With events in Ukraine now in their fifth day and Western countries currently imposing sanctions on Russia, we would like to update our investors on the key considerations for Vietnam.

**IMPACT OF THE UKRAINE SITUATION ON VIETNAM’S ECONOMY:**

The Russia-Ukraine conflict will affect Vietnam, particularly with its increasing role in international trade, now 1.8% of all global exports (source: DC forecasts). The direct trade impact could look small but there are emerging risks from production chain disruption. Meanwhile, energy price inflation may pose some pressure, but we believe this is manageable.

1. Trade:

a. **Direct trade between VN and Russia/Ukraine: LIMITED**

Vietnam's trade with Russia and Ukraine accounts for a very small proportion of Vietnam’s total trade, 1% and 0.1% respectively. Vietnam buys mainly fertilizers ($150m), iron and steel ($500m), coal ($500m), and agricultural products ($300m) from these two countries and exports mobile phones ($1,230m), textiles & garments ($480m), and electronic equipment ($640m) to them. These exposures are exceedingly modest compared to Vietnam’s total trade value of $668bn. Therefore, the direct influence on Vietnam from trade with Russia and Ukraine is very limited.

b. **Indirect impact from Global Supply Chain: POTENTIAL**

While the direct impact from Ukraine or Russia is limited in our view, Vietnam might not completely avoid the cost of this event due to global supply chain disruption, particularly on Vietnam’s mobile phone and electronics exports.

Russia and Ukraine are the world's major suppliers of nickel, neon, krypton, aluminium, and palladium that are crucial materials for semiconductor chips. Therefore, any restrictions/disruptions in Russian commodity supply could cause a bottleneck in electronics production. Although Vietnam does not import these materials directly from Russia and Ukraine, it does import chips from South Korea, Japan, and Taiwan, which are among Vietnam’s top four trading partners. In 2021, Vietnam purchased $59bn worth of semiconductors, phones, and electrical products from those markets, accounting for 17.6% of total import value. The East Asian countries have also voiced their support for Western economic sanctions and may potentially implement some themselves. Therefore, any tension between Russia and these countries could impact Vietnam.
Impact of Ukraine Situation on Vietnam
28 February 2022

Table 1: Vietnam’s trade value of electrical products, machines, and phones with South Korea, Japan and Taiwan

<table>
<thead>
<tr>
<th>Country</th>
<th>Exports ($bn)</th>
<th>Imports ($bn)</th>
<th>Total</th>
<th>Notice</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>4.4</td>
<td>10.8</td>
<td>16.9</td>
<td>5.1% of total exports</td>
</tr>
<tr>
<td>Korea</td>
<td>10.8</td>
<td>37.1</td>
<td>59.2</td>
<td>17.6% of total imports</td>
</tr>
<tr>
<td>Taiwan</td>
<td>1.7</td>
<td>11.3</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: General Department of Vietnam Customs, GSO

**c. Trade deficit: SLIGHT IMPACT**

Vietnam has imported approximately $6bn/annum of oil and oil products over the last four years. Hence, a higher oil price will have a slightly negative impact on Vietnam’s trade position. Our current estimate for the 2022 trade balance is $13.2bn in surplus, assuming an average oil price of $85/bbl. However, given a more likely scenario of $100/bbl, Vietnam’s trade surplus could narrow to $12bn, meaning the impact from higher oil price is about 7%.

**2. Inflation: MOST APPARENT, BUT MANAGEABLE**

The most palpable effect of the conflict on Vietnam’s economy is likely to be inflation via the increased oil price. Fuel currently constitutes 3.6% of the inflation basket, whilst the transportation group makes up 9.7% overall.

Year to date, Brent crude oil is up +27.2%. What happens next to the oil price depends on several factors, including how the Ukraine conflict and the Iran nuclear deal develop. According to JP Morgan, the three most likely scenarios, and their impact on the oil price on average, are:

1. Russia may take retaliatory measures + no deal on Iran: $105/bbl
2. Russian escalation + Iranian deal: $100/bbl
3. Fading geopolitical risks + Iranian deal: $88/bbl

Based on the above three scenarios, we forecast the impact of the international oil price on Vietnam’s headline inflation to be an increase of +0.65%, +0.3%, and +0.08% over our current estimate.
The additional impact may therefore not be as significant as might have been expected. Although Vietnam’s domestic gasoline price is a function of the international oil price, the two do not always move in tandem. Vietnam’s fuel price also includes various taxes (import tax, environmental tax) as well as a stabilisation factor. As such, in order to keep inflation under control, the Government may make some policy adjustments. Up to now, solutions that have been deployed include:

(1) The Government financing a local oil refinery company to solve its temporary financial difficulties and raise their production to normal levels.

(2) The Ministry of Finance (MoF) is set to auction 100m litres of RON-92 (local gasoline) from the national reserves this month to increase supply.

(3) Vietnam’s PM has also requested the MoF to consider a reduction of environmental tax on gasoline, which will be discussed in the next National Assembly meeting. Currently, the environmental tax accounts for 15% of the local oil price while total taxes and fees make up 42% of the price.

Overall, we are not particularly concerned about inflation based on just the oil price alone. There are other areas of the consumer price basket such as electricity and water (3.9%), healthcare (5.4%), or education (5.5%) where the Government may be flexible on the pricing. However, there is a concern if there is also an increase in the price of pork, rice, and poultry.

Conclusion:

In summary, there should be a limited impact on Vietnam’s trade given minimal direct exposure to Russia and Ukraine. However, given those countries’ significant roles in global energy and supply chains, Vietnam may not be completely sheltered. The most visible impact on Vietnam’s economy will be through the oil price, which results in an uptick in inflation. In addition, Vietnam’s trade balance may not be as bullish as previously expected, due to the higher cost of oil imports, and, potentially, lower export volume from semiconductor shortages.

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28 February 2022
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