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ANALYSIS

Vietnam Outlook: Resiliency Amid Emerging Market Uncertainty

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Introduction

Vietnam's expansion has charged ahead despite the recent financial and trade turmoil inflicting pain across Southeast Asia's emerging markets. Following a banner year in 2017 when real GDP growth registered at a six-year high of 6.8%, the Vietnam outlook remains upbeat. Moody's Analytics estimates output growth at 6.7% in 2018.

Vietnam Outlook: Resiliency Amid Emerging Market Uncertainty

BY STEVEN G. COCHRANE AND STEVEN SHIELDS

Vietnam's expansion has charged ahead despite the recent financial and trade turmoil inflicting pain across Southeast Asia's emerging markets. Following a banner year in 2017 when real GDP growth registered at a six-year high of 6.8%, the Vietnam outlook remains upbeat. Moody's Analytics estimates output growth at 6.7% in 2018 (see Chart 1).

The positive economic outlook is supported by burgeoning electronic and textile exports, a modest recovery in agriculture, and steady inflows of foreign investment. Additionally—unlike in years past—a strong domestic market will further support headline growth. With tourism traffic at a record high in the first nine months of this year and a healthy labor market, consumer sales have been rising at a double-digit clip since last year.

Trade remains the primary driver for continued expansion within Vietnam. The country's low cost of labor and comparatively young and growing population make it an attractive locale for manufacturers setting up shop or relocating from higher-cost areas. Strong foreign direct investment inflows supported export growth through the first half of this year. As a result, the improved trade balance has increased Vietnam's current account surplus to an estimated 6.6% of GDP in the second quarter from 5.1% of GDP in 2017 (see Chart 2).

Global trade frictions and a strengthening U.S. dollar have hurt Vietnam's financial markets this year, although they are less affected than other emerging markets. The Ho Chi Minh Stock Index is down more than 20% since reaching its April peak, but it remains one of the few emerging markets to maintain a positive performance year to date.

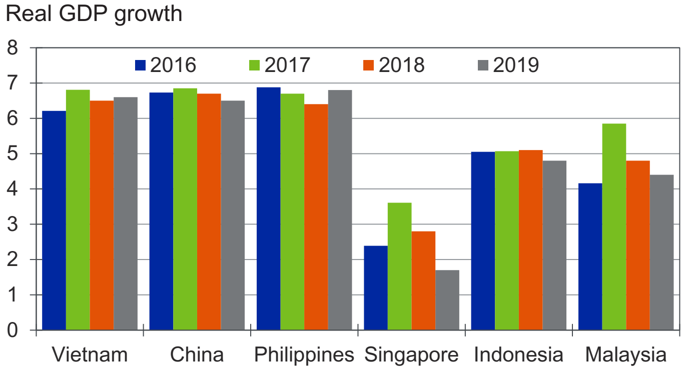
A minor decline

The Vietnamese dong, meanwhile, has depreciated 2.7% against the U.S. dollar since the beginning of the year. This is a minor decline when compared with the Indian rupee, which is hovering around a record low after losing 15% year to date, or the Indonesian rupiah, which has depreciated more than 12% since January. Vietnam's current account surplus and large foreign reserves will continue to position the country better than other emerging markets facing widening current account deficits.

Similar to its ASEAN counterparts, Vietnam's export-reliant economy is alarmed by escalated trade tensions. Through the first quarter of this year, exports as a share of real

Chart 1: Vietnam Accelerated in 2017

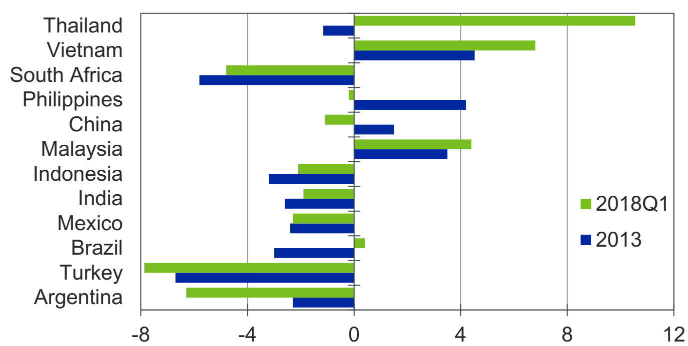
Real GDP growth



Sources: National statistics offices, Moody's Analytics

Chart 2: Current Account Offers Cushion

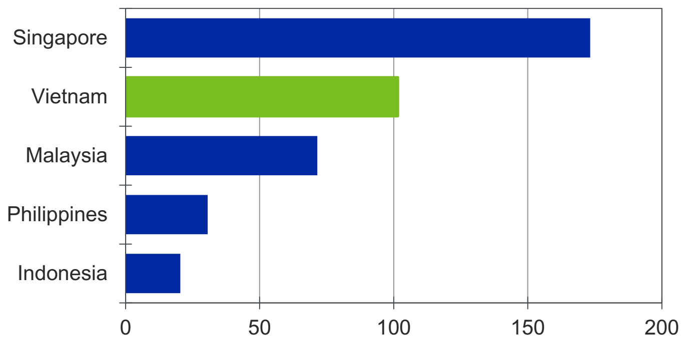
Current account balance as % of GDP



Sources: National statistical agencies, World Bank, Moody's Analytics

Chart 3: Tariffs Alarm ASEAN Countries

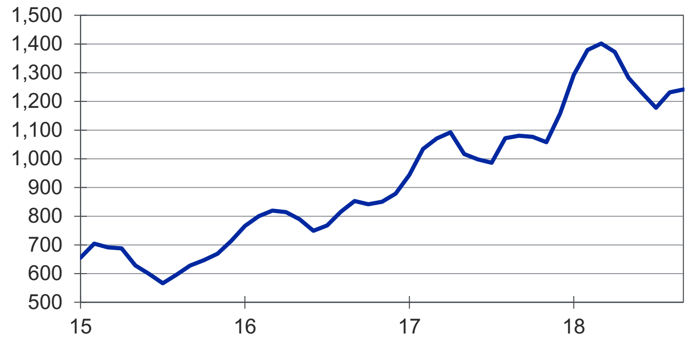
Exports as % of GDP, 2017



Sources: World Bank, Moody's Analytics

Chart 4: Vietnam Tourism on the Rise…

Foreign visitors, ths, 3-mo MA



Sources: General Statistics of Vietnam, Moody's Analytics

GDP reached 121%, ranking the highest of all ASEAN countries outside of Singapore (see Chart 3).

Vietnam's dependency on offshore demand, particularly from China and the U.S., to fuel its manufacturing sector indicates the country has little to gain in a drawn-out trade war. However, the U.S.-China trade spat does invite near-term upside to Vietnam. In an effort to escape tariffs on Chinese exports, multinational companies have been shifting some production from China to other areas, including Vietnam. Examples include LG and Samsung, both of which have shifted a portion of their electronic manufacturing from China to Vietnam this year. A near-term boost could prove fleeting, however, if the U.S. were to pursue similar tariffs on Vietnam to prevent China-based producers from evading tariffs. The U.S. has not yet proposed such tariffs, however.

Increase in Chinese tourism

China is an important source of tourist arrivals, and growing economic ties between Vietnam and China are driving up visitor numbers. Nearly one-third of tourists to Vietnam came from China, with Korea (20%) and Japan (5%) being the next biggest sources.

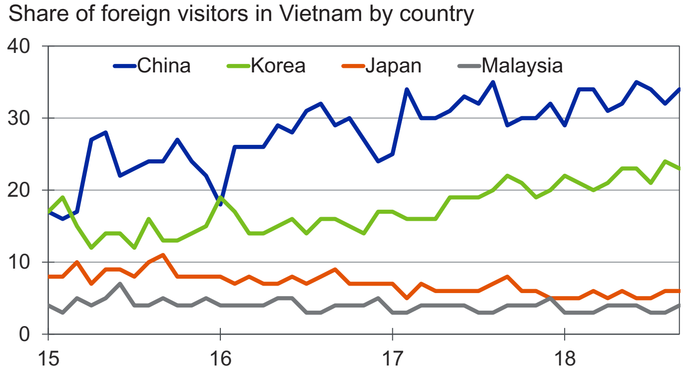
Total visitors to Vietnam increased more than 30% in 2017 alone, and although it accounts for a small share of GDP, tourism is an important source of growth for retail and leisure/hospitality. However, with China's economy slowing and the ongoing trade war, near-term risks for Vietnamese tourism are weighted to the downside. The medium-term outlook remains upbeat as China's rising and wealthier middle class serves as a lucrative source of visitors to Vietnam (see Charts 4 and 5).

We anticipate the State Bank of Vietnam to maintain a neutral stance through the end of the year, deviating from a handful of other central banks in Asia that have been tightening policy settings. The central bank is largely content with how economic conditions are playing out this year and wants to maintain an environment that supports foreign investment into the country.

The SBV unexpectedly cut rates by 25 basis points in the second half of last year, but strong headline growth and near-target inflation indicate that the central bank will refrain from any further cuts in the near term. However, rising energy and administered prices are placing upward pressure on inflation, making it possible that monetary tightening will occur earlier than expected. Vietnam's CPI ticked up to 4.5% in August, rising above the central bank's 4% 2018 target. A continuation of this trend would force the SBV to tighten its monetary stance to counter pricing pressures (see Chart 6).

Chart 5: …As More Chinese Visitors Arrive

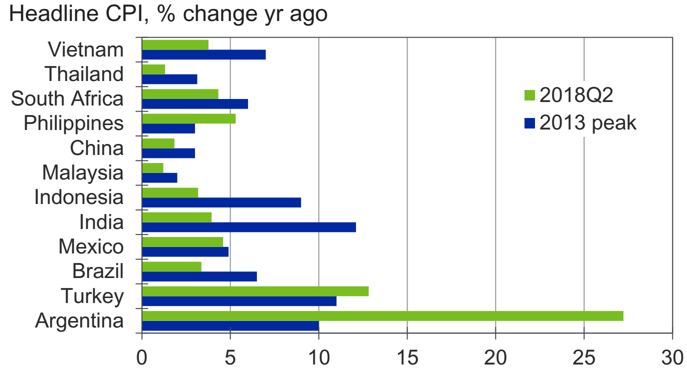
Share of foreign visitors in Vietnam by country



Sources: General Statistics of Vietnam, Moody's Analytics

Chart 6: Vietnam's Inflation Within Target

Headline CPI, % change yr ago



Sources: National statistical agencies, Moody's Analytics

Sound macroeconomic policy and further structural reforms are vital for continued growth in the medium and long term. Policymakers are working on stabilizing the government's debt load, as debt to GDP rose to an estimated 63.7% in 2017, according to the Ministry of Finance.

The banking sector, meanwhile, has regained its footing following the 2012 banking downturn. Following a surge in nonperforming loans, which are defined as loans in nonpayment for more than 90 days, lending standards have tightened considerably. In addition, Vietnam's central bank established the Vietnam Asset Management Co. in 2013 to purchase bad debt from banks in exchange for special bonds. Offloading bad debt has been key to improving asset quality and strengthening bank balance sheets.

While lending standards have tightened, credit growth is set to rise 17% in 2018 after increasing in the high teens over the past decade. The Vietnamese government has set a target real GDP growth rate of 6.5% to 7% through 2020. This seems reasonable, given the economy has averaged annual growth of nearly 6.2% from 2010 to 2017, but may prove difficult with global growth expected to slow.

About the Authors

Steven G. Cochrane, PhD, is Chief APAC Economist with Moody's Analytics. He leads the Asia economic analysis and forecasting activities of the Moody's Analytics research team, as well as the continual expansion of the company's international, national and subnational forecast models. In addition, Steve directs consulting projects for clients to help them understand the effect of regional economic developments on their business under baseline forecasts and alternative scenarios. Steve's expertise lies in providing clear insights into an area's or region's strengths, weaknesses and comparative advantages, relative to macro or global economic trends. A highly regarded speaker, Dr. Cochrane has provided economic insights at hundreds of engagements over the past 20 years and has been featured on Wall Street Radio, the PBS News Hour, C-SPAN and CNBC. Through his research and presentations, Steve dissects how various components of the macro and regional economies shape patterns of growth. Steve holds a PhD from the University of Pennsylvania and is a Penn Institute for Urban Research Scholar. He also holds master's degree from the University of Colorado at Denver and a bachelor's degree from the University of California at Davis. Dr. Cochrane is based out of the Moody's Analytics Singapore office.

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