VIETNAM

THE HEALTH SHOCK WAS MORE SEVERE IN 2021 THAN IN 2020

Vietnam weathered the 2020 health crisis without any major waves of infection, without a contraction in GDP and without a notable deterioration in its macroeconomic fundamentals. In 2021, the situation was much more complicated. In Q3, an upsurge in the number of Covid-19 cases and strict lockdown measures brought the economy to a standstill. The epidemic curve deteriorated further in Q4, but the economy picked up again thanks to the increase in vaccinations and the adjustment of the "zero Covid" strategy. In the manufacturing sector, production and exports rebounded, and growth prospects are still solid. In contrast, private consumption and activity in the services sector remain weak. The government still has some manoeuvring room to boost its fiscal support.

SEVERE ECONOMIC CONTRACTION IN Q3 2021

In 2020, the Covid-19 epidemic was very limited in scope in Vietnam, resulting in a very mild deterioration in its macroeconomic performance. In 2021, new waves of infection had much more severe consequences. The number of Covid-19 cases began rising in May and then soared in July and August, leading the authorities to introduce extremely strict lockdown restrictions and quarantine measures during the summer (chart 1). Economic activity collapsed across the board. Real GDP contracted by 6% year-on-year (y/y) in Q3 2021 (after increasing by 5.7% in H1 2021), the country's worst performance since the early 2000s.

The health situation is still fragile. After declining in September-October, the number of new cases has skyrocketed since November as lockdown restrictions have been eased. Although mobility indexes were still lower in December than at the beginning of the year, they have continued to improve slowly in recent weeks, despite another upturn in the epidemic curve. The authorities seem to be moving away from a strict "zero Covid" strategy, thanks notably to the rapid advancement of the vaccination campaign recently. By January 7th, 80% of the population had been partially or totally vaccinated, up from less than 5% at the end of June.

UNEVEN REBOUND IN Q4 2021

In this environment, manufacturing production and exports picked up again as of Q4 2021. Industrial output rebounded by 4.2% y/y in Q4 after contracting by 3.7% in Q3 (vs +10% in H1 2021). Export growth accelerated rapidly from 3.2% y/y in Q3 to 19.1% in Q4, driven by still strong global demand for telephones, computers and other electronic devices, as well as for lower value-added goods such as textiles and footwear.

In the services sector, in contrast, activity is still affected by the effects of the latest epidemic outbreaks. It is constrained by the prudence of consumers, remaining restrictions and the absence of foreign tourists (the direct contribution of tourism to growth was estimated at 6% of GDP in 2019). Retail sales volumes declined by another 9% y/y in Q4 after plunging by 32% in Q3. Activity continued to contract in the hotel, restaurant, transport and leisure services sectors in Q4 2021.

All in all, real GDP growth rebounded to 5.2% y/y in Q4 and reached an average of 2.6% in 2021. Assuming there are no more strict lockdowns, economic growth should continue to accelerate and is projected to exceed 7% in 2022, as it did in 2018 and 2019. Growth should be driven by the gradual recovery in domestic demand and the continued development of the export manufacturing sector. In fact, foreign direct investment (FDI) should continue to support the expansion and upmarket shift in Vietnamese exports.

FORECASTS

	2019	2020	2021e	2022e	2023e
Real GDP growth (%)	7.2	2.9	2.6	7.3	7.0
Inflation (CPI, year average, %)	3.8	3.2	1.8	2.9	3.5
Budget balance / GDP (%)	-3.3	-3.9	-4.7	-5.0	-4.6
General government debt / GDP (%)	43.6	46.3	49.0	49.5	49.4
Current account balance / GDP (%)	3.7	4.3	-0.8	2.9	2.7
External debt / GDP (%)	35.8	36.4	36.7	35.6	34.0
Forex reserves (USD bn)	78.3	94.8	107.0	110.0	115.0
Forex reserves, in months of imports	3.6	4.2	4.0	3.7	3.7

TABLE 1 — e: ESTIMATE & FORECASTS — SOURCE: BNP PARIBAS ECONOMIC RESEARCH

MAJOR COVID-19 WAVES SINCE LAST SUMMER

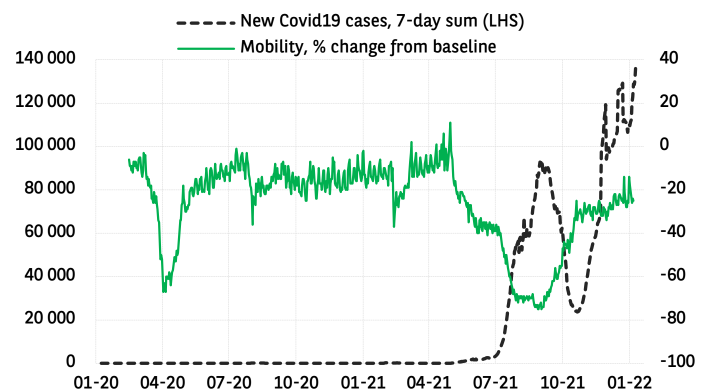

CHART 1 — SOURCES: WHO, GOOGLE

TEMPORARY RETURN TO A CURRENT ACCOUNT DEFICIT

Vietnam's external accounts strengthened significantly in the years prior to the Covid-19 pandemic, thanks to large FDI inflows, steady growth in the export base and current account surpluses, increasing forex reserves, and the stabilisation of external debt ratios at moderate levels.

In 2020, these dynamics were not called into question (chart 2). The export sector was able to respond to growing global demand in the aftermath of the Covid-19 shock and increased its market share (Vietnam accounted for 1.6% of world exports in 2020, up from 1.4% in 2019). The current account surplus strengthened and exceeded 4% of GDP in 2020, thanks to an increase in the trade surplus, and despite the deterioration in the deficit of the balance of services (resulting from the fall in tourism activity). FDI inflows only dipped slightly. Forex reserves continued to rise and the external debt ratio held close to 36% of GDP.

In 2021, in contrast, the current account balance deteriorated sharply, and the full-year deficit is estimated at close to 1% of GDP. However, this current account deficit is not considered to be a major source of vulnerability.

First, it will be temporary. While the deficit in the balance of services continued to widen in 2021, the current account deficit mainly resulted from a major but transitory deterioration in the trade balance, which swung into a deficit in Q2 and Q3 2021. While import growth remained strong, export growth slowed as a result of the lockdown measures, supply-chain disruptions for intermediate goods and transport problems. Once the export engine started up again in October, both the trade and current account balances swung into surpluses again in Q4. This positive trend is expected to continue in the very short term, even though it may remain hampered by shortages still plaguing the region's industries.

Second, FDI is resilient. In 2021, net FDI inflows registered in the balance of payments continued to decline slightly, but held close to an estimated 4% of GDP. As a result, Vietnam managed to preserve a positive "basic balance" (current account + FDI), which means it did not have to resort to new debt to cover its external financing needs. The country also continued to accumulate forex reserves, which now exceed USD 100 bn and cover four months of imports. These dynamics also contributed to the dong's slight appreciation against the US dollar.

Vietnam is well positioned to continue to attract foreign investors and expand its export base in the short and medium term. We expect its current account surplus and its external liquidity and solvency position to consolidate in the future.

NEED FOR FISCAL SUPPORT

The authorities will need to strengthen fiscal support measures in the very short term. Domestic market-oriented activity is struggling to recover and the most vulnerable households and enterprises need assistance. The government has some manoeuvring room to ease its fiscal policy. The health crisis hit Vietnam after several years of public-account consolidation, and the stimulus plans launched since 2020 have been relatively small. The fiscal deficit is expected to increase to 4.7% of GDP in 2021 from 3.9% in 2020 and 3.3% in 2019 (based on IMF data). Government debt is still moderate, estimated at 49% of GDP at year-end 2021, compared to 43.6% in 2019. In 2022, assuming the fiscal deficit increases to 5% of GDP and the economy records a strong rebound, the public debt-to-GDP ratio should barely increase.

Moreover, the government has had no difficulty to cover its financing needs over the past two years, mainly on the local bond market (dong-denominated bonds now account for 60% of total government debt). The yield on 10-year government bonds (residual maturity) gradually declined to an average of 1.9% in Q4 2021, from 2.2% in Q4 2020 and 3.6% in Q4 2019.

THE CURRENT ACCOUNT BALANCE DETERIORATED IN 2021

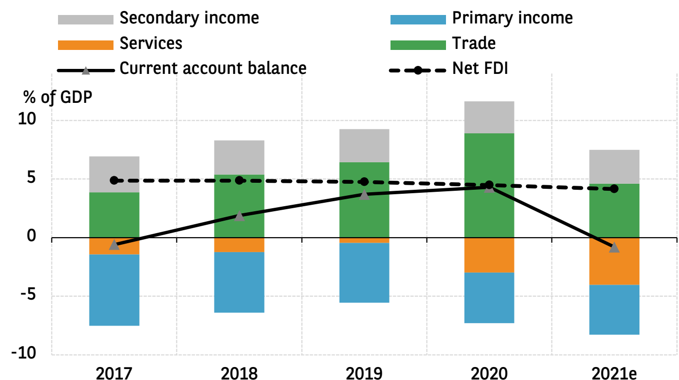

CHART 2 SOURCE: STATE BANK OF VIETNAM, BNP PARIBAS

In contrast, monetary policy will have less manoeuvring room in 2022. First, inflationary pressures are on the rise. Consumer price inflation slowed in 2020 before accelerating again in 2021, rising from 0.3% y/y in Q1 to an average of 2.7% for the period April-August. In Q4, inflation eased to 1.9%, but it is likely to pick up again in the short term, driven up by the recovery in domestic demand and by higher logistics and transport costs. Before reaching the central bank's 4% target, higher CPI inflation could lead to policy rate hikes by the end of 2022 (the key policy rate has been held at 4% since October 2020, down from 6% at year-end 2019).

Moreover, the economy's excessive debt burden is likely to push the central bank to be cautious. Monetary conditions have remained very accommodative since the beginning of the health crisis (given rate cuts, liquidity injections, the easing of macro-prudential rules, and loan rescheduling measures). Domestic credit growth accelerated from 10% y/y in mid-2020 to about 15% in mid-2021, before dipping a bit thereafter. It then levelled off at a persistently high rate of about 14% y/y in Q4. Consequently, total domestic credit represented 139% of GDP in 2021, up from 121% in 2019 (based on the new figures for annual nominal GDP, which was revised up by 25% by the Vietnamese statistics office). The authorities must act to slow down the increase in debt. At the same time, given the troubles some enterprises have encountered in the last two years, coupled with the fragility of some banks (which still lack sufficient capital ratios), an overly rapid tightening of monetary conditions is unlikely as it could result in a dangerous increase in credit risk.

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