Country report

VIETNAM

Summary

Vietnam's pro-growth policies will result in economic growth of around 6% year on year (yoy) in 2011, but at the expense of macro-economic stability. External imbalances are very high, as the current account posts large deficits and the country's liquidity position is in a dismal state. FX-reserves cover only 1-2 months of imports. While the central bank has commenced a monetary tightening cycle, inflation is still too high. This has eroded confidence the domestic currency, which was devalued several times in the past year. The current account deficit is matched by a fiscal deficit, and these twin deficits are not expected to be solved in the forecast period. The political environment is stable as the communist regime dictates a one-party political system. However, to ensure this stability, the government cracks down hard on any form of opposition.

Things to watch:

- The weak external liquidity position
- Will monetary tightening continue?
- Crackdown on forms of opposition

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Vietnam

National facts		
Type of government	Communist	
Capital	Hanoi	
Surface area (thousand sq km)	331	
Population (millions)	87.0	
Main languages	Vietnamese	
	English	
Main religions	None (81%)	
	Buddhist (9%)	
	Catholic (7%)	
Head of State (president)	Nguyen Minh Triet	
Head of Government (prime-minister)	Nguyen Tan Dung	
Monetary unit	Dong (VND)	
Economy		**2010**
Economic size	*bn USD*	*% world total*
Nominal GDP	104	0.17
Nominal GDP at PPP	278	0.38
Export value of goods and services	79	0.42
IMF quotum (in mln SDR)	329	0.15
Economic structure	*2010*	*5-year av.*
Real GDP growth	6.8	7.4
Agriculture (% of GDP)	21	21
Industry (% of GDP)	41	41
Services (% of GDP)	38	38
Standards of living	*USD*	*% world av.*
Nominal GDP per head	1181	12
Nominal GDP per head at PPP	3161	27
Real GDP per head	847	11

Social and governance indicators	rank / total
Human Development Index (rank)	113 / 169
Ease of doing business (rank)	78 / 183
Economic freedom index (rank)	139 / 179
Corruption perceptions index (rank)	116 / 178
Press freedom index (rank)	165 / 178
Gini index (income distribution)	37.77
Population below $1.25 per day (PPP)	21%

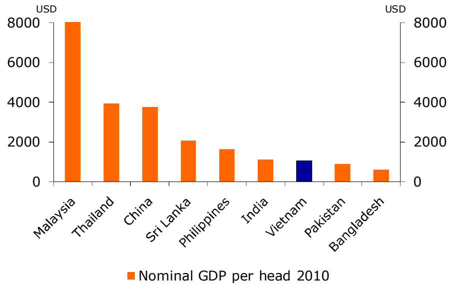
Foreign trade			2010
Main export partners (%)		*Main import partners (%)*	
US	20	China	24
Japan	11	Japan	11
China	9	South Korea	10
Switzerland	4	Thailand	6
Main export products (%)			
Textiles & garments			16
Crude oil			7
Footwear			7
Fisheries products			7
Main import products (%)			
Machinery, equipment & parts			16
Refined petroleum			7
Steel			7
Materials for textile industry			6
Openness of the economy			
Export value of G&S (% of GDP)			76
Import value of G&S (% of GDP)			84
Inward FDI (% of GDP)			8.8

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Economic structure and growth

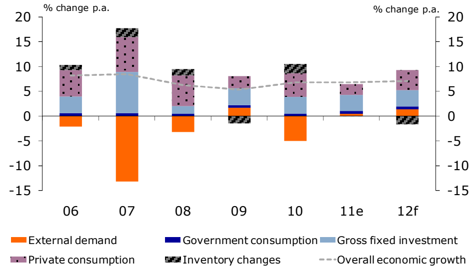
The conquest by France of Vietnam meant Vietnam became part of French Indochina in 1887. Although Vietnam declared independence after World War II, the French continued to rule until they were defeated in 1954 by the Ho Chi Minh communist forces. Under the Geneva Accord, Vietnam was split up into the Communist north and the anti-communist south. However, in 1975, the north took control of the south and Vietnam has been under communist rule ever since. The country experienced little economic growth until the "doi moi" (renovation) policy was introduced in 1986. Since, the Vietnamese authorities committed to economic liberalization and enacted structural reforms needed to modernize the economy and to produce more competitive, export-driven industries. This has resulted in a modern economic structure, in which services contribute 38% and agriculture 21% to the overall economy. The economy has modernized and GDP per head has risen. Even so, nominal GDP per head remains low at USD 1,181 in 2010. Low wages have allowed for a competitive export sector and a very open economy, with the total export and import value of goods and services amounting to 160% of GDP. Vietnam's main export products are textiles, footwear and crude oil. Its main export partners are the three largest economies in the world: US, China and Japan. Vietnam mainly imports machinery for its industrial sector, materials for the textile industry, petroleum and steel. The Vietnamese economy has grown robustly in recently years, averaging 7% annually in the past five years on the back of gross fixed investment and private consumption. For 2011, growth of 6.8% is expected. A shift from the government's growth- oriented policies towards a more conservative stance, as it attempts to rein in inflation could subdue growth. The effects from the tsunami and nuclear disaster in Japan are minimal,

Chart 1: Income level



Source: EIU

Chart 2: Growth performance



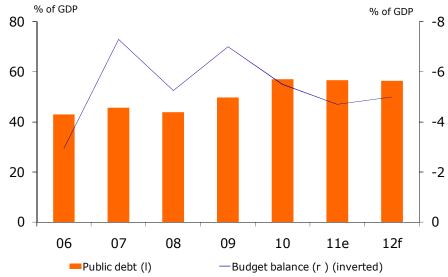
Source: EIU

as supply disruptions will not significantly affect overall economic growth.
A large concern is the banking sector, which is currently less stable than we expected it to be last year. Concerns rose after the default of Vinashin, a 100% government owned shipbuilder. Even though the government did provide a soft guarantee (a letter of comfort), it did not honour the agreement. This makes us question the validity of state guarantees to the banking sector. We believe the government is only willing to bail out the larger, systemically important banks and would choose to let smaller banks fail or be taken over by state banks in case of problems.

Political and social situation

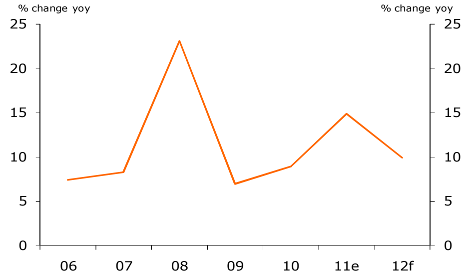
The political situation is Vietnam is very stable, as the communist state maintains a one party rule by the Communist Party of Vietnam (CPV). The CPV was re-elected in January 2011 in the 11th National Congress to rule for the next five years. Prime Minister (PM) Dung was reappointed for a second term in the January election, but this remains subject to a symbolic vote and appointment by the National Assembly in May. Even so, his reappointment is a foregone conclusion. Truong Dang Sang was appointed as the President in January which is only a symbolic position. During his second term from 2011 to 2016, PM Dung is likely to continue to support greater economic liberalisation while his military background and strict adherence to CPV policies will continue to appease hardliners. With all leadership appointments agreed unanimously, the political outlook appears relatively stable with the transfer of political power expected to be smooth.
We expect stabilizing economic growth will be a high priority for the CPV. This is because the party believes that by securing economic growth it will be able to satisfy the social and material needs of the population, thereby quelling discontent and demands for greater political and social freedoms. The CPV continues to crack down heavily on opposition and the media. Vietnam has taken an increasingly tough stance against internet bloggers and journalists, as reflected by its poor ranking of 165 out of 178 countries on the Press Freedom index. The problem of endemic corruption could further fuel discontent about the uncontested dominance of the CPV.
Relations with China have worsened due to a conflict regarding the disputed Spratley Islands in the South China Sea. This archipelago is an oil and gas rich area that is claimed by several of the adjacent countries. China however, has become increasingly assertive in its claims; stating the archipelago is a core interest for China. Vietnam has reacted with an arms-procurement process. However, despite mutual distrust in political and security relations, a large-scale military conflict is unlikely, as Vietnam's government recognizes the huge importance of China for Vietnam's future economic development.

Chart 3: Public finances



Source: EIU

Chart 4: Inflation



Source: EIU

Economic policy

Vietnam's fiscal position is in bad shape as a result of the government's pro-growth policies. In recent years, the government has been running continuous budget deficits. The budget deficit is forecasted at 4.7% of GDP in 2011. Government revenues are below potential. The tax system has a complicated structure and lacks transparency. Further reform is needed, although the government's bid to modernize the tax system has been somewhat successful in recent years, as it at least satisfied the criteria to join the WTO in 2007.

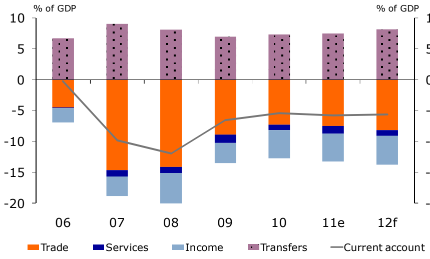
Corruption is deeply embedded and diminishes government revenues. This strain on government finances has traditionally been compensated by charging foreign companies excessive tax rates. Another weakness of government finances is that it is very dependent on volatile oil export revenues. In the period of 2000-2009, oil revenues contributed 22% on average to total government revenues.

Expenditures are set to decline in 2011 as several of the stimulus measures introduced in 2009 to shield the economy from the effects of the global financial crisis will expire. A large concern last year was the default of Vinashin. The shipbuilder, which is 100% owned by the Vietnamese state, failed to meet its debt obligations. The Vietnamese government did provide a soft guarantee (a letter of comfort) but did not bail out Vinashin. While this does not classify as a sovereign default, it does have ramifications for the perception of creditworthiness of the public sector. The financial markets will react by demanding higher interest rates on the international capital markets, implying higher borrowing costs for the Vietnamese government.

The country's central bank, the State Bank of Vietnam (SBV), is tightening monetary policies to bring down inflation. This year, it has already raised the refinance rate by 300bps and the discount rate by 500bps (both now stand at 12%). Inflation was high at 13.9% yoy in March 2011, on the back of high food prices. Although food price inflation is cyclical, food price levels are expected to remain high in 2011. As such, we expect the SBV to continue monetary tightening throughout the year. Another reason we believe the SBV's tightening stance will continue is to rein in credit growth. The SBV targets credit growth of 20% yoy in 2011, which is still high, but lower than the 23% yoy increase in 2010. Furthermore, it stated to emphasize on reducing banks' loan exposure to non-productive sectors, which is a wise move.

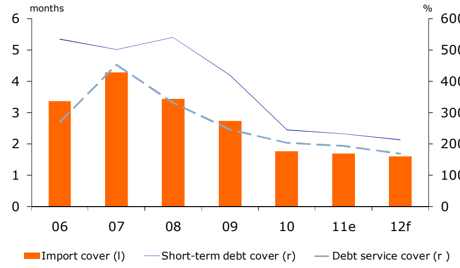
Higher interest rates would also help stabilize the domestic currency, the dong (VND), which has been under continuous downward pressure in recent years. The VND was devalued several times last year and once again in February 2011. Confidence in the VND remains low as the government has failed to stem inflationary pressures, which have eroded purchasing power, increased dollarization levels and even led to the hoarding of gold. Inconsistent policies, for example policymakers recently suggesting the need for lower interest rates before hiking them, further undermine the credibility of the SBV.

Chart 5: Current account



Source: EIU

Chart 6: External position



Source: EIU

Balance of Payments

Vietnam's current account is in bad shape as it has been posting large current account deficit since 2007. It is forecasted to post a deficit of 5.4% of GDP in 2011, slightly down from the 5.8% deficit posted in 2010. The main reason for the large deficits is the pro-growth policy of the government. The country imports mostly capital goods, which has led to an excessive trade deficit of 7.3% of GDP in 2010. The trade deficit is the main drag on the current account, followed by the income balance as foreign companies repatriate profits and income. The income balance posted a deficit of 4.5% of GDP in 2010. Both the trade and income balance are forecasted to post similar deficits in 2011. The only pillar supporting the current account are remittances, posting large surpluses on the transfer balance, at 7.3% of GDP in 2010 and a forecasted 7.4% in 2011.
While FDI inflows have been sufficient in recent years to cover the current account deficit, we are concerned about new FDI pledges. New FDI approvals, which include both entirely new projects and extensions to existing projects) have been disappointing in the first four months of 2011, plunging 48% yoy. FDI inflows are crucial to support the balance of payments, if these would fall away Vietnam would need to finance the deficit via debt or donor aid, enhancing its external vulnerability. The SBV did state that the recent tightening of monetary policy has supported capital inflows and somewhat alleviated pressures on the country's FX-markets, but this policy needs to continue throughout the year to ensure substantial improvement.

External position

Vietnam's external debt position is moderate. External debt is expected to increase to USD 34bn in 2011 from USD 31bn in 2010, but total external debt remains low at 32% of GDP. A comforting factor is that only USD 6.4bn is short-term debt. As external debt is low, the covers offered by the FX-reserves for external debt are sound. The debt service and short-term debt covers are 193% and 242% respectively in 2011. The fact that most of the medium- and long-term debt is owed to official creditors on concessional terms and that Vietnam enjoys huge donor support is also very favourable for Vietnam's external position.
Of more concern is the country's liquidity position, as continued high imports have taken a toll on the stock of FX-reserves. While the SBV has not officially released data on the level of FX-reserves for a while now, the Asian Development Bank has estimated the level stood at USD 10bn at end-2010, which only covers 1-2 months of imports, which is a worrisome level. Any improvement in the coming years hinges on the willingness of the government to shift to a more stabilizing economic policy, which appears unlikely.

Vietnam

Selection of economic indicators	2006	2007	2008	2009	2010	2011e	2012f
Key country risk indicators							
GDP (% real change pa)	8.2	8.5	6.3	5.3	6.8	6.8	7.1
Consumer prices (average % change pa)	7.4	8.3	23.1	7.0	9.0	14.9	9.9
Current account balance (% of GDP)	-0.3	-9.8	-11.9	-6.6	-5.4	-5.8	-5.7
Total foreign exchange reserves (mln USD)	13384	23479	23890	16447	12824	15020	15330
Economic growth							
GDP (% real change pa)	8.2	8.5	6.3	5.3	6.8	6.8	7.1
Gross fixed investment (% real change pa)	9.9	24.2	3.8	8.7	8.5	8.0	8.0
Private consumption (real % change pa)	8.3	10.8	9.3	3.7	7.0	3.2	6.3
Government consumption (% real change pa)	8.5	8.9	7.5	7.6	8.0	7.8	7.8
Exports of G&S (% real change pa)	17.7	16.0	15.1	-6.0	15.2	13.4	13.6
Imports of G&S (% real change pa)	18.9	28.2	15.4	-6.3	17.2	10.6	10.4
Economic policy							
Budget balance (% of GDP)	-2.9	-7.3	-5.2	-7.0	-5.5	-4.7	-5.0
Public debt (% of GDP)	43	46	44	50	57	57	56
Money market interest rate (%)	6.5	6.5	10.3	8.0	8.3	11.3	10.0
M2 growth (% change pa)	30	49	21	26	26	20	16
Consumer prices (average % change pa)	7.4	8.3	23.1	7.0	9.0	14.9	9.9
Exchange rate LCU to USD (average)	15980.5	16077.9	16440.4	17799.6	19127.0	21234.4	22812.9
Recorded unemployment (%)	4.8	4.6	4.7	4.6	4.4	4.1	4.1
Balance of payments (mln USD)							
Current account balance	-164	-6953	-10787	-6117	-5614	-6190	-6340
Trade balance	-2776	-10438	-12782	-8307	-7562	-8020	-9210
Export value of goods	39826	48561	62685	57096	71881	89650	95940
Import value of goods	42602	58999	75467	65403	79443	97670	105150
Services balance	-8	-755	-915	-1230	-967	-1330	-1040
Income balance	-1429	-2190	-4401	-3028	-4677	-4750	-5250
Transfer balance	4049	6430	7311	6448	7591	7910	9160
Net direct investment flows	2315	6516	9279	6900	8360	9000	10920
Net portfolio investment flows	1339	6269	-552	153	1525	1740	1590
Net debt flows	662	3341	818	560	3667	2840	2890
Other capital flows (negative is flight)	223	983	1670	-8869	-11492	-5160	-8750
Change in international reserves	4375	10157	428	-7373	-3554	2230	310
External position (mln USD)							
Total foreign debt	20126	23865	26158	27031	30801	34050	36680
Short-term debt	2503	4679	4419	3915	5242	6460	7200
Total debt service due, incl. short-term debt	4961	5190	7215	6709	6291	7780	9100
Total foreign exchange reserves	13384	23479	23890	16447	12824	15020	15330
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	-4.6	-14.7	-14.2	-8.9	-7.3	-7.5	-8.2
Current account balance (% of GDP)	-0.3	-9.8	-11.9	-6.6	-5.4	-5.8	-5.7
Inward FDI (% of GDP)	3.9	9.4	10.6	8.2	8.8	9.2	10.5
Foreign debt (% of GDP)	33	34	29	29	30	32	33
FX-reserves import cover (months)	3.4	4.3	3.4	2.7	1.8	1.7	1.6
FX-reserves debt service cover (%)	270	452	331	245	204	193	168

Source: EIU