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Vietnam is most vulnerable in Southeast Asia to trade war

Indonesia and Philippines also face big risks

FT Confidential Research

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Shipping containers are loaded to a ship at a port in Hai Phong city, Vietnam © Reuters

Vietnam, the Philippines and Indonesia risk incurring serious damage from the spiralling trade war between the United States and China, with Hanoi the most exposed because of its high level of exports, according to analysis by FT Confidential Research.

The biggest five ASEAN economies are generally better insulated against market turmoil than they were during the "taper tantrum" of 2013, a wave of panic selling induced by a hint from the U.S. Federal Reserve that it would reduce monetary stimulus. But they are unprepared for an extended period of reduced global demand, which could happen as a result of tit-for-tat protectionist measures imposed by the U.S. and China on each other.

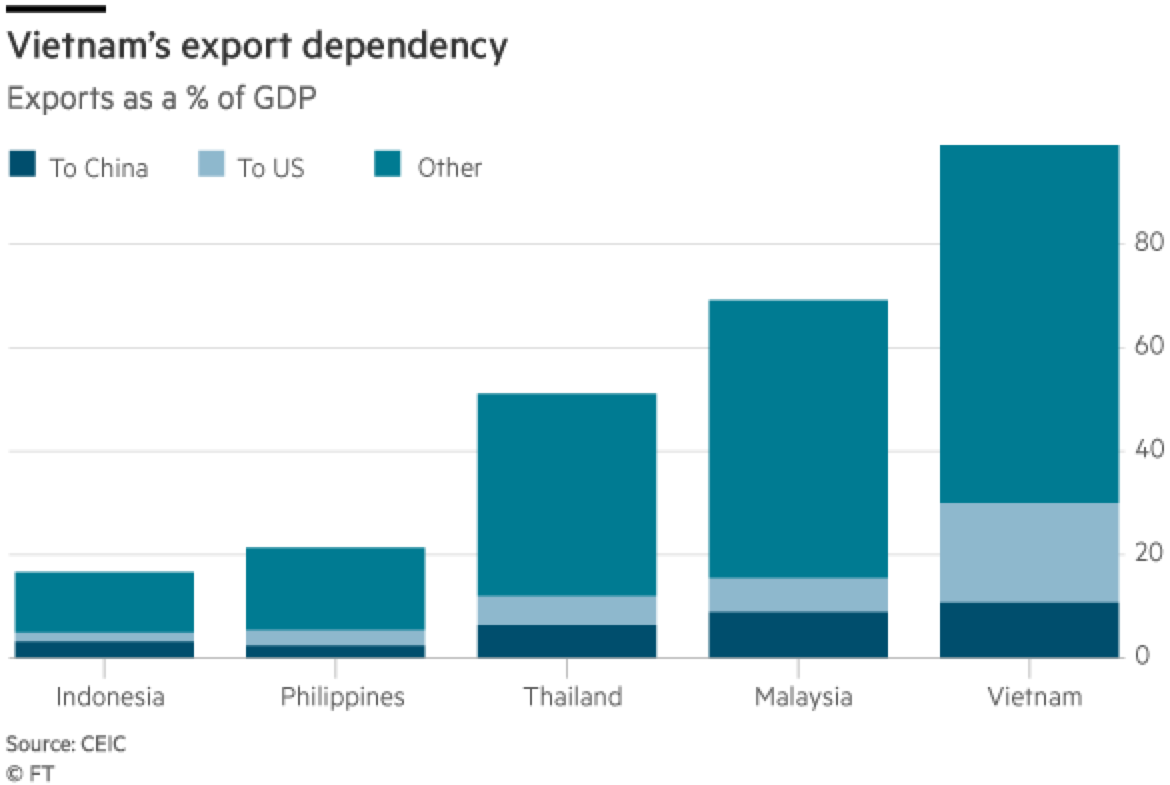
While export-driven Vietnam is the most directly exposed to a global slowdown, the fragile current accounts of the Philippines and Indonesia leave these countries vulnerable to balance of payments crises.

The White House has so far imposed 25% direct tariffs on $34 billion in annual imports from China, with another $16 billion to follow on Aug. 23, and the Chinese government has responded in kind. If this is the extent of the trade fight, then the ASEAN big five economies need not worry.

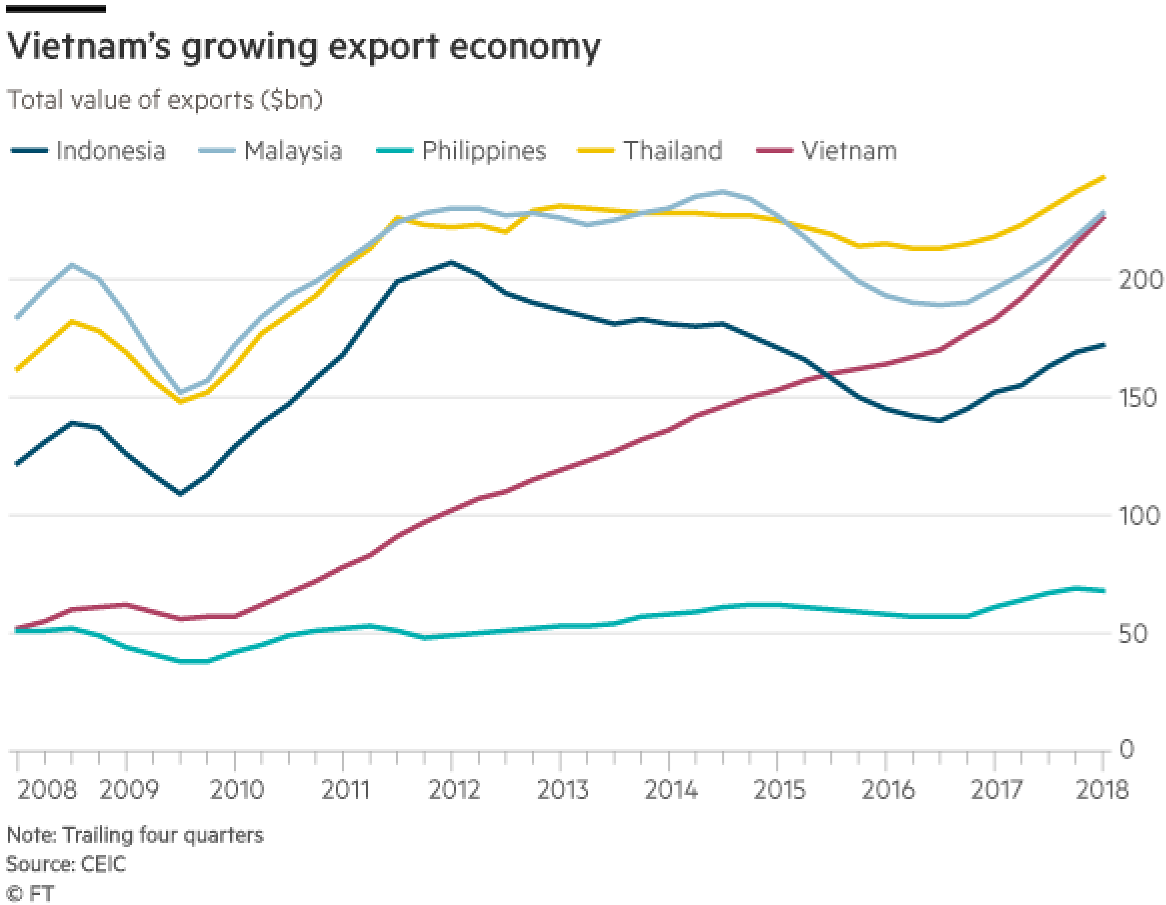
However, these may be only the opening salvos. The U.S. administration is considering levying duties of between 10% and 25% on another $200 billion of imports, and President Donald Trump has threatened to tax all $500 billion in shipments from China. He has also picked trade fights with the EU and other U.S. allies.

As bluster has given way to action, the threat of an all-out global trade war is now being taken seriously. Few countries would be immune to its effects.

Vietnam's roaring economy - it grew at an annualized pace of just over 7% in the second quarter - is by far the most export-dependent among the ASEAN big five. For the 12 months ending March 2018, the country shipped goods equivalent to 99.2% of gross domestic product.



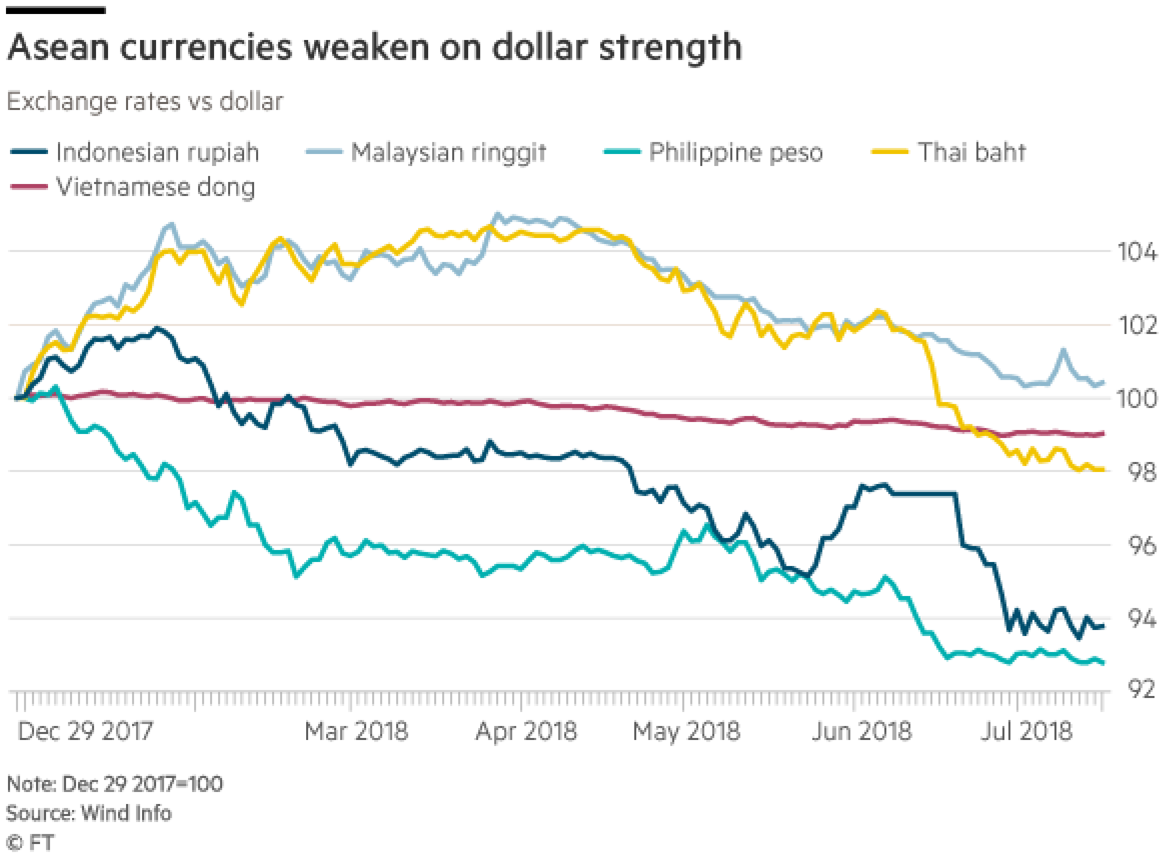
To a much greater extent than its Asean-5 peers, Vietnam has relied on exports for growth over the past decade, nearly quadrupling its shipments between 2008 and 2017. The country's annual exports have reached $226 billion, just $17 billion behind Thailand, the regional leader.



At $43.7 billion, Vietnam's annual exports to the U.S. rank first among the ASEAN five, making the country sensitive to softening U.S. consumer demand. It is sales to the U.S., EU and other developed markets, and not to China, that have propelled Vietnam's growth over the past decade.

The threat of serious trade conflict is adding to the pressure on emerging markets caused by the strengthening U.S. dollar. Although the ASEAN five have not been hit as hard as Turkey or Argentina, equities in all five countries have sold off sharply, with only Vietnam holding on to many of last year's gains.

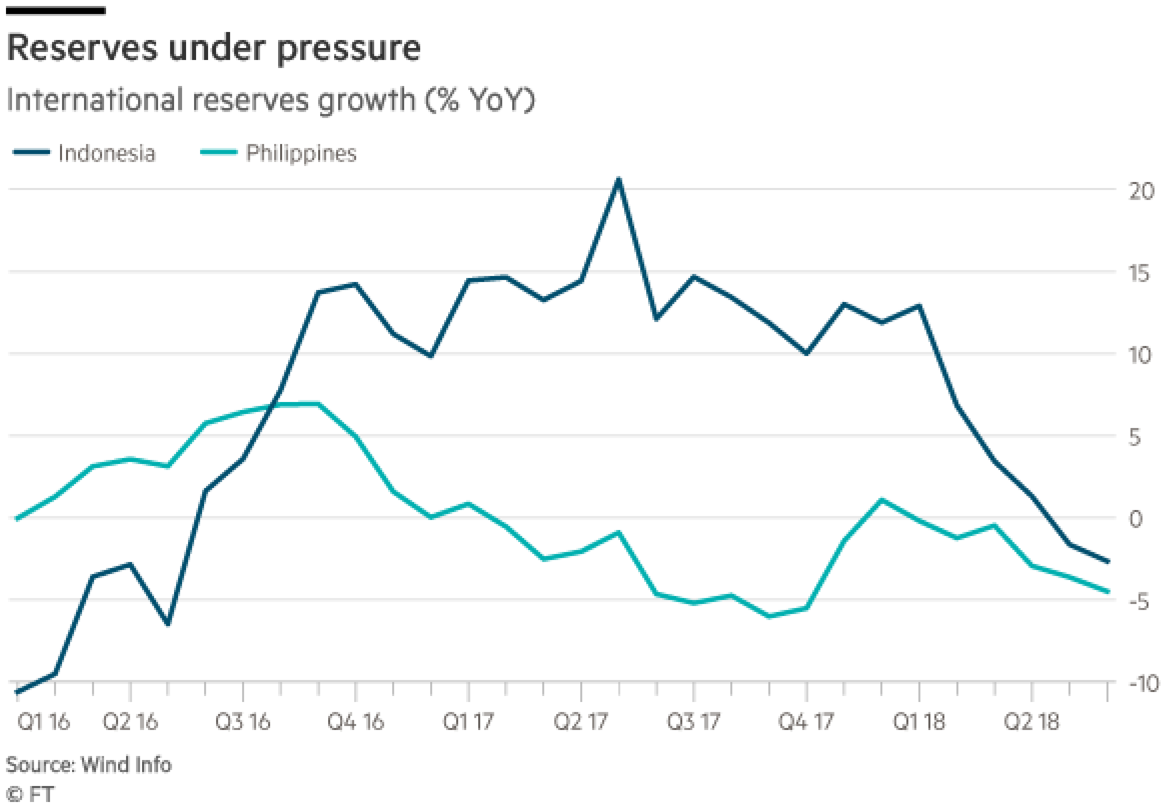
The Philippine peso has been the worst performer among the ASEAN five currencies, shedding more than 7.3% so far this year against the dollar, followed by the Indonesian rupiah at 6.1%. Quietly, the Vietnamese central bank has devalued the dong, which is fixed to the dollar via a crawling peg. The dong is down 1.5% so far this year, and the government could take more aggressive action if exports slow significantly.



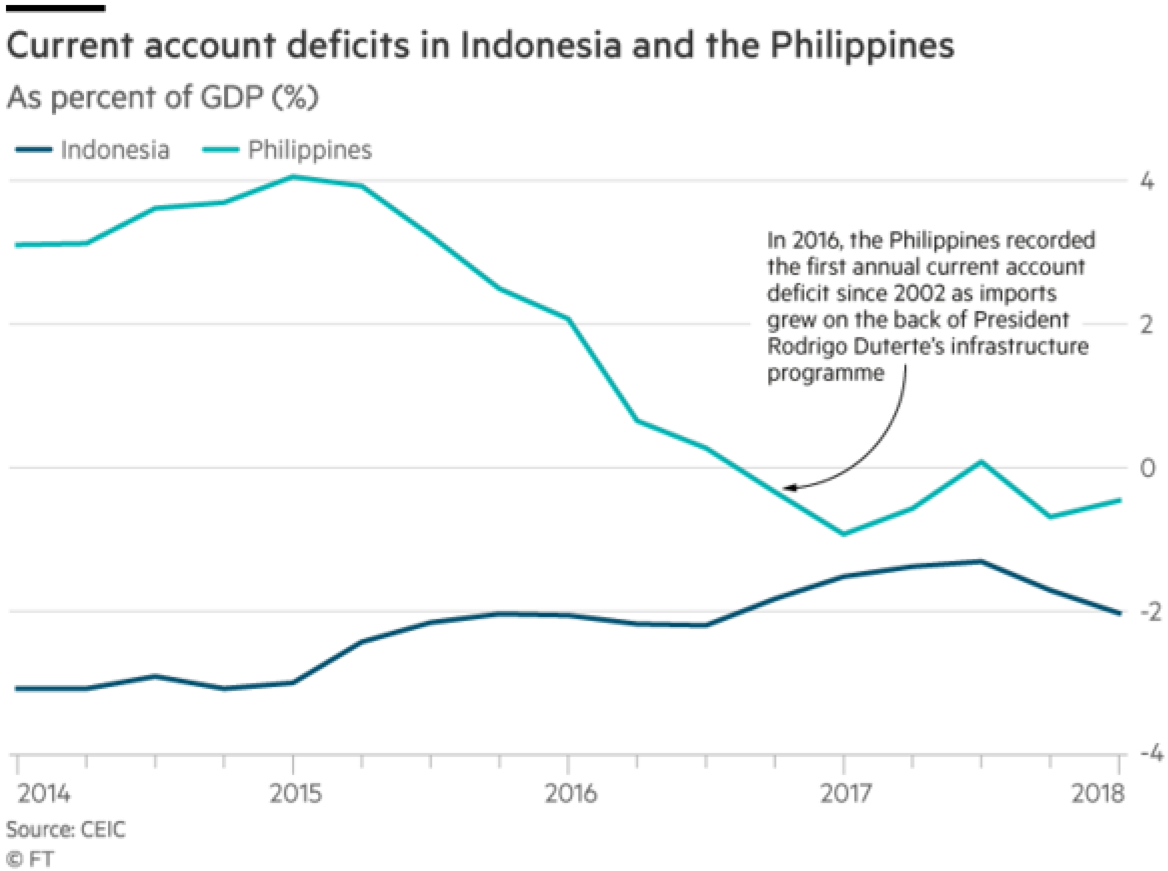
Some currency weakness may help cushion export-focused economies such as Vietnam, Thailand and Malaysia. They could also benefit in the longer run if foreign direct investment shifts away from China as more companies hedge against the risk of trade action. Likewise, tariffs on goods produced within its borders will encourage China to accelerate offshoring to less expensive ASEAN economies.

However, for the less export-reliant economies of the Philippines and Indonesia, whose currencies have declined the most rapidly, depreciation means faster-growing current account deficits and greater inflationary pressure.

The Philippines and Indonesia have been running persistent current account deficits, making them more susceptible to currency depreciation and - in extreme scenarios - balance of payments crises. For now, their import cover is sufficient, with foreign exchange reserves equal to 8.8 months of imports for the Philippines and 8.1 for Indonesia.



The situation in the Philippines is the more precarious. The economy is being squeezed by a deteriorating trade balance and decelerating remittance growth. The country has run a current account deficit since late 2016, reducing foreign currency reserves by 10.7% from their September 2016 peak.



Worse, the trend is accelerating. Almost half of the country's reserve losses have come in the past six months, a pace that could become unsustainable if external conditions worsen. The Philippines also has the ASEAN 5's highest dependency on dollar-denominated energy imports, so a weaker peso is increasing its import bill.

Inflation compounds such challenges. The consumer price index for the Philippines has increased every month so far this year because of rising oil prices and a rice shortage, growing 5.7% in June from 3.3% in 2017.

In Indonesia, inflation is currently under control, but the country has run the largest current account deficit among the ASEAN 5 since 2012, and its foreign exchange reserves dropped 8.1% in the first half alone. Indonesia may have a low overall reliance on exports, but it ships huge amounts of coal, palm oil and other commodities, so a global demand shock would have an outsized impact on its trade balance.

In a full-blown U.S.-China trade war, there will be nowhere to hide - but some Asean-5 countries are more exposed than others.

FT Confidential Research is an independent research service from the Financial Times, providing in-depth analysis of and statistical insight into China and Southeast Asia. Our team of researchers in these key markets combine findings from our proprietary surveys with on-the-ground research to provide predictive analysis for investors.