% GDP.
  - Geopolitical tension in the South China Sea resurfaced with The Hague's court ruling in favor of the Philippines' against China's claim in the South China Sea. However, it appears that Vietnam has reached a separate agreement with China to temporary set aside this issue.
  - The lifting of the US arms embargo in May represents another milestone in the Vietnam – US relationship.
  - Brexit's impact on Vietnam's economy was not significant in 2016 and is expected to be mild in 2017.
  - Trump's victory and his vocal protectionism induced uncertainties to emerging economies. On one hand, Vietnam's growth outlook is expected to dampen if TPP is not enacted. On the other hand, the country may benefit from increasing FDI redirection from China as a result of Trump's anti-China policies.
- **For 2017, the Government re-affirms its pro-growth policies with targeted GDP growth of 6.7% and credit growth of 18.0%.** At the same time, it also places importance on sustainability by speeding up SOE reforms and improving the banking system. To balance targeted growth and the need to keep the budget deficit and public debt under control, the government has slowly taken measures to free up barriers for the private sector, particularly in infrastructure development. We expect this will release a source of ample capital from the private sector to fund growth besides FDI capital.

INVESTING IN VIETNAM

1. **The investment theme:**
   - Strong GDP growth (2017F: 6.5%)
   - Relatively attractive valuations compared to regional peers
     - ✓ Lowest P/E in the regions (16.0x vs ASEAN's average of 18.4x)
     - ✓ Dividend yield of 3.0%
   - Political stability.

2. **Do we expect Vietnam's economic outlook be adversely affected as a result of potential Trump protectionism and the likelihood that TPP is not enacted?**
   - ***Yes, but not by any means drastically***, and the negative fallout is already ***priced in*** by the market.
   - Economic growth has been driven by the manufacturing sector (2016:+11.90% YoY) and the service sector (2016: +6.98% YoY) which are expected to continue in their robust trajectory. ***Growth drivers come from domestic consumption and the global relocation of factories into Vietnam***:
     - ✓ Domestic consumption is underpinned by demographic dividend as the country has the 14th largest population with more than 60% under 35.
     - ✓ GDP per capita growing at CAGR of 10.5% per annum over the last decade and rapid urbanization has expanded the middle and affluent class, resulting in higher demand for consumption, entertainment, recreation and premium goods.
     - ✓ More than 60% of FDI in Vietnam in the last few years flowed into the manufacturing sector, resulting in higher productivity and more employment for skilled workers. This, in turn, leads to faster income growth and consumption.
   - Disbursed FDI in 2016 was a record high at US$15.8 billion, surpassing the previous peak of US$ 14.5 billion set in 2015. Potential protectionism is not likely to decrease FDI flow into Vietnam, because:
     - ✓ FDI in Vietnam flows into the manufacturing sector thanks to not only TPP but also ***low labor costs, and macroeconomic and political stability.***
     - ✓ The wave of FDI redirection from China to other countries and China's growing overseas direct investments are expected to benefit Vietnam as ***factories are relocated to Vietnam*** over time.
     - ✓ ***Korea and Singapore (not the US) have been the major FDI investors in Vietnam***, and they are not likely to be aligned on broad-based protectionist measures.
     - ✓ Without TPP, ***Vietnam's further integration in the global economy remains on track*** due to its participation in the ASEAN Economic Community and important FTAs with EuraAsia Economic Union, Korea and EU.
     - ✓ Vietnam could be a potential beneficiary of US protectionism against China and Mexico.
   - The VN government is committed to pro-growth policies, including stable interest rates and supporting infrastructure development. The participation of the private sector is expected to increase and be the driving force for infrastructure development.
   - 2017 GDP growth is expected to improve to 6.5% (from 2016's 6.2%) on the back of recovery in agriculture sector which was adversely affected by El Nino last year.

3. **Key concern - Currency depreciation:**
   - Pressures come from USD interest rate hikes, decreasing remittances and a potential lower trade surplus.
   - However, FX reserves at a record high level provide the VN State Bank with a buffer against capital outflows and currency speculation.

- The USD/VND FX rate stabilized towards the end of 2016 and we expect it will hold its value well in 2017. The VND is forecast to depreciate only by 2% - 5% against the USD in 2017.

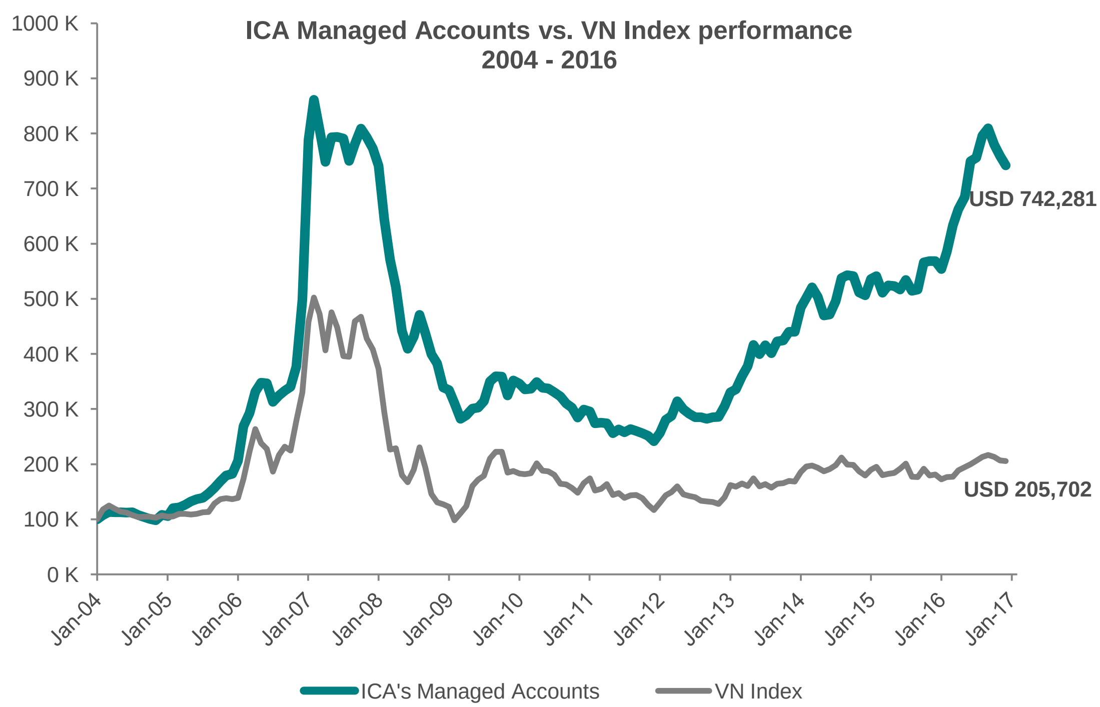
4. Is market valuation already high with the VN Index P/E at 16.0x?

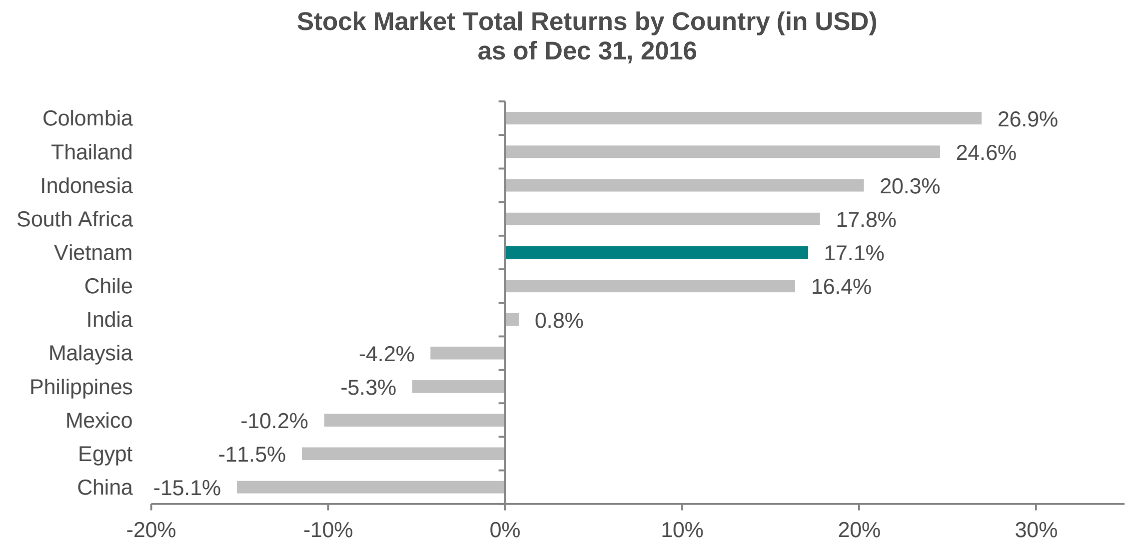
- Regionally it remains one of the markets with the lowest P/E.
- Historically the market is at its highest level since 2009, yet still less than half the level of 2007 (40.0x).
- Market P/E is distorted by recently listed large cap stocks, including Faros Construction (ROS) and Saigon Beer (SAB) with P/Es of 400.0x and 40.0x, respectively. These stocks both have low free float and are subject to speculative forces. Excluding these stocks market P/E would be around 13.9x.
- 60% of listed stocks are trading at P/E lower than 12.0x.
- Many companies are expected to post **double digit growth in each of the next 2 years with 2017's averag**e P/E of 10.0x.

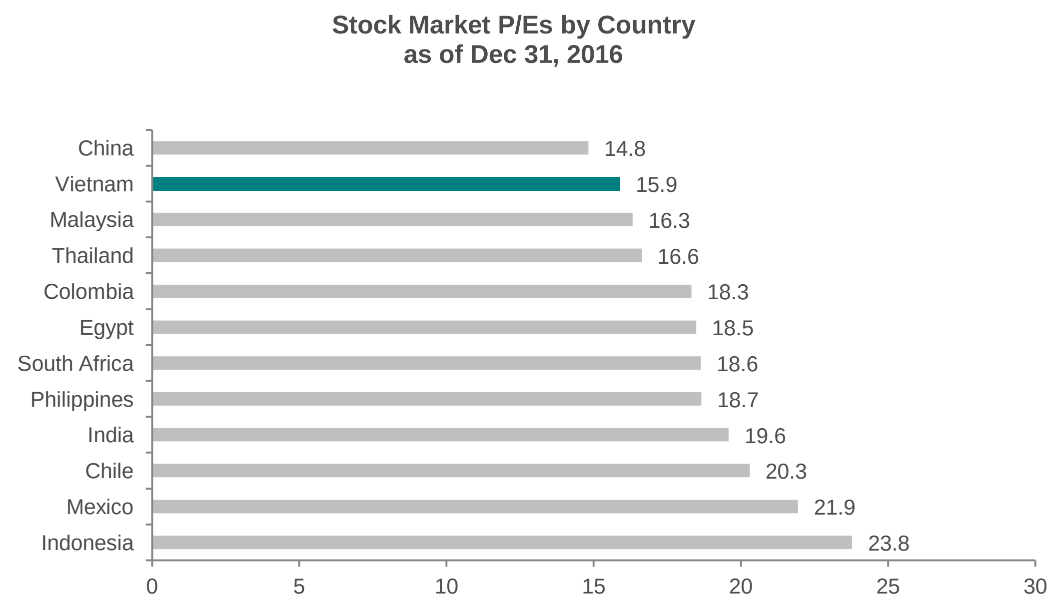
➔ Valuation is still attractive given positive growth prospects. 2017 Market P/E is expected at 12.4x **at current price levels.**

5. Which stocks to invest?

- The investible universe has expanded.
  - ✓ The combined market cap of the VNIndex and VHIndex is USD68 billion, up by 20% YoY. Including the UPCOM (Unlisted Public Company Market), the total market cap of easily investible stocks is USD81 billion, expanding 38% YoY.
  - ✓ New supply coming from IPOs of large private companies and forced listings of SOEs since the end of 2016 has increased the investible universe significantly. These include Novaland (NVL), Vietjet Air, Quang Ngai Sugar (QNS), Power Construction 1 (PC1), Sabeco (SAB), Airport Corporation of Vietnam (ACV).
  - ✓ Market cap available to foreign investors increased to USD45 billion, up 67% since end of 2015.
  - ✓ The removal of FOL of some large caps (most notable VNM and CII) provides foreign investors with more access to quality investments.
  - ✓ This trend is expected to continue into 2017 with more SOE divestments, IPOs and new listings.







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