Euler Hermes Economic Research

Country Report

Vietnam

Better economic prospects dampened by a weak banking system

General Information

GDP	USD141.669bn (World ranking 56, World Bank 2012)
Population	88.78 million (World ranking 14, World Bank 2012)
Form of state	Communist State
Head of government	Nguyen Tan DUNG
Next elections	2016, legislative

Strengths

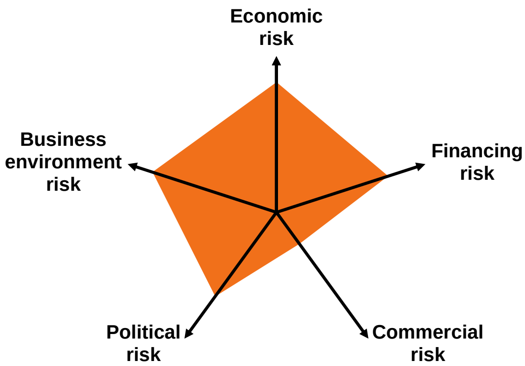
- Low wage but skilled workforce
- Relatively open economy with growth model based on trade
- Strong performance in agriculture and potential with various natural resources, especially minerals (iron ore, copper, gold) and energy (oil, natural gas, coal)
- Ongoing shift towards higher value-added sectors

Weaknesses

- Lack of transparency
- A fragile and opaque banking system
- Infrastructure to be improved
- A complicated business environment
- High regional disparities in terms of development and rising inequalities
- Low external reserves
- Recurrent tensions with China

Country Rating

C3



Source: Euler Hermes

Trade structure

By destination/origin (% of total)

Exports		Rank		Imports
China	16%	1	31%	China
United States	14%	2	12%	South Korea
Japan	11%	3	8%	Japan
Germany	4%	4	6%	Taiwan
South Korea	4%	5	6%	Thailand

By product (% of total)

Exports		Rank		Imports
Telecommunications Equipment	15%	1	8%	Yarns Fabrics
Leather	9%	2	8%	Refined Petroleum Products
Crude Oil	7%	3	5%	Electrical Apparatus
Clothing	6%	4	5%	Plastic Articles
Other Edible Agricultural Products	5%	5	5%	Electronic Components

Source: Chelem (2012)

Economic Overview

Solid economic growth

GDP growth is expected to stagnate at +5.4% in 2014 and accelerate slightly to +5.7% in 2015. The economic outlook remains positive in line with encouraging short term and advanced indicators. Retail sales continue to expand at high rates (+12% y/y in August 2014) suggesting a continuous strengthening of household consumption. Since September 2013, the manufacturing PMI has been in expansionary territory (50.3 in August 2014). However, output growth slowed and new orders fell slightly in August compared to previous months. June saw a small and controlled devaluation, which should cause a slight rebound in H2's exports, supported by the recovery in the U.S. and Japan (Vietnam's second and third largest export destinations).

Shifting towards higher value-added sectors will increase potential

The secondary and tertiary sectors are growing in importance, benefitting from cheap labor and increased FDI inflows. The share of value added created by the agricultural sector dropped from 23% in 2000 to 18% in 2013. In the manufacturing sector, the country shifted from the textile and clothing industry to electronics. Thus, telecommunication equipment led export earnings (15% of exports), ahead of leather and clothing.

In 2012, the country received USD8.4 bn FDI inflows, with annual growth averaging +11% since 2007. With lower labor costs than China, better infrastructure than its neighbors (Logistics Performance Index of the World Bank ranked the country 48th out of 160 countries in 2014), and access to the sea, FDI will continue to fuel growth in Vietnam.

Inflation, despite decelerating, remains a concern

Inflation slowed in early 2014 to +4.4% in March 2014, against +6% at the end of 2013. Thus, the central bank lowered its policy rate from 7% to 6.5% in March 2014. By the end of July 2014, inflation reached +4.9% y/y. Given Vietnam's dependence on manufacturing inputs, recurrent tensions with neighboring China and relatively ineffective monetary policy, inflation is rather volatile and EH expects it will reach +5.1% y/y by the end of 2014 and +6% y/y by the end of 2015.

Banking system remains fragile

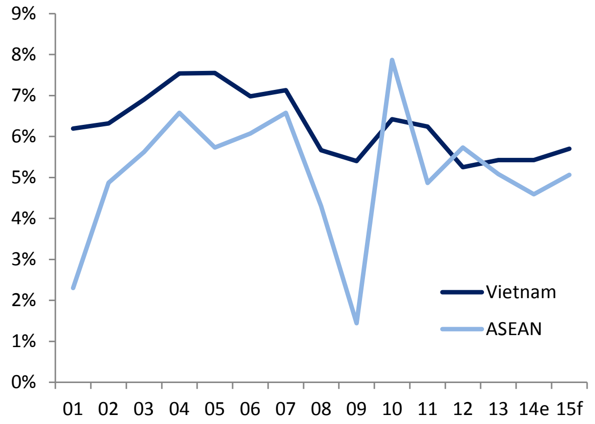
Vietnamese banks' non-performing loans ratio (NPL) was estimated by the Vietnamese central bank at 4% in April 2014. This ratio has substantially decreased since 2013 when the authorities launched the Vietnam Asset Management Company (VAMC), already purchasing USD2.4 bn of NPLs. However, Moody's Investors Service estimates that NPLs actually account for 10% to 15% of total loans because of assets misclassification and underreporting. The implementation of international standards was expected for the end of June 2014 but Vietnamese banks have been given 6 additional months to comply. The NPL ratio is expected to increase substantially, thus banks would need to raise provisioning, leading to a slowdown of lending to the private sector, potentially affecting economic growth. Real domestic credit growth remains high but slowed down in the past years (+8.2% in April 2014 from +15.5% in April 2011).

Key economic forecasts

	2012	2013	2014f	2015f
GDP growth (% change)	5.2	5.4	5.4	5.7
Inflation (%, end-year)	6.8	6.0	5.1	6.0
Fiscal balance (% of GDP)	-4.8	-5.7	-6.0	-5.5
Public debt (% of GDP)	50.0	55.0	56.2	54.4
Current account (% of GDP)	5.8	5.5	4.7	4.0
External debt (% of GDP)	37.9	39.8	39.8	38.5

Sources: IHS Global Insight, Euler Hermes

GDP growth (y/y)



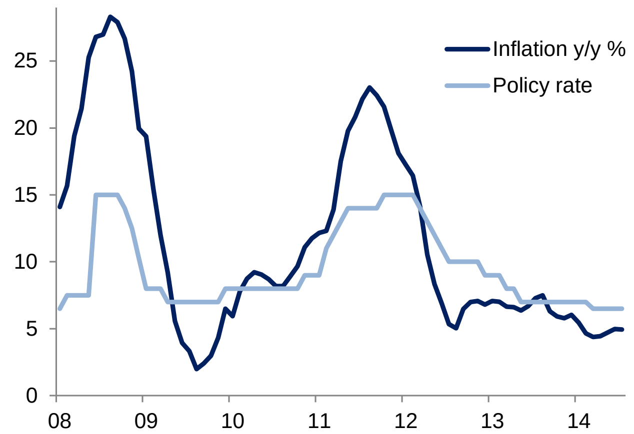
Sources: IHS Global Insight, Euler Hermes

FDI inflows by origin in 2012

Rank	Total (USD bn)	8.37
1	Japan	34%
2	Taiwan	16%
3	Singapore	12%
4	Korea	8%
5	Samoa	6%

Sources: UNCTAD, Euler Hermes

Inflation rate and policy rate



Sources: IHS Global Insight, Euler Hermes

Public finances to be monitored closely

Price controls and a history of poor public management saw the fiscal balance deteriorate to -5.7% of GDP in 2013 (IMF definition). EH expects it will widen further in 2014 to -6% of GDP. Public debt will remain above 55% in 2014 but should stabilize thereafter: the government decided to slow down the buoyant infrastructure development because of a lower growth rate and increased public debt. Public-Private partnerships should however allow the country to maintain major investment projects.

External position: still an issue

Since the shift towards manufacturing and higher value added products, external accounts ameliorated and since 2011, the country has benefitted from a large trade surplus (+USD8.7 bn in 2013). There may be some negative impact from the slowdown in Chinese growth, Vietnam's largest export and import market. The managed exchange rate allows the central bank to control the country's competiveness: in June 2014, in response to anti-Chinese riots, the central bank devaluated the currency by -1%. However, maintaining Vietnam's long run competitiveness might require further exchange rate adjustments, given the high inflation rate.

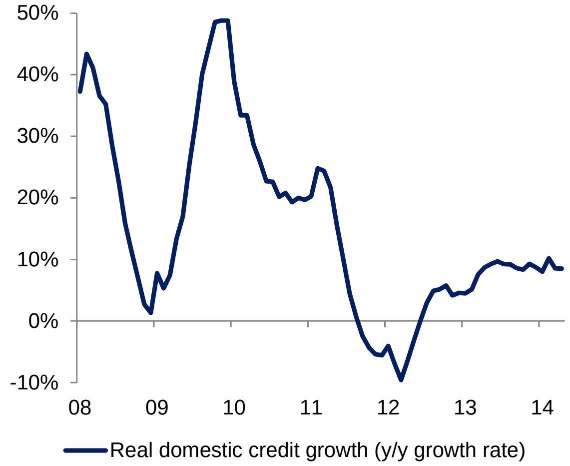
External debt should be monitored closely. Its level is relatively high, standing at 39.8% of GDP in 2013. However the dynamic is not worrying. It is projected to stabilize in 2014 and 2015, external debt service accounts for 3.3% of exports earnings, making it sustainable in the short term.

Foreign reserves are still weak, covering only 2.7 months of imports (instead of the 3 months recommended by the IMF). In 2011, foreign reserves reached about 1.3 months of imports and led the Central bank to devaluate its currency by 9%. Since then, foreign reserves have continuously increased and helped to maintain the managed floating exchange rate.

Tensions with China are on hold... but for how long?

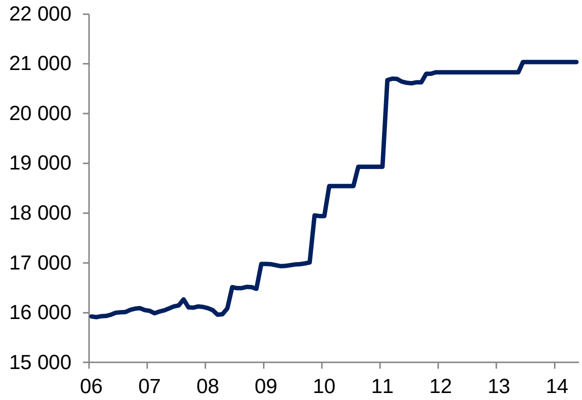
Tensions with China increased in Q1 on the back of land ownership rivalries in the Chinese Sea. Significant street protests followed. The situation is now on hold but anti-Chinese sentiment remains quite strong in the country. China is the largest trade partner and an escalation of the conflict could strongly affect the Vietnamese economy. Such a scenario is unlikely at this stage, but political development regarding this matter should be monitored closely.

Domestic credit growth (y/y change)



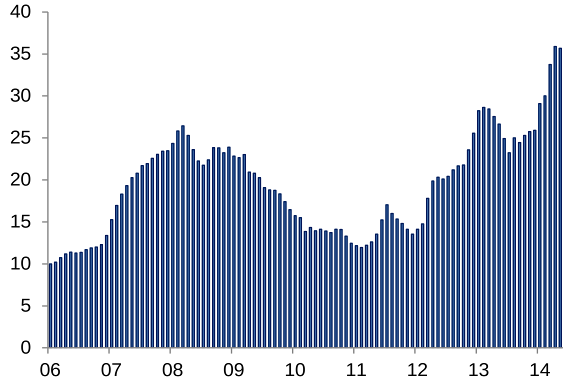
Sources: IHS Global Insight, Euler Hermes

Vietnamese Dong (VND) per USD



Sources: IHS Global Insight, Euler Hermes

Foreign reserves (USD bn)



Sources: IHS Global Insight, Euler Hermes

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