Vietnam

A resilient export sector

Given its dependence on foreign trade and its integration within Asian supply chains, the Vietnamese economy is squeezed by the weakening in global demand and Sino-American trade tensions. Real GDP, exports and industry have all registered a growth slowdown in recent months. Yet Vietnam could also benefit from China's troubles: in the short term, it could benefit from some carry-over effects if merchandise is shipped directly to US businesses seeking to avoid the new tariff barriers. Vietnam could also benefit from new foreign direct investment projects of international groups seeking to manufacture outside of China. Moreover, Vietnam's external financial position is also expected to continue to improve.

Vietnam continues to report solid economic growth rates. Real GDP has increased at an average annual rate of 6.6% since 2014, higher than the 6.3% average recorded by Asian emerging countries as a whole. After peaking at 7.1% in 2018, the highest growth rate in the past ten years, economic growth has slowed slightly since early 2019. It reached 6.7% year-on-year (y/y) in H1 and is expected to slow further in H2. Given its high degree of trade openness, Vietnam is vulnerable to the weakening in global demand and the spillover effects of Sino-American trade tensions. The United States and China (including Hong Kong) each absorbed 20% of Vietnamese exports in 2018.

Yet economic growth prospects are still very favourable in the short and medium terms, driven by a strong domestic demand and the continued expansion of the export sector. The sector could even benefit from new foreign direct investments (FDI) by corporates seeking to establish production centres outside of China.

Sino-American tensions: a damper on exports…

Vietnam's export performance has deteriorated over the past year due to the weakening in global demand and the knock-on effects of higher US tariffs on imports of Chinese goods. Merchandise exports (in current dollars) rose only 7% y/y in H1 2019, vs. 13% in 2018 and 22% in 2017 (chart 2). US tariff measures have had a sharp impact since fall 2018, mainly via the spillover effect on regional supply chains, as well as through the indirect negative effects on global confidence, investment and demand. As a result, Vietnamese manufacturing growth slowed to 11% y/y in real terms in H2 2019, from 13% in 2018 and 14.4% in 2017.

However, on the whole, the manufacturing and export sectors are still posting relatively solid performances compared to the region's other economies, and Vietnam continues to win international market share (it accounted for 1.3% of total world exports in 2018). After hitting a low in Q1 2019, export growth has regained a bit of vigour in Q2. This slight upturn has also benefited the other countries integrated within Asian supply chains, but Vietnamese export growth has maintained its lead.

Vietnam's manufacturing export base has expanded steadily over the past ten years, largely supported by FDI inflows. Merchandise exports as a percentage of GDP increased from 67% in 2012 to 100% in 2018. Moreover, this expansion was accompanied by the diversification and continued rise in the value-added of exported products. Computers, electronics and phones now account for 33% of total exports, up from 17% at year-end 2011.

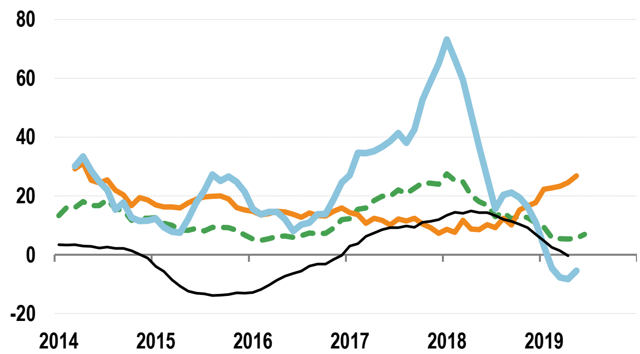
1- Forecasts

	2017	2018	2019e	2020e
Real GDP growth (%)	6.8	7.1	6.5	6.5
Inflation (CPI, year average, %)	3.5	3.5	3.1	3.3
Budget balance / GDP (%)	-4.8	-4.6	-4.5	-4.3
General government debt / GDP (%)	58.2	57.5	57.4	57.1
Current account balance / GDP (%)	2.9	2.4	2.1	2.1
External debt / GDP (%)	47.2	48.1	49.2	49.6
Forex reserves (USD bn)	49.1	55.5	65.0	74.0
Forex reserves, in months of imports	2.7	3.0	3.1	3.1
Exchange rate VND/USD (year end)	22 700	23 190	23 450	23 700

e: BNP Paribas Group Economic Research estimates and forecasts

2- A mild deterioration in export performance

Exports in USD, y/y, %, 6-month moving average



Source: Vietnamese Statistics Office

… but also an opportunity

Vietnam could benefit from the current troubles of Chinese exporters: in the very short term, by partially replacing Chinese exports by shipping manufactured or semi-manufactured goods directly to US companies seeking to avoid the new tariff barriers, and, then, by attracting investors seeking to move their production centres outside of China.

As a matter of fact, the slowdown in total export growth since November 2018 has been mainly due to the contraction in shipments to China and Hong Kong (down 4.5% y/y over the period November-May) while exports to the United States surged by 24.7% y/y over the same period. This suggests that Vietnamese manufacturers have benefited from some carry-over effects.

Moreover, the recent increase in the number of FDI projects in the manufacturing sector (mostly initiated by China's and Hong Kong's corporates) also suggests that the relocation of some production centres outside of China should benefit Vietnam. Major Japanese and Korean groups have also recently expressed interest in increasing their production capacity in Vietnam.

Vietnam maintains several comparative advantages that should enable it to continue to attract foreign investors. It is already well integrated in Asian supply chains, wages costs are still competitive, and the authorities are slowly pursuing reforms that aim to consolidate macroeconomic stability, strengthen the institutional framework and improve the business environment (for the sake of illustration, Vietnam improved from 99th in 2013 to 69th in 2019 in the World Bank's Doing Business rankings).

Vietnam has also participated in many trade agreements, demonstrating the authorities' determination to promote free trade policy. Two examples are the Trans-Pacific Partnership (TPP), which partially took effect in early 2019, and the free trade agreement with the European Union, which should take effect by 2020. Vietnam is also participating in talks to harmonise all of the bilateral trade agreements between the ASEAN countries in order to create a broad regional partnership.

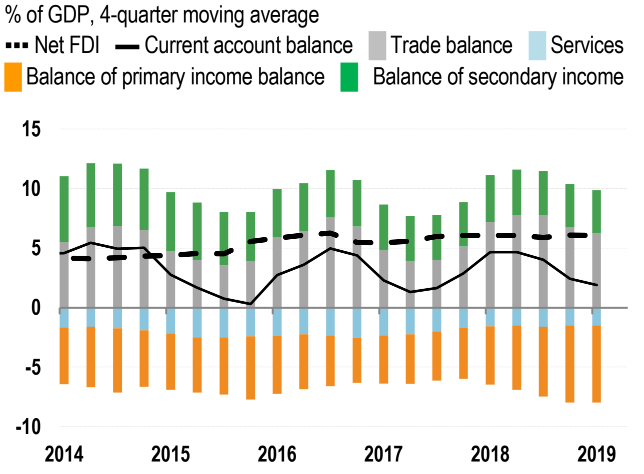
The external position is strengthening gradually but some vulnerabilities persist

Vietnam's current account balance has been in surplus since 2011. The trade surplus is the main component: it has averaged 5.7% of GDP since 2013 and peaked at 6.8% in full-year 2018 (chart 3). After rising in the first three quarters of 2018, the trade surplus has narrowed since Q4 2018 due to the erosion of its export performance. Given the high import content of exports, import growth also weakened, but continued to outpace exports, thanks to robust domestic demand.

Transfers (international aid and remittances from the diaspora) are the second key contributor to the current account surplus. Despite a slow structural decline in recent years, net transfers are still solid and accounted for 3.6% of GDP in 2018. In contrast, the balance of primary income is negative and has deteriorated rapidly since 2017 (-6.5% of GDP in 2018), notably due to the increase in earnings repatriated by foreign enterprises. The services deficit is moderate (1.5% of GDP in 2018) and has improved slightly since 2017 thanks to the development of the tourism sector.

All in all, the current account surplus narrowed from 2.9% of GDP in 2017 to 2.4% in 2018 and is projected at 2.1% in 2019. This mild deterioration is due to both external shocks (slowdown in merchandise exports) and structural factors (increase in earnings repatriated by foreign groups, which the export sector depends heavily on). Assuming the export base continues to widen, the current account surplus should stabilize or even pick up slightly in 2020.

3- A very comfortable basic balance



Source: State Bank of Vietnam

Vietnam has benefited from a largely positive basic balance (current account balance + net FDI) for several years, and its reliance on external debt has thus remained very moderate. Yet its foreign debt stock has increased in recent years, mainly due to private-sector debt, including inter-company loans. The external debt-to-GDP ratio rose from 40% in 2012 to 48% in 2018, and the debt servicing burden has remained all the more moderate since export revenues have increased strongly (it was estimated at 5.3% of exports of goods and services in 2018).

The external liquidity position has also improved but remains fragile. Foreign exchange reserves have more than doubled since 2012 to USD 55 bn at year-end 2018, but they do not yet cover more than three months of imports of goods and services. Therefore, foreign exchange reserves do not provide a comfortable buffer against external shocks. But they are projected to continue to increase in 2019-2020.

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