Vietnam

SEB GROUP – COUNTRY RISK ANALYSIS 16 March, 2022

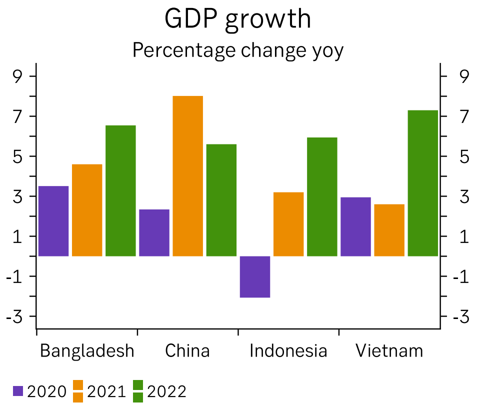
Analyst: Martin Carlens. Tel: +46 8-763 96 05. E-mail: martin.carlens@seb.se

Strict lockdowns across the country weighed on economic growth last year but a recovery is on the cards in 2022. The longer-term outlook is broadly unchanged, including the FDI driven manufacturing industry's gradual move up the value chain and a bright demographic outlook. Risks stem from the economy's openness and from tough competition in the region to benefit from the ongoing shift in supply-chains.

Country Risk Analysis

Recent economic developments

Recovery progressed slower than expected. Vietnam was in the regional forefront in handling the pandemic in 2020 but lengthy and very strict shutdowns during 2021 took a heavy toll on economic activity and the labour market. Following the government's shift to a strategy of "living with covid" growth accelerated towards the end of the year. Still, full year GDP growth was limited to 2.6%, down from 3% in 2020. This was much lower than expected at the start of the year. Unemployment which rose to a record high in Q3 subsequently edged down. At the same time, labour shortages are still severe since a large share of workers who left cities during the pandemic and the shutdowns have not yet returned. The muted economic activity led to inflation falling below 2% in 2021.



Source: Oxford Economics and IMF (WEO)

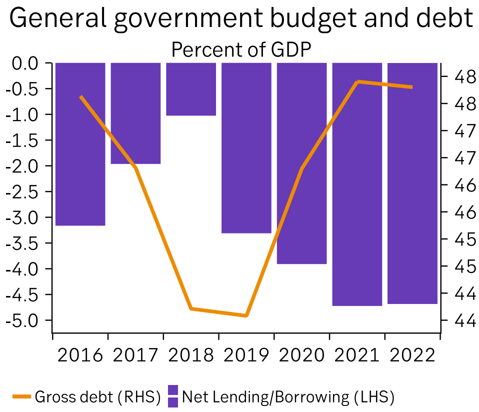
Temporary current account deficit… External balances strengthened in the years leading up to the pandemic, driven by large foreign direct investment (FDI) inflows, steady export growth and rising FX reserves. Last year saw some weakening but external accounts remain a relative credit strength for the country. Imports rose more than exports producing a small and temporary deficit on the current account (-0.3% of GDP). Goods exports suffered from lockdown measures and supply-chain disruptions while travel restrictions weighed on services exports. The US has passed China to become the most important export market.

…overshadowed by resilient FDI. Despite the Covid related challenges faced by foreign companies in 2021, foreign direct investment (FDI) held up reasonably well.

FDI are mostly supplied from Korea but flows from other countries have risen over the past few years. Relatively solid FDIs implied that there was no need to raise additional external debt which remained moderate as a share of GDP. Despite the shift to a deficit on the current account, international reserves rose during the year. At about USD 107 bn in late 2021 they were equivalent to roughly 4 months of imports.

Economic policies

Modest fiscal expansion. The relatively good health of government finances provide room for manoeuvre, but pandemic related spending has continued to be modest compared to regional peers. This is partly a consequence of fiscal regulations making it difficult to flexibly shift government funds to spending areas mostly affected by the pandemic. Nevertheless, the general government deficit rose slightly in 2021 to 4.7% of GDP. A new support programme for the economy was launched in early 2022, including a reduction in VAT rates and increased public investment.



Source: International Monetary Fund (IMF), Macrobond

Government debt edging higher.
Public debt, including government guarantees were on a declining trend prior to the pandemic. At 43.6% of GDP in 2019, debt was moderate compared to country risk peers. Deficits since then are expected to have raised the debt ratio to about 48% in 2021. We would note that contingent liabilities from large state-owned enterprises are non-negligible. Financing of the debt has mostly been done in the deepening domestic capital markets. As more than one third of the debt is in foreign currency, the debt burden is sensitive to exchange rate fluctuations. Most of the foreign debt is on concessional terms. The IMF expects the debt ratio to stabilise in 2022.

Banking system. The banking sector is large in relation to GDP for a country at this level of development, thus making up a moderate contingent liability of the government. Prior to the pandemic, the performance of the sector had been improving, supported by measures such as a strengthening of the regulatory framework. The central bank's forbearance measures still mask the full impact of the pandemic on banks' balance sheets but most observers expect a deterioration in capital quality, in particular among state-owned banks and smaller private banks.

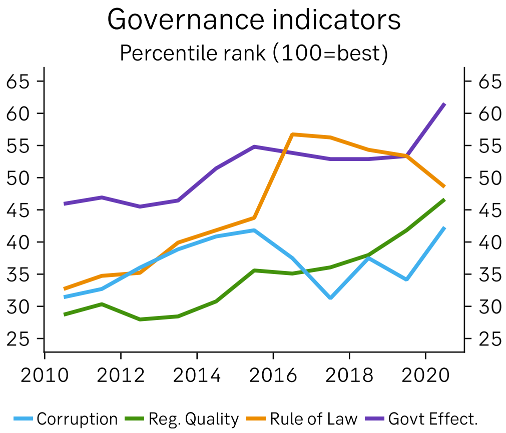
Political and security situation

Political risk mainly relates to geopolitical risks. The centralised political decision-making process implies very opaque and unpredictable decision making. At the same time the one-party system under the Communist Party of Vietnam (CPV) bodes for a high degree of political stability and limited domestic political risk. Geopolitical risk is higher, reflecting complicated relations with China given the conflicting territorial claims in the South China Sea. Vietnam is also potentially vulnerable to a deterioration on the Korean peninsula given strong investment ties to South Korea.

Rating agencies kept sovereign ratings unchanged. None of the major external credit rating agencies have changed their sovereign ratings over the past year. All agencies have a positive outlook.

Structural issues

Income levels are lower than among peers. Economic policy making is generally considered sound and some indicators of government effectiveness have been improving over the past few years. On the other hand, the quality of institutions, and governance indicators relating to corruption and regulatory quality are weaker than among peers. The judiciary, for example, is under the control of the CPV. The business climate is also a relative weakness despite significant gains in the World Bank's Doing Business index in 2019. The level of GDP per capita has continued to pick up over the past years, although from a low level. Incomes and the broader level of human development are still lower than average among country risk class peers.



Source: World Bank

Outlook

Growth should bounce back in near-term. Given the government's shift away from strict lockdowns and given the rising vaccination rates, economic growth should accelerate in 2022. Exports, where we assume continued strong demand for electronics, have already started to pick up. Tourism activity, normally generating 6-8% of GDP, is also expected to restart slowly as the country recently opened up to foreign travellers. Together with recovering domestic demand and base effects from 2021 this should lift real GDP growth to 7.3%. In the medium term, rapidly rising incomes will continue to lift consumer spending. Investment is also set to grow strongly, assisted by high FDI, as exports shift from textiles to higher-tech manufacturing.

Long-term outlook. Longer-term trend growth at 6-7% is higher than country risk peers. A favourable demographic structure is a key driving factor. The growth of the working age population has begun to slow but it is still around 0.7% per year. In addition, expectations of continued strong FDI flows should contribute to new technology transfers, facilitating a move up the value-added chain. Most observers expect that the country will continue to gain market shares in the global electronics market. Tough competition, however, not least from the rest of Asia, in the sector, and for supply-chain-related investments in people, plants, and assets means that this is not a given.

Economy's openness makes it vulnerable to a global trade slowdown. It is likely that the economy will increasingly benefit from the participation in multilateral trade arrangements such as the CPTPP and the RCEP. At the same time, with exports equivalent to around 90% of GDP, the outlook is subject to risks from a renewed significant decline in global trade flows and the disruption of global supply chains. The trade and investment ties with South Korea also exposes the country to some event risk from tensions on the Korean peninsula.

Climate change and natural disasters pose long-term risks. Vietnam is often classified as one of the top 10 countries in the world facing climate change risk and the risk of natural disasters with severe economic consequences. Rising sea levels are of particular concern.

Vietnam: Key Economic Indicators

	2017	2018	2019	2020	2021	2022	2023	2024	2025
Macroeconomic									
GDP (% chg)	6,7	7,1	7,0	2,8	2,5	7,3	8,8	6,6	6,2
GDP (USD bn)	278	304	328	342	366	409	462	505	549
GDP/capita (USD)	2944	3184	3404	3517	3733	4143	4643	5029	5429
Investments/GDP	19%	19%	19%	19%	20%	21%	21%	21%	21%
Trade/GDP	151%	155%	154%	156%	178%	176%	170%	167%	164%
Oil production, bpd ('000)	272	241	222	193	221	234	246	248	248
Money & Prices									
CPI inflation (%)	2,6	3,0	5,2	0,2	1,8	2,8	3,9	4,0	4,0
Money supply, M2 (% chg)	10,4	10,3	10,4	10,4	9,5	10,1	10,3	10,1	10,1
Interest rates, short-term	4,26	3,86	4,35	2,3	1,58	2,38	3,14	3,9	4,58
Oil price (USD, Brent)	54,3	71,1	64,4	41,8	70,7	86,3	73,9	66,4	65,8
Government Finances									
Budget balance/GDP	-2,0	-1,0	-3,3	-3,9	-4,7	-4,7	-4,4	-4,2	-3,9
Govt debt/GDP	46%	44%	44%	46%	48%	48%	48%	47%	46%
Interest rate costs/revenues	-	-	-	-	-	-	-	-	-
Balance of Payments (USD bn)									
Current account	-1,6	5,9	13,1	15,0	-1,2	13,0	18,8	21,4	18,1
% of GDP	-0,6	1,9	4,0	4,4	-0,3	3,2	4,1	4,3	3,3
Exports of goods	215,1	243,7	264,2	282,7	336,3	374,6	407,9	435,7	462,2
Imports of goods	204,3	227,2	242,7	251,7	317,4	347,1	379,2	406,2	435,9
FDI, net	13,6	14,9	15,7	15,4	16,2	18,4	21,3	23,6	25,9
% of GDP	4,9	4,9	4,8	4,5	4,4	4,5	4,6	4,7	4,7
Loan repayments	11,2	14,7	13,0	13,8	14,3	14,8	15,6	16,4	17,6
External Debt & Liquidity (USD bn)									
Total debt	104,1	106,9	117,3	125,0	128,7	131,9	137,1	142,5	150,3
o/w short term debt	21,9	19,6	24,4	26,6	27,4	28,1	29,2	30,4	32,1
as % of GDP	37,4	35,1	35,7	36,5	35,1	32,2	29,7	28,2	27,4
Reserves (ave.)	48,7	55,1	78,0	94,4	90,9	92,4	94,5	96,7	98,9
months of imports	2,9	2,9	3,9	4,5	3,4	3,2	3,0	2,9	2,7
Exchange rate vs USD	22705	23012	23224	23223	22922	22758	22820	23185	23559

Source: Oxford Economics, IMF

Rating history (eoy)					
Fitch	BB-	BB	BB	BB	BB
Moodys	B1	Ba3	Ba3	Ba3	Ba3

Type of government:	The Communist Party of Vietnam
Next elections	Next 5-yearly party conference in 2026
Other:	
Latest PC deal	1993
Latest IMF programs	PRGF (Poverty Reduction and Growth Facility) interrupted before expiry in 2004