VIETNAM

Vietnam's economy grew 6.2% yoy in 2016, versus 6.7% in 2015, weighed down by a slowdown in the agriculture and mining sectors. There was a further moderation to 5.1% growth in 1Q17. Nonetheless, on the back of strong FDI and the fading of some temporary headwinds, growth is expected to rebound and average 6.2% for 2017. Vietnam has been a recipient of strong and steady FDI inflows over the last few years and the trend should continue in 2017. Manufacturing and services sectors remain the green shoots. Inflation is expected to be within target. On the fiscal front, consolidation remains a high priority and achieving it requires tax reforms as well as better revenue administration. External debt remains vulnerable to real depreciation and current account shocks. Overall, expect a favourable medium-term outlook for Vietnam.

Growth weighed down by transitory factors

- Despite a drought hit agriculture and slowdown in mining, economic growth in Vietnam averaged 6.2% in 2016. Manufacturing and services sector provided a fillip to the growth story.
- GDP growth decelerated from 5.5% in 1Q16 (and 6.1% in 1Q15) to 5.1% in 1Q17. Oil production fell 14% yoy, as low oil prices prompted the government to cut back production. The decline led to a 10% fall in Vietnam's mining production, which accounts for 10% of GDP.
- Consumption fell from 7.5% yoy in 1Q16 to 6.2% in 1Q17, which is a bit worrying given that consumption constitutes 65% of GDP. As Vietnam continues to have one of the highest consumer confidence rankings in the world, therefore, the decline in the rate of consumption growth could be attributed to seasonal effects, as the Vietnamese Tet New Year Holiday was particularly early this year.
- Construction activity slowed from 9% in 1Q16 to 6% in 1Q17, due to the fact that industrial construction (factories, and other production facilities) was flat. Residential construction grew at a robust 10% yoy, indicating that confidence among home buyers is still high.
- Manufacturing output grew 8% in both 1Q16 and in 1Q17, despite the slowdown in Samsung's production. This reflects the strength of the manufacturing story in Vietnam, which is also reflected by an increase in Vietnam's PMI survey from 54.2 in February to a 22-month high of 54.6 in March.
- In 2017, economic activity will average 6.2%. Manufacturing and services remain buoyant. Production in agriculture has also rebounded, though at a moderate pace.

The FDI-driven export growth story continues to power ahead despite the US withdrawal from TPP

- The value of newly registered, planned FDI projects soared 92% yoy in 1Q17 to US$7.7 bn, but those newly planned projects included Samsung's planned US$ 2.5 bn display factory. Excluding that, newly registered FDI projects still grew by an impressive 30% yoy. These figures could indicate that firms began to hold back on actually following through on their prior FDI commitments immediately after Mr Trump was elected and he withdrew the US from the TPP, but then as a more benign picture emerged, company executives felt free to resuming committing to new projects.

- Vietnam's exports grew 13% yoy in 1Q17, which was an acceleration from the country's 9% export growth in 2016, enabled by robust FDI inflows.
- High tech exports grew 6% yoy because of the retooling of the Samsung smartphone production line (in 2016, high tech items contributed nearly 1/3 of Vietnam's overall exports).
- Vietnam ran a US$ 1.9 bn trade deficit in 1Q17 because import growth surged from 5% yoy in 2016 to 22% in 1Q17. At first glance, the statistic may seem alarming, but the vast majority of Vietnam's imports are used as intermediate inputs for exports (about 70% of Vietnam's imports are attributable to FDI companies). Furthermore, imports of machinery and equipment surged 28% yoy in 1Q17, which is a strong, positive leading indicator that manufacturing growth will remain robust this year.
- The current account surplus will narrow as FDI inflows draw in imports of capital goods and manufacturing inputs. Consumer goods imports have also been rising, primarily automobiles.

Inflation remains stable

- Inflation in Vietnam is currently being driven by administrative price hikes especially for health and education services.
- Headline CPI inflation increased 5% in 1Q17 yoy, partly on account of higher energy and food prices – core inflation grew 1.7% yoy during the same period. The recent easing of global food and fuel prices and a strong dollar may result in imported inflation.
- On the whole, expect inflation to average 4% in 2017.

Expect a gradual pace of fiscal consolidation

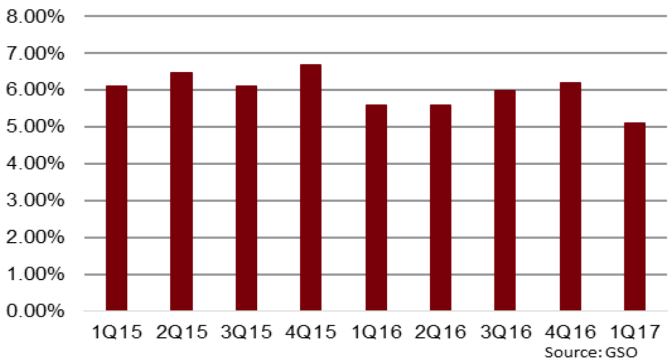
- Fiscal policy has been relatively loose in recent years; the fiscal deficit was at a high of close to 6.6% in 2016. The single most important reason is the rapid increase in recurrent expenditures. The government seeks to increase its revenue from domestic taxes and fees and sell its stakes in equitized companies.
- The government remains committed to fiscal consolidation as concerns grow about the likely negative impact on investor confidence if Vietnam's debt-to-GDP ratios surpass the safety limits set by the authorities. However given its ambitious infrastructure development plans, growing welfare costs and revenue shortfall resulting from phased cuts to import duties, the pace of fiscal consolidation will be gradual.
- Monetary policy can stay loose as long as inflation is within target.
- Exchange rate will depreciate in line with other regional currencies.

Risks and Other Issues

- Domestically, delayed implementation of structural and fiscal reforms (to rein in public debt) as well as vulnerability in the financial sector (slow NPL resolution progress) are the primary risks to the economy.
- On the external front, risks of protectionist measures undermine Vietnam's trade position.

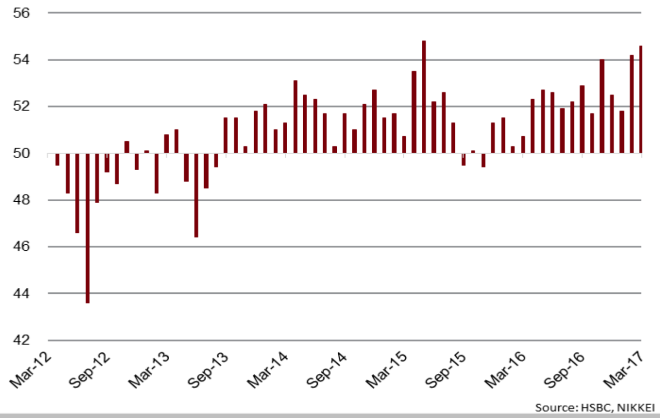
The economy shifted into a lower gear in the first quarter of the year-weighed down by transitory factors

Figure 1: Quarterly GDP Growth



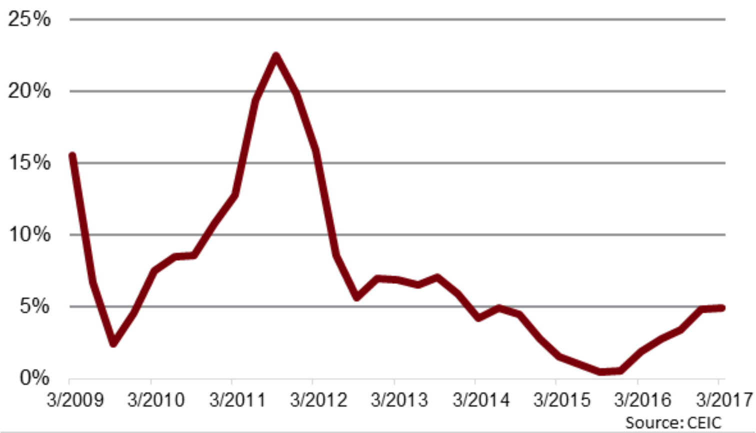
The manufacturing sector ended 2016 on a positive note and the momentum continues in 2017

Figure 2: Vietnam PMI



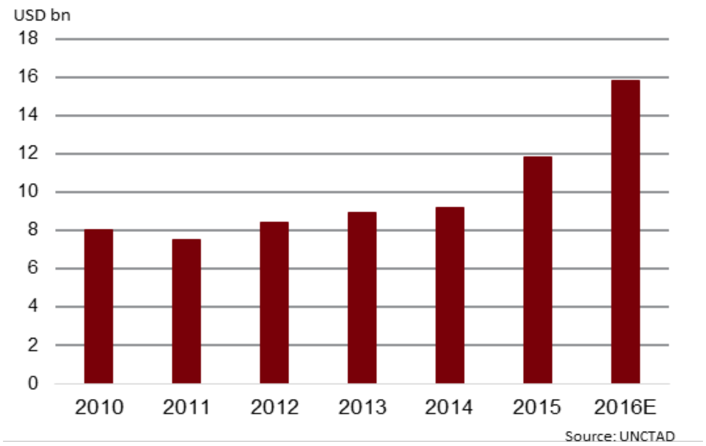
Prices have been pushed up by hikes in medical and education costs

Figure 3: Inflation



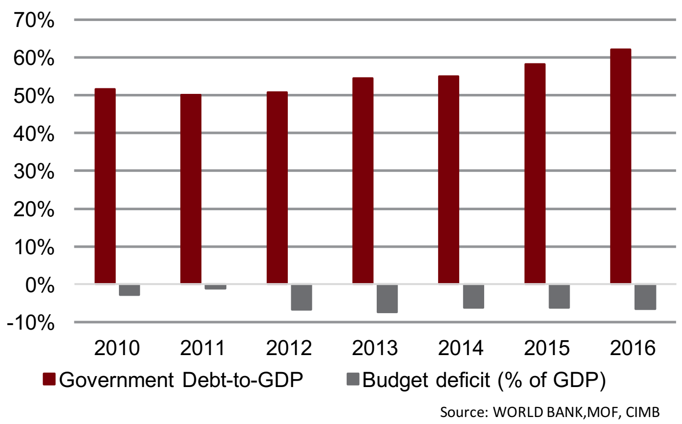
FDI in export oriented manufacturing has been a boon to the economy

Figure 4: FDI



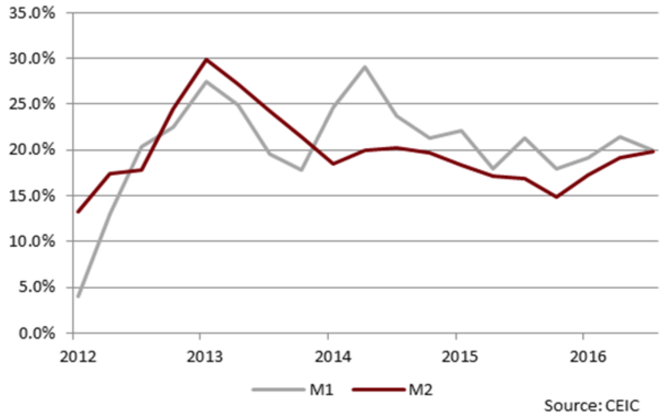
One area that does need work is the public finances as the fiscal deficit has been on a high

Figure 5: Government Debt-to-GDP and Budget Deficit



Narrowing gap between narrow and broad money points to a rise in credit growth

Figure 6: Money Supply



Annual Data

	2016
Nominal GDP (USD bn)	205.3
GDP per capita (USD)	2173.3
Population (mln)	92.6

	2013	2014	2015	2016	2017F	2018F
Real GDP growth (%yoy)	5.4	6.0	6.7	6.2	6.2	6.3
Real consumption growth (%yoy)	5.4	6.2	9.1	8.1	6.1	7.0
- Public consumption (%yoy)	7.3	7.0	7.0	8.8	5.0	6.7
- Private consumption (%yoy)	5.2	6.1	9.3	7.4	7.2	7.2
Real gross capital formation (%yoy)	5.4	8.9	9.0	9.3	8.7	8.2
Real export growth (%yoy)	17.4	11.6	8.8	17.9	14.6	13.6
Real import growth (%yoy)	16.0	12.8	14.3	19.2	15.3	14.0
Nominal export growth (%yoy)	15.3	13.8	7.9	8.5	7.0	9.0
Nominal import growth (%yoy)	16.0	12.0	12.0	5.2	5.0	6.0
Trade balance (USD bn)	8.7	12.1	7.4	14.1	18.3	25.1
- % of GDP (%)	5.1	6.5	3.9	7.0	8.5	10.8
Current account balance (USD bn)	7.7	9.5	0.9	9.4	8.8	8.0
- % of GDP (%)	4.5	5.2	0.5	4.7	4.0	3.4
Reserves, end of period (USD bn)	25.9	34.3	28.3	41.0	-	-
- foreign reserves to months of imports	2.1	2.5	1.9	2.8	-	-
Fiscal balance (% GDP)	-7.4	-6.2	-6.2	-6.6	-5.7	-5.6
Retail sales growth (%yoy)	12.3	11.6	10.9	9.0	9.0	9.0
Industrial Production Index growth, average (%yoy)	7.7	7.5	11.9	16.3	11.0	9.0
Narrow money (M1) growth, average (%yoy)	17.8	21.2	18.0	21.5	16.1	14.3
Broad money (M2) growth, average (%yoy)	21.4	19.7	14.9	20.9	18.0	15.1
Domestic credit to private sector (% GDP)	96.8	100.3	111.9	125.1	135.8	138.0
Consumer Price Index (CPI), end of period (%yoy)	6.0	1.8	0.6	4.7	5.0	5.0
Consumer Price Index (CPI), average (%yoy)	6.6	4.1	0.6	2.7	4.0	5.0
Policy rates (end period)	7.0	6.5	6.5	6.5	6.5	6.5
Exchange rate vs. USD, end period	21,036	21,246	21,890	22,769	22,500	23,200

Quarterly data

	3Q15	4Q15	1Q16	2Q16	3Q16	4Q16
GDP (%yoy)	6.1	6.7	5.6	5.6	6.0	6.2
CPI, average (%yoy)	0.5	0.3	1.3	2.2	2.8	4.4
Exchange rate vs. USD, end period	22470.0	22485.0	22280.0	22295.0	22290.0	22740.0

SOURCE: CEIC, CIMB Research

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