

Vietnam Country Report

August 2021

Covid-19 vaccinations key to
sustain Vietnam's GDP growth in
2021

Vietnam industries performance forecast

August 2021

 Excellent: The credit risk situation in the sector is strong / business performance in the sector is strong compared to its long-term trend.	Agriculture	Automotive/ Transport	Chemicals/ Pharma	Construction	Construction Materials
					
	Consumer Durables	Electronics/ICT	Financial Services	Food	Machines/ Engineering
					
	Metals	Paper	Services	Steel	Textiles
					
 Good: The credit risk situation in the sector is benign / business performance in the sector is above its long-term trend.					
 Fair: The credit risk credit situation in the sector is average / business performance in the sector is stable.					
 Poor: The credit risk situation in the sector is relatively high / business performance in the sector is below long-term trend.					
 Bleak: The credit risk situation in the sector is poor / business performance in the sector is weak compared to its long-term trend.					

Political Situation

Some strains in the Vietnam-China relationship

The Vietnamese Communist Party remains firmly in power, despite some public discontent over the lack of personal freedom, government corruption and land seizures by the administration. Effective measures against the spread of the Coronavirus pandemic have increased the legitimacy of the government.

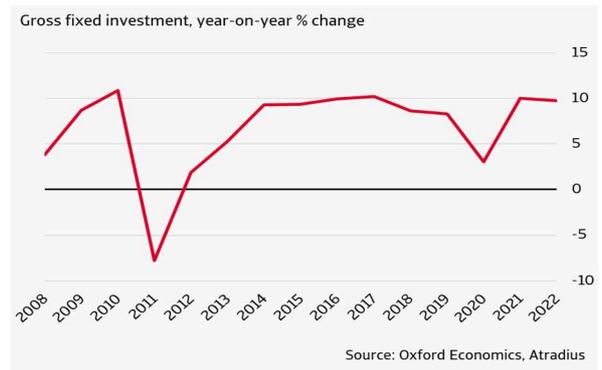
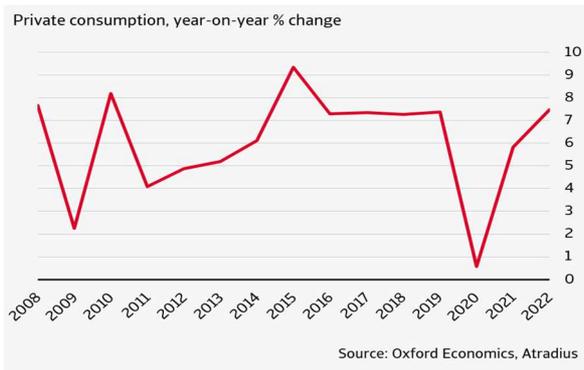
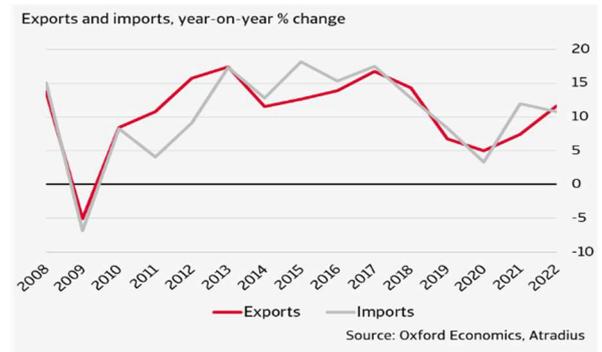
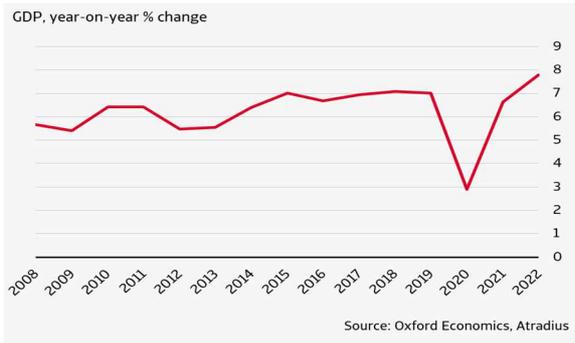
The fight against corruption is a key political issue, whereas other issues such as institutional reform and labour rights are not high on the agenda.

The territorial dispute with China over conflicting claims in the South China Sea remains a serious issue in the bilateral relationship for the future. Another issue is the construction of new dams in the Mekong River

by China (and Laos), which reduces the flow of essential water to Vietnam.

In order to counter growing Chinese assertiveness, Vietnam is keen to improve its political and security cooperation with the US and Japan. However, despite enhancing its naval forces, Vietnam lacks the military capability to pose a serious challenge to any Chinese actions. At the same time, China is an important and powerful trade partner, which accounts for 14% of Vietnamese exports and 24% of imports (Vietnam's manufacturing sector depends heavily on raw materials imported from China). Moreover, given the ideological similarities of the regimes in both countries, there is still a strong pro-China faction within Vietnam's Communist Party.

Economic Situation



Rising coronavirus cases affect the Vietnamese economy

After annual growth rates of about 7% over the past five years, Vietnam's GDP growth slowed down to 2.9% in 2020. Vietnam was one of the few economies in the world that avoided an economic contraction last year.

In H1 of 2021 economic growth gained momentum, and Vietnamese GDP increased 6.6% year-on-year in Q2 of 2021. Exports from Vietnam grew by 28%, as the country benefitted from robust demand for electronics and garments from its key exports markets China, US, and the EU. Supported by the strong export growth, industrial production increased by 9.3% in H1 of 2021.

In 2020 and in early 2021 Vietnam was very successful in containing the spread of coronavirus with contact tracing, isolation and quarantining, which helped to sustain the economic performance. However, since May 2021 daily cases have significantly increased, while vaccination rates are still very low, with only about 1.8% of the population fully vaccinated. Lockdowns and movement restrictions have been imposed across about a third of the country's cities and provinces.

Industrial production has slowed down markedly since June, and the Purchasing Managers Index contracted in June and July due to social distancing measures, temporary factory closures and supply chain disruptions.

Currently industrial production and private consumption are still expected to grow by 8% and 6% respectively in 2021. GDP of Vietnam is forecast to increase by 6.6% in 2021 and 7.8% in 2022. However, those figures could result lower in case of a further spread of the pandemic. A marked acceleration of vaccine rollout in the coming months is key to sustain the envisaged robust growth rates.

Fiscal and monetary measures taken to support the economy of Vietnam

In order to sustain the economic performance during the pandemic, the Central Bank lowered the benchmark interest rate three times in 2020, from 6% to 4%, supporting banks and facilitating loans. In August 2021, the Central Bank stated that it has no imminent plan to cut policy rates for the time being. Inflation is forecast to decrease to 2.2% in 2021 after 3.2% in 2020, rising to 3.5% next year.

In 2020, the government launched tax breaks for businesses, as well as cash transfers to the

poorest households. The fiscal deficit increased by 4.6% in 2020, public debt rising to 47% of GDP, remaining at a manageable level. In 2021, the fiscal deficit will amount to about 4% of GDP, while public debt will rise slightly before falling in the years to come. Contingent liabilities continue to weigh on the public finances.

Vietnam's foreign debt structure is stable (long maturities and financed by public creditors over the past couple of years) and expected to decrease further in the coming years. Foreign exchange reserves have increased since 2015, and are sufficient to cover external financing requirements.

In the banking sector, it is estimated that the ratio of non-performing loans is currently rather high, between 5% and 10%. Additionally, an increasing household loans portfolio has made banks more vulnerable to a downturn of the housing market. Other structural weaknesses in the sector include political influence, corruption and weak data quality. The capital adequacy ratios differ substantially between private-owned banks (sufficient) and state-owned banks (low).

Short-term downside risks remain

Domestically a major surge of coronavirus cases, coupled with a slow vaccination rollout, could seriously affect domestic demand, and lead to increased disruptions of manufacturing output.

In a downside scenario an ongoing global spread of the pandemic, due to inadequate effectiveness of vaccinations against virus variants like Delta, would drag the global economy downward. Whereas the recovery in 2021 would be depressed, the 2022 global economic performance could take a major hit. Such a scenario would pose a major downside risk for Vietnam's economic performance, as the open economy is heavily dependent on external trade, but also tourism.

Additionally, any rising protectionism (e.g. another escalation of the Sino-US trade dispute and potential US protectionist measures against Vietnam itself) could hurt the economy. The US repeatedly complained about the rising trade deficit with Vietnam, and launched investigations into Hanoi's trade policies in October 2020. In April 2021, the US Treasury dropped allegations that Vietnam manipulates

its currency for the time being, but the trade deficit will remain an issue in the future.

Good growth prospects in the medium- and long-term

In the longer run, Vietnam will continue to remain one of the fastest growing economies in the Asia-Pacific region, benefiting from a large and skilled labour force and still relatively low wage costs. The country is the main low-cost regional alternative to China for export-orientated manufacturing. The shift of export manufacturing from China to Vietnam already took off before the Sino-US trade dispute, due to Vietnam's relatively low production costs, especially in the ready-made garments (RMG) sector. This trend accelerated in 2019 as the country benefited from trade diversification triggered by the trade conflict. Besides textile production, the manufacturing of consumer goods and ICT products are increasingly shifting from China to Vietnam.

Additionally, the trend to move production away from China has accelerated by the coronavirus-related supply chain disruptions in H1 of 2020 that affected many companies around the world.

Supporting factors besides lower production costs are the fact that Vietnam is already part of several value chains and has a strong road, rail and port infrastructure. Strong investment promotion and the existence of special economic zones make Vietnam attractive for companies looking to start new production sites or to expand existing ones. Vietnam's long-term growth potential should benefit from a progressing (albeit slowly) privatisation process, which also allows an increased foreign ownership of domestic companies. All this should lead to robust investments and exports in the coming years.

A large network of free trade agreements

A major asset is Vietnam's participation in several free-trade agreements. The country benefits from its ASEAN membership, in particular the ASEAN Free Trade Agreement (AFTA) and ASEAN's bilateral trade agreements with other economies in the region. Vietnam is member of the Regional Comprehensive Economic Partnership (RCEP) free trade agreement, which includes 15 Asian-Pacific states, and of the Comprehensive and Progressive Agreement for Trans-Pacific

Partnership (CPTPP) with 11 members, including Canada, Chile, Mexico, and Peru. A major step for Vietnam's trade policy is the EU-Vietnam Free Trade Agreement, which entered into force in August 2020, and will ultimately scrap duties on 99% of all goods traded between the two sides. Vietnam's trade agreement with

the EU pays off. In the January-May 2021 period, Vietnamese exports of goods to the EU increased 20% year-on-year, while imports from the EU increased 17%.

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