HSBC Global Research

4 July 2023

Vietnam at a glance

Summer blues

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Economics - Vietnam

- While Vietnam's 2Q GDP rose at a higher-than-expected pace, by 4.1% y-o-y, mounting broad-based challenges linger
- We recently trimmed our 2023 GDP growth forecast to 5.0% (prev: 5.2%), expecting a meaningful rebound only in 4Q23
- We see more reasons for further policy support: we expect another 50bp rate cut in 3Q23, but fiscal room may be limited

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Trade still subdued

With growth of 4.1% y-o-y, Vietnam's 2Q GDP print is a reflection of what high-frequency data points to. The economic conditions have not deteriorated, but they have not meaningfully improved either. In other words, Vietnam is still grappling with heightened downside risks to growth, particularly from the trade cycle. Indeed, exports continued to slump at a double-digit pace similar to that in 1Q. Given Vietnam's sensitivity to the US economic slowdown, falling orders suggest that the trade downturn could be protracted, taking the weakness throughout 3Q.

Services holding up

That said, services continued to provide a strong bedrock to offset some trade weakness. In particular, tourism recovery remains firmly on track, and is likely to easily exceed the annual tourist target of 8 million. Progress is in part due to its efforts to add flight capacity, and more encouragingly, recently announced relaxation of tourist visa will further boost Vietnam's attractiveness as a popular tourist destination. All in all, we have recently trimmed our 2023 growth forecast to 5.0%, from 5.2% previously.

Support on the way

Amid intensifying headwinds, the authorities have been swift in introducing support. Not only has the State Bank of Vietnam surprisingly cut its policy rate three times, each by 50bp, in 2Q, but also the government has announced fiscal measures, including tax deferrals and VAT cuts, almost by the same magnitude as those introduced during the pandemic. That said, an "all-in" fiscal package may be limited.

Table 1. Summary of key recent economic indicators

	Apr 23	May 23	Jun 23
PMI	46.7	45.3	46.2
Exports (% y-o-y)	-16.2	-9.1	-11.4
Imports (% y-o-y)	-23.1	-20.8	-16.9
CPI (% y-o-y)	2.8	2.4	2.0
Manufacturing IP (% y-o-y)	-18.3	-20.9	-17.7

Source: CEIC, S&P Global, HSBC

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Driving in the mist

After half a year, challenges are not dissipating. With growth of 4.1% y-o-y, Vietnam's 2Q GDP overshot market expectations of 3.8% slightly (Chart 1). That said, it does not overshadow the mounting challenges. After all, Vietnam's growth has slowed sharply from last year's impressive growth of 8%, due mainly to external risks.

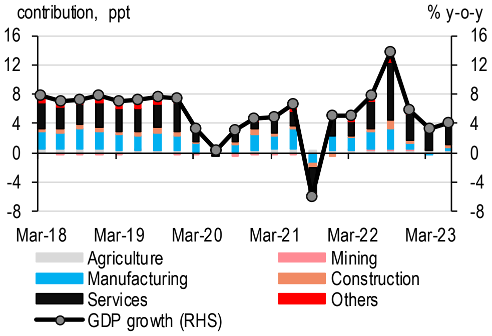
Trade, one of Vietnam's main growth engines, has been losing steam since 4Q22. The **manufacturing** malaise is a notable reflection of the intensifying trade challenges Vietnam has been facing. Although manufacturing growth in 2Q was a positive surprise to us (we factored in a y-o-y decline), the contribution to lift growth was barely minimum (Table 1). The good news is that trade has not deteriorated further. However, Vietnam's trade is not out of the woods yet, as we see no signs yet of a meaningful rebound.

Vietnam's **exports** continued to fall by double-digit in 2Q23, a pace on par with that of 1Q (Chart 3). The only bright spot is agriculture exports, but its 10% share is too small to offset broad-based weakness elsewhere. Major shipments, including consumer electronics, textiles/footwear, machinery and wooden furniture, all suffered double-digit declines. This is largely due to a slump in US import demand, as the US is the dominant buyer in almost all products. Indeed, Vietnam's exports to the US fell at a striking pace of 20% y-o-y YTD, reflecting the severity of the trade downturn.

In addition, Vietnam's manufacturing sector has been facing power shortages in the north in June, home to large tech giants' production facilities, due to heatwaves. While the energy issue has reportedly eased (*Bloomberg*, 12 June), cuts in production have added to manufacturing woes. The key question for Vietnam's manufacturing sector is, when will the global trade cycle turn? The leading PMI indicators point to no reprieve in the near term, as the ongoing trade 'pay-back' in the West continues to weigh on orders. We expect the earliest change in the trade tide to be around 4Q23, but stabilisation will likely precede any meaningful pick-up in shipments. In other words, we expect Vietnam to suffer from a protracted trade downswing, particularly when unfavourable base effects intensify in 3Q23.

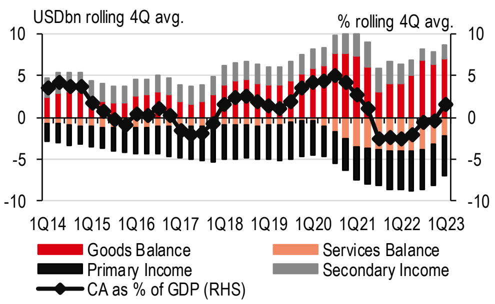
That said, one unintended positive spill-over is on Vietnam's current account. As we have flagged, Vietnam's manufacturing sector is heavily import-intensive. Unsurprisingly, imports have plunged more than exports, leading to a sizeable trade surplus. Along with increasing tourism receipts that have minimised its services deficit, Vietnam's current account improved notably to 6.1% of GDP in 1Q23 (Chart 2), providing some much-needed anchor to the VND.

Chart 1. Despite better than expected, Vietnam's 2Q23 growth was weak



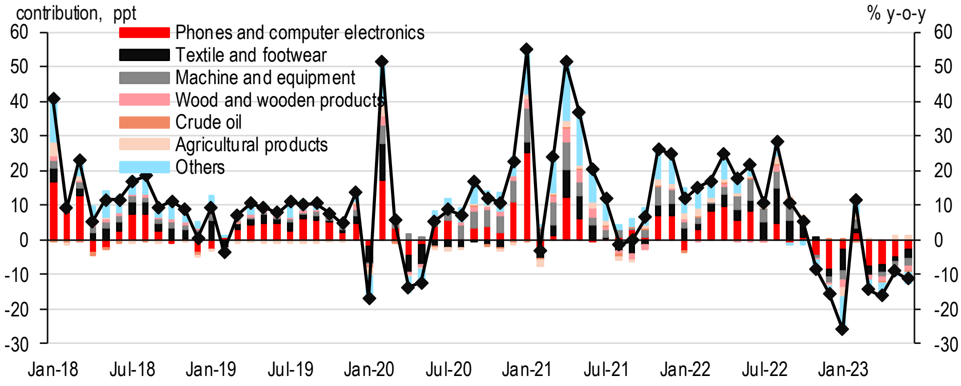
Source: CEIC, HSBC

Chart 2. Despite external woes, current account has improved sharply



Source: CEIC, HSBC

Chart 3. Vietnam's exports are not out of the woods yet



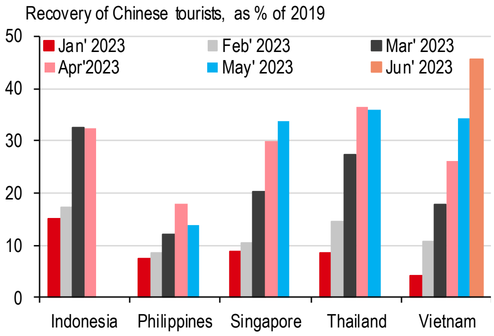
Source: CEIC, HSBC

Despite the export drag, Vietnam's **services sector** came to the partial rescue with its ongoing recovery. In particular, tourism-related services, including transport, accommodation and 'food & beverage' sectors continued to sustain strong growth. Halfway into 2023, Vietnam has seen visitors return 80% of 2019's monthly level, welcoming a total of 5.6 million tourists in 1H23. In particular, Chinese visitors, a major source of tourist arrivals, quickly approached 50% of the equivalent level (Chart 4). Part of the recovery was thanks to efforts to restore direct flights with China, with Vietnam topping ASEAN just after Singapore (Chart 5). This progress suggests that Vietnam is on a firm track to exceed its initial annual target of 8 million tourists.

Vietnam's National Assembly has passed the long-anticipated law to further ease visa restrictions. Effective from 15 August, the new rule will extend the validity for visa-exempt markets to 45 days (up from 15) and those with e-visa arrangements in 80 markets to 90 days (up from 30) (VNExpress, 23 June). The change will come in time for the popular winter season, aiming to facilitate easier travel and attracting an increasing influx of tourists.

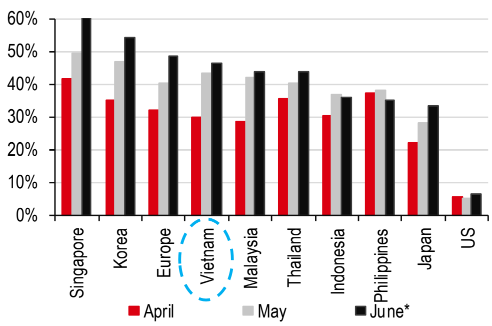
Outside of growth, inflation has been consistently delivering good news. Headline inflation moderated to 2.0% y-o-y in June, in line with our expectations. The main driver is energy disinflation, which has dragged down headline prices further away from the State Bank of Vietnam's 4.5% inflation ceiling (Chart 6). While the electricity hike pushed up inflation momentum, reflected in inflation with a one-month lag, the sub-3% magnitude added little impact. Even more encouragingly, core inflation cooled to 4.3% y-o-y, the first time below the ceiling in nine months. That said, upside risks linger. For one, food inflation momentum jumped in June, reflecting a notable rise in pork prices. But price pressures came from higher demand due to sustained recovery in tourism, not supply-side disruptions, like the African Swine Flu episodes previously. In addition, the El Nino impact warrants a close watch on agriculture production, especially in staple foods like rice.

Chart 4. Chinese tourists approached 45% of 2019's monthly level in Vietnam



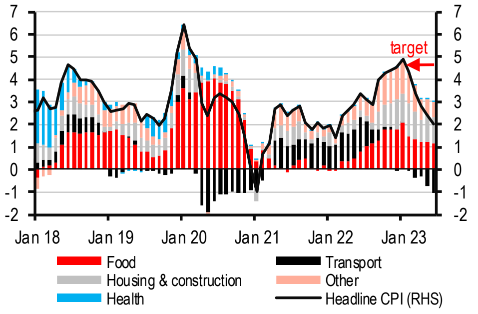
Source: CEIC, HSBC; NB: Malaysia's 2023 tourism data is not yet available

Chart 5. Flights in ASEAN have restored quicker than elsewhere, notably in the US



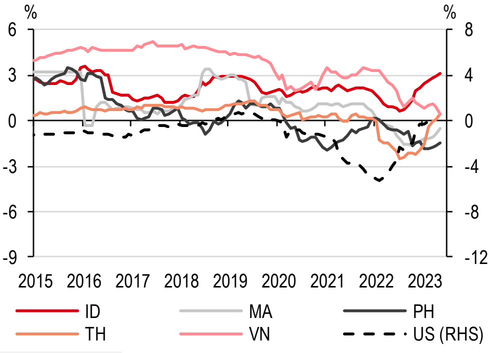
Source: Flight Master, HSBC; NB: June data as of the latest available weekly data

Chart 6. Inflation continues to cool, thanks to energy disinflation



Source: CEIC, HSBC

Chart 7. Vietnam's real yields have been shrinking



Source: CEIC, HSBC

Table 2. Monetary policy comparison (2023 vs pandemic years)

Time		Magnitude of rate cuts (bps)
1H23	Refinancing rate	150
	Discount rate	150
During the pandemic	Refinancing rate	200
	Discount rate	150

Source: CEIC, State Bank of Vietnam, HSBC

Amid intensifying economic challenges, Vietnam's authorities have stepped up efforts to roll out stimulus measures. On the monetary front, the State Bank of Vietnam made a series of surprising moves in 2Q. In less than three months, the State Bank of Vietnam has delivered surprising cuts to its policy rate three times, each time by 50bp. Easing inflation has provided breathing room, while a relatively stable VND also provides valuable support for looser monetary policy. That said, upside risks linger for the former, while the latter may face downward pressure from eroding real interest rate yields (Chart 7). We only expect growth to meaningfully stage a turnaround in 4Q23, warranting more monetary support. We expect the State Bank of Vietnam to deliver another 50bp rate cut in 3Q23, bringing the policy rate to 4.0%. This will likely reverse the State Bank of Vietnam's tightening efforts in 2022, as well as matching the magnitude of monetary support during the pandemic (Table 2).

On the fiscal front, the authorities have also announced various fiscal support measures, with the magnitude almost matching those introduced during the pandemic (Table 4). This includes a 2ppt VAT reduction for selective sectors (which has been recently approved by the National Assembly), tax payment deferrals on various taxes for 3-6 months, as well as environment tax cuts on gasoline and diesel. That said, the authorities are also aware of fiscal constraints of revenue shortfall, suggesting limits of an "all-in" fiscal rescue package.

Table 4. Fiscal policy comparison (2023 vs pandemic years)

Date		Policy	Description
2023YTD	Jun	Car excise tax payment deferrals	For domestically manufactured and assembled cars; 4th time being extended since the pandemic
	Apr	VAT cut (from 10% to 8%)	Extend 2022's VAT cut until end-2023 in selected sectors
	Apr	Tax payment deferrals	Payment deferrals for enterprises on value-added (VAT), corporate income (CIT), personal income (PIT) taxes, and land rentals by 3-6 months
	Mar	Bond term extension	Decree 08 will allow enterprises to extend the term of bonds by up to 2 years, and allow companies to make bond payments with other assets
	Jan	Environment tax cut	Environment tax on gasoline and diesel at VND2000/litre and VND1000/litre, respectively for 2023 (around Apr 2022 levels)
Pandemic era	2022 Jul	Environment tax cut	Environment tax on gasoline and diesel cut further to VND1000/litre and VND500/litre respectively (cut once in Apr 2022)
	2022 Jan	VAT cut	VAT cut on some goods and services to 8% from 10% during Feb-Dec 2022
	2021 Apr	Tax payment deferrals	Payment deferrals for VAT, CIT, PIT, and land rental fees for eligible businesses by 3-6 months
	2020 Jun	Corporate income tax cut	Cut by 30% for some businesses for 2020
	2020 Jun	Personal income tax policy change	Increase minimum taxable threshold, as well as raise conditional deductions (e.g. having a dependent)
	2020 Apr	Electricity price cut	10% reduction for 3 months
	2020 Apr	Cash transfers	Around USD2.6bn for affected and vulnerable workers from April to June 2020
	2020 Apr	Tax payment deferrals	Payment deferrals for VAT, CIT, PIT, and land rental fees for eligible businesses by 5 months

Source: News, HSBC

Disclosure appendix

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