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Vietnam defies emerging market slowdown

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Strong export growth helps the Southeast Asian nation remain on track

The high-rise skyline of Ho Chi Minh City's financial district

With the clouds hanging ominously over emerging markets darkening by the week, there are not many bright spots to lift the gloom. Arguably one of the remaining shafts of light is emanating from Vietnam.

Number crunching by Capital Economics suggests Vietnam is among a small band of developing markets to have delivered stronger economic growth in the past year than their average growth rate since 2010 (*see the first chart*).

All of its four peers in this select group — Hungary, the Czech

Republic, Romania and Poland — are eastern European nations that have benefited from tumbling oil prices and the relative resilience of the German economy, a big export market.

Moreover, most of these countries are merely recovering from a global financial crisis-induced slump.

While Romania, the Czech Republic and Hungary saw no rise in real gross domestic product between 2008 and 2014, Vietnam's economy expanded by 40 per cent (more than twice the rate of Poland).

Many believe this success story has further to run. Vietnam's economic growth has accelerated from 5.2 per cent in 2012, to 5.4 per cent in 2013 and 6 per cent last year. Market forecasts collated by Consensus Economics suggest the rate will rise again to 6.1 per cent this year and 6.2 per cent in 2016.

Dominic Scriven, chief executive of Dragon Capital, the biggest investor in the Vietnamese stock market bar the government, is more upbeat still, pencilling in growth of 6.5 per cent this year and "close to 7 per cent" in 2016. "It's the only economy I know of that is accelerating," he says.

As to why Vietnam has seemingly been able to defy gravity when others are sinking into the mire, analysts point to the country's success in attracting the sort of low-wage jobs China is attempting to move beyond.

"It is benefiting hugely from rising wages in China, which is seeing the relocation of low-end manufacturing elsewhere, mostly within Asia," says Gareth Leather, Asia economist at Capital Economics.

"It has integrated itself into the supply chains of southern China [in sectors such as] textiles and low-end assembly. China doesn't really want to be in the position of making T-shirts etc"

While regional rivals such as Bangladesh and Cambodia are vying for the same jobs, Mr Leather says Vietnam has a geographical advantage over them, as well as political stability, courtesy of its Chinese-style Communist government.

Mr Scriven also points to Vietnam's high level of female participation in its labour force, which at 75 per cent is appreciably higher than in the likes of Bangladesh and India.

The country's industrialisation may have much further to run. "Vietnam is similar to China, maybe 15-20 years ago. They still have this huge surplus rural labour force that they are bringing

into the cities and the factories. That's also helping to keep wages pretty low," Mr Leather says.

Vietnam is a big exporter of mobile phones and textiles (each account for around a sixth of sales), and the world's second-largest exporter of footwear, according to Dragon Economics.

Even the commodities it exports in volume, such as rice, coffee, shrimp, cashews and peppercorn, are foodstuffs for which demand is likely to hold up relatively well, although rubber producers are more exposed to sluggish global growth.

This has allowed Vietnam's export growth to comfortably outstrip that of its regional rivals in recent years (*see the second chart*).

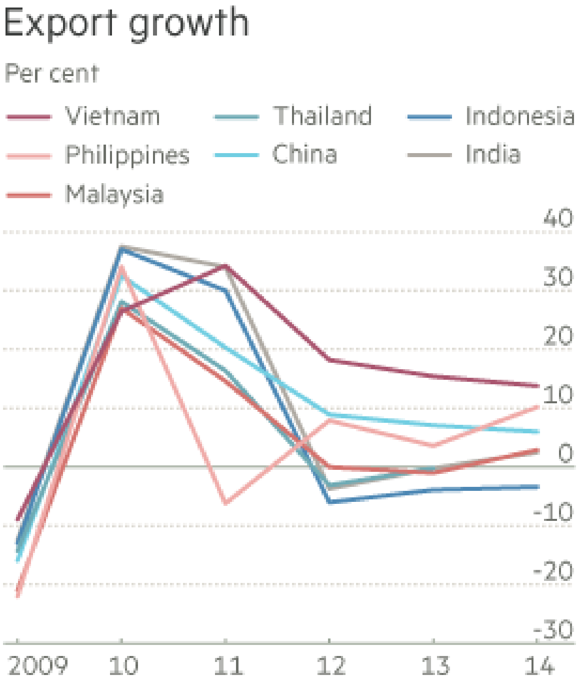
The country has seen its export growth rate slow this year, as a global trade recession has taken hold, but it is still doing better than most.

"Vietnam is a real outlier. A lot of emerging markets are seeing exports falling year on year. Vietnam's growth rate has fallen, but they are still growing at a double-digit pace," Mr Leather says.

Figures from Trading Economics, a data provider, show exports hit a record $14.5bn in August, well ahead of the $6bn or so a month recorded as recently as 2010.

Despite the global backdrop, Mr Scriven is hopeful of more to come. He notes that much of export growth has been driven by trade agreements with the likes of the EU, and speculates that agreement on a mooted 12-country Trans-Pacific Partnership free trade agreement, involving the US and Japan, could bolster Vietnam's GDP by a percentage point a year.

The country may even be a rare beneficiary of China's decision to let its currency weaken, Mr Scriven says. Given that Vietnam runs a trade deficit of 15 per cent of GDP with its northern



Source: Dragon Capital

neighbour, the primary effect will be to make Vietnam's imports cheaper.

Perhaps unsurprisingly, given Dragon's focus on Vietnam, Mr Scriven says the country's robust growth is attracting foreign capital.

Vietnam has seen a surge in foreign direct investment in recent years. And even though growth has slowed this year, Vietnam was one of a relatively small cadre of emerging market countries not to see a fall in inbound FDI during the first half of 2015, according to figures from fDi Markets, an FT data service.

Mr Scriven is also upbeat about Vietnam's equity markets, which are trading 50 per cent below the peak level they reached in 2007 and are cheaper than regional peers in both price-to-earnings and price-to-book terms.

"You have an accelerating economy, driven by recovery and reform, and a pretty undervalued market," says Mr Scriven, who sees two specific catalysts to expand the equity market, which has a modest capitalisation of around $60bn.

First, as of this month, the government has scrapped rules limiting foreign ownership of listed companies to 49 per cent, although this limit still applies in 46 sectors, such as seafood processing and chemicals, which are deemed to be essential or sensitive.

Vietnam is also in the midst of what, in theory, is a privatisation boom, a key plank of its reform agenda.

According to Dragon Capital, 430 privatisations with a combined book value of $28bn, were planned for 2014 to 2016. The fact that 100 such deals, with a combined value of just $3bn, occurred last year, combined with the declining global appetite for all things EM, might lead to some scepticism that this target will be met.

Mr Scriven, though, remains confident it will be. "It's a political programme rather than an economic one. The people running the privatisations are being told that they will get the sack if they don't privatise," he says, in anticipation of deals in sectors such as airports, oil refineries, processed food, telecommunications, power generation, gas stations and beer. "Why on earth is the government making beer?" Mr Scriven asks rhetorically.

The government bond market may also offer opportunities, with 10-year paper currently yielding 7.07 per cent, even as inflation has fallen to just 0.6 per cent.

Risks remain, of course. Mr Leather points to a history of poor management of economic cycles, with loose monetary policy often spurring a surge in lending, "often for very poor quality projects" in the past, pushing inflation higher and driving "huge" cycles of boom and bust.

"At the moment we are in the early stages of a cyclical rebound. The current account has gone from a surplus to a deficit [of 4.4 per cent of GDP] and FX reserves are quite low [covering less than three months of imports at the end of 2014]," he says.

"They have had to devalue the dong several times this year [by a total of 4.4 per cent against the dollar]. Inflation can reappear, therefore they might have to hike interest rates sharply."

Moreover, Mr Leather says the banking sector, which suffered a crisis in 2011, is "struggling", with 15 per cent of personal loans probably non-performing at present.

Mr Scriven admits the path is rarely smooth in Vietnam. "We have been there for 21 years and there have been three crises in that time," he says. "For the last five years it has been pretty unpleasant talking about Vietnam. It has been an underperformer and a source of disappointment, but now it's drawing a fair bit of interest."

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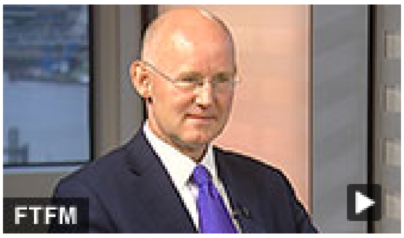

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