Arcadia Market Commentary

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Vietnam – Attractive in Long Run

Over the past 20 years, Vietnam has shifted from a centrally-planned economy to a market economy. Progress has included land reform, price liberalization, exchange rate unification, tax reform, public enterprise restructuring, modernization of the financial system, and opening up of the economy towards freer trade. Along with its reforms, the country has managed spectacular growth. In the past nine years, the country has been Asia's third fastest growing economy. It recorded an average GDP growth of 7.0% during the period of 2001 to third quarter of 2009, after China (9.4%) and India (7.4%). This article is quoted from Fundsupermart – Vietnam – A Gem In The Making, it examine the growth drivers of the Vietnamese economy, and the challenges faced by one of the most densely populated nations in Asia.

Rising Investment Levels Due To Economic Transformation

Twenty years of reform have had a profound impact on the structure of Vietnam's economy, transforming the economy from an agriculture-based economy to an industrial-based economy. During the 1980s, the agriculture sector contributed over 40% to its GDP and it has since halved to about 18% in 2008. Meanwhile, the industrial sector has quadrupled its contribution to GDP from about 10% in the 1980s to over 40% in 2008 On the other hand, the service sector has been relatively stable, contributing 30% to 40% of GDP over the years.

Along with the structural transformation of the economy, investment in Vietnam has boomed. The private sector is playing an important role in encouraging a spectacular rise in investment levels. The private and foreign invested sectors contributed to more than 70% of all investments in the economy in 2008.

Strong Consumption Growth Potential

Today, Vietnam is one of the most densely populated countries with an estimated population of close to 87 million people. It ranked as the 13th most populous country worldwide by the United State's Central Intelligence Agency (CIA) in 2009. Private consumption accounted for about 60% of GDP in 2006, and a large population base should sustain strong consumption growth for many years to come.

"China-Plus-One" is a new expansion strategy for Asia. It is a strategy of locating a company's production facilities and operating headquarters in other countries, apart from China. To some extent, the allure of some of the major cities in China is fading. Cost of production in major cities such as Beijing, Shanghai, and Guangzhou has gotten increasingly expensive for the foreign enterprises. The push into China's inland regions is less attractive financially due to higher transportation cost. In recent years, the Chinese government has changed its tax laws and regulations significantly. According to the Hong Kong Institute of Certified Public Accountants, during the first half of 2009, the tax revenue from non-resident companies has increased by more than 40% as compared to the same period last year. Lesser tax incentives in China may also make foreign corporations think twice about tax implications and the feasibility of setting up new operations or business in China. Other considerations, such as to mitigate country and political risk in a single country, friendlier trade policies and growing demand from middle class consumers in other Asian countries are among the reasons why multinational companies would like to venture into other Asian countries.

Vietnam is one of the prime recipients of foreign investment under this "China-Plus-One" policy. Some countries, such as Japan, have officially pronounced Vietnam to be their preferred investment destination, after China. According to the annual survey done by Japan External Trade Organization (JETRO), Vietnam is highly competitive with low investment-related costs – including workers' wages, telephone charges, rent and utilities. In addition, Vietnam's strategic location – a mid-point between China and other ASEAN countries is a good access point to intermediate goods trade. The country has a long coastline and is able to offer transportation facilities at a budget cost.

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Increasing FDI

Vietnam's FDI flow over the past twenty years recorded a remarkable compounded annual growth rate (CAGR) of 30% from a registered capital of US$341.7 million in 1998 to US$6301.0 million in 2008. The government is showing its commitment to attract foreign investors. In mid-2009, the authority introduced new guidelines on foreign-ownership limits. Starting from June 2009, foreign investors can own up to 49% of listed and unlisted domestic public companies. Prior to this change, foreign investment ownership was limited up to 30% only. As part of her obligations as a World Trade Organization (WTO) member to lower the barriers to entry, Vietnam is scheduled to open up parts of the service sector to foreign investors.

Young Population Entering The Workforce

Labor availability is also another advantage of Vietnam. The country has a huge population to support its development. Out of the population of 87 million, about 69% of its total population is at the age range of 15 to 64 years old. In addition, as a developing country, the literacy rate of Vietnam is high at 90.3%, comparable to Indonesia (90.4%) and China (91%). By definition of the CIA, a person is literate when he is able to read and write at an age of 15 years old or above. Higher literacy rate would translate to more skilled labor joining the foreign and local companies in Vietnam.

Key Risks – Devaluation of Dong

Despite being an export-oriented country, Vietnam is facing a trade deficit. Imports are highly linked to its exports. For example, Vietnam exports crude oil but imports refined petroleum as it is short of refining capabilities. The country exports garments but its fabrics are imported. In order to narrow its trade deficit, the country has devalued its currency three times within these two years. The latest devaluation was in late November 2009, which brought the official mid point exchange rate to 17,961 dong : US$1. The country is hoping that a weaker dong will make Vietnamese exporters more competitive as compared to the others.

Corruption & Lack of Transparency

Corruption and lack of transparency are often the key risks of investing in developing countries. A study by Transparency International, a global organization leading the fight against corruption, found that there is poor enforcement in mechanisms to tackle corruption in Vietnam. Under its Corruption Perceptions Index, an index to measure the perceived level of public-sector corruption in 180 countries and territories around the world, Vietnam ranked 120th out of the 180 countries in 2009.

Lack of Infrastructure

Lack of infrastructure is another constraint on businesses operating in Vietnam. Port congestion (in terms of storage capacity and number of vessels), especially in the Ho Chi Minh City area is getting worse. The government budget is not enough to solve the electricity supply problem. In order to tackle the lack of infrastructure, the Vietnamese government has implemented policies to encourage private investment in infrastructure.

Growth Potential Remains

Despite the temporary economic setback from the global economic crisis and other obstacles mentioned earlier on, we believe there is still plenty of potential for Vietnam to grow. Vietnam's GDP per capita has grown at a strong 14% CAGR during the period of 1990 to 2008. In USD terms, income per capita increased from US$95 in 1990 to US$1,042 in 2009. However, when compared with its regional peers, Vietnam's relatively low GDP per capita is an indication of further growth potential. Increasing wealth and stable population growth contributed to the consumption boom in Vietnam. Total retail sales jumped 23.2% year-on-year in November 2009 as compared to a year ago. Such a high growth rate amid the global economic crisis is quite impressive and it demonstrates the resilience of the Vietnamese economy.

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