VIETNAM MACRO COVERAGE

Summary Highlights

- **GDP growth accelerated to 6.78% year-over-year in 2010**
- **Annualized inflation rises to 11.75% year-over-year by the end of December 2010**
- **Policymakers are rethinking their pro-growth stance amid rising inflation**
- **Devalued the VND by 9% following the National Congress in January 2011—ending the "Pre-Party Paralysis"**

GDP Growth Outpaces Government Targets

In 2010, Vietnam churned out higher-than-expected GDP growth of 6.78% year-over year, surpassing the government's target of 6.5%. Economic expansion accelerated quarter-on-quarter, as GDP growth rose from 5.84% in Q1 to 6.44% in Q2 and further expanding by 7.18% in Q3 and 7.34% in Q4. Strong growth though came at the expense of double-digit annual inflation and a depreciating currency.

Fueling Vietnam's GDP growth, the industrial sector grew strongly in 2010, with industrial output doubling from a year-end low of 7.5% in 2009. In Q4, industrial production continued to accelerate rising from 14.3% in November to 16.2% in December. Strong growth in key industrial sectors such as natural gas, footwear, and ceramic tiles boosted Vietnam's industrial output in the fourth quarter—a trend that carried over into the start of 2011, with industrial production rising 16.1% in January.

Industrial production strongly expanded by 16.1% year-over-year

By sector, Vietnam's manufacturing sector posted a particularly sharp uptick of 8.38%, as well as the services sector, which expanded by 7.52%. Mining was down 3.69%, the first decline in two years, and agriculture and fisheries only modestly expanded by 2.78%. The slump in mining may be attributed to lower production at the White Tiger oilfield, and the muted growth in the agriculture and fisheries sector was due to poor autumn crop production caused by seasonal flooding.

For the year ahead, Vietnam is steadily pacing to sustain economic growth, but although it is undeniable that Vietnam's growth momentum remains strong, policymakers are beginning to look at the broader picture of macro stability, realizing that sustainable growth is dependent on the government's commitment to containing inflation and stabilizing the currency through systematic policy changes.

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As of January 2011, the government has revised down its annual GDP growth target to 7.0-7.5% for the 2011-2015 period. Although a modest pullback from previous estimates, the downward revision is viewed as positive and signals the government's awareness of mounting inflationary pressures.

Inflationary Pressures Remain

Inflationary pressures rise in Asia, resulting in rate hikes across the region

Inflationary pressures are not isolated to Vietnam alone; they are spreading throughout the Asian region. With inflation rates rising across Asia, many Central Banks have hiked rates at the start of 2011: The Reserve Bank of India increased its key policy rate by 25 bps in January; the Central Bank of Indonesia in February increased its key interest rate by 25 bps—the first increase since October 2008; and the People's Bank of China raised its 1-year Yuan lending rate 25 bps in February.

Likewise, inflation remains a key challenge in Vietnam. Fueled by an increase in the money supply and domestic credit outpacing nominal GDP, inflation rates tipped into double-digit territory at the end of 2010. For the year, the money supply grew by 25.3% along with credit growth of 28%, driving inflation up to 11.75% year-over-year.

Carrying over into 2011, Vietnam's headline inflation rate accelerated in January to 12.2% year-over-year. Food prices, which account for 40% of the CPI basket, rose 16.6% year-over-year in January, a notch higher than the 16.2% year-over-year increase recorded in December. Price growth in housing and construction materials (including utilities) moderated from 15.7% in December to 15.4% year-over-year in January.

Food prices rose 16.6% year-over-year, fueling inflation

Inflation risks in Vietnam are up on par with the rest of the region and will likely trend higher, with food costs expected to pick up in Q1 2011. Furthermore, the pass through of the devaluation of Vietnam dong (VND) in February 2011 will also add to inflation.

With rising inflationary pressures, a sizeable albeit manageable trade deficit and currency woes, the government is hyperaware of its need to balance growth with economic stability. To this aim, the State Bank of Vietnam (SBV) has moderated its credit growth target down to 23% and policymakers have passed through monetary reforms following the National Congress in January 2011 by devaluing the currency and hiking the refinancing rate.

Narrowing the Trade Deficit with Robust Export Growth

Export turnover increased to 26.5% year-over-year in 2010

Given the export rebound in Q3, export turnover demonstrated robust growth toward the end of the year. For 2010, export turnover amounted to US$71.6 billion, a 26.5% increase against 2009. Exceeding the government's export target, there was uniform growth in most export sectors, with the FDI sector leading at 47.4% of total exports, up 39% from 2009.

It is notable to account the structural change in export turnover in 2010. Crude oil export turnover has declined, as the country's new oil refinery in Dung Quat is beginning to absorb local supply. Historically, crude oil has comprised almost a quarter of Vietnam's total export value, whereas it accounted for only 12% of export turnover in 2010.

With crude oil exports waning, manufacturing is playing a larger role. Exports in industrial and processing sectors are on the rise, up 62.3% year-over-year compared to 58.2% in 2009. Computers and electronic products are also trending up, rising 28.8% against 2009, which is accredited to the new Intel plant pioneering the way as Vietnam moves up the value chain.

Domestic consumption and import demand drive import growth

In terms of import growth, yearend import turnover grew 22% year-over-year against 2009 to an estimated US$84 billion. This growth is attributed to high domestic consumption and import demand of raw materials for inputs into export products. There is a notable trend in the import growth of electronic products, up 23% year-over-year in 2010. With the opening of the retail market for consumer electronics in accordance with WTO regulations, Vietnam's import spending is forecasted to inch higher in the coming years in the electronics sector.

By yearend, the trade deficit was approximately US$12.4 billion. Compared to figures in 2009, the trade deficit marginally widened by 1.6%. However, the trade gap is forecasted to narrow in 2011 as export turnover growth is expected to continue to outpace that of imports.

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FDI Disbursement: Steady Momentum

As of yearend 2010, Vietnam attracted a total of US$17.2 billion in registered FDI. Although registered FDI has declined from the high of 2008, more importantly disbursed FDI has remained remarkably steady. In 2010, FDI disbursement was estimated at US$11 billion, up 10% compared to 2009.

In terms of origin, Singapore was the dominant source of registered FDI, with total capital amounting to US$4.3 billion. The Netherlands registered second, with total inflows of US$2.3 billion, followed by Japan (US$2 billion), South Korea (US$2 billion), and the United States (US$1.8 billion). Out of all the invested countries, South Korea recorded the most licensed FDI projects, totaling 256.

The manufacturing sector attracted 46% of registered FDI while real estate receded to 34%

FDI in Vietnam has undergone two major shifts in recent years, in terms of investment targets. The speculative real-estate frenzy of 2007 and 2008 thrust real estate and tourism to the forefront, overtaking the traditionally dominant category of processing and manufacturing. By 2009, real estate projects represented 33.8% of registered FDI, hotels and restaurants pulled in another 40.9%, and manufacturing made up just 17.1% of the total.

This shift proved to be short-lived, however, as the composition of FDI has readjusted toward the previous standard in 2010, with the manufacturing sector attracting 46% of registered FDI and real estate receding to 34%. This positive shift in the quality of FDI is due to both an increase in investment in the manufacturing sector, as well as a decline of multi-billion dollar real estate projects, which are often never realized. Dubbed the “Intel effect” following the opening of the chip maker’s factory in HCM City, Vietnam’s manufacturing sector is not what it used to be: high value-added products like microprocessors and laptop components are slowly supplanting low value-added T-shirts, handbags and ceramics.

VND Devaluation & Monetary Tightening

The devaluation of the VND was a necessary and long overdue move

The pre-Party Congress paralysis that persisted throughout Q4 and January 2011, lasting through the Tet holiday in early February, was finally lifted on February 11th with the SBV shifting the VND/USD reference rate from 18,932 to 20,693. The change in the reference rate effectively devalued the currency by approximately 9% and was coupled with a narrowing of the trading band from ±3.0% to ±1.0%.

The devaluation was considered a necessary action, albeit long overdue and larger than many expected. However, with the Party Congress over, the backlog of reform measures is now being worked through the system. While the government neglected to raise the prime lending rate in tandem with the devaluation, the SBV resumed monetary tightening on February 17th by raising the refinancing rate 200 bps to 11%. Both deposit and lending rates are expected to increase as a result, thereby dampening credit growth and ultimately inflation.

The latest measures undertaken by the authorities come as welcome reforms and assurances that the government is prepared to limit credit growth, contain inflation, and address pressing economic issues. The devaluation will also aid in narrowing the trade gap, and the hike of the refinancing rate will likely lead to higher deposit rates, encouraging VND holdings.

Given that inflation is unlikely to abate in Q1 and the devaluation is estimated to feed into inflation—a 1% weakening of the VND/USD exchange rate is forecasted to add approximately 15 bps to inflation—more policy changes are expected in the form of monetary tightening and fiscal consolidation.

Rethinking the Pure Pro-Growth Stance

The highly anticipated 11th National Party Congress in January 2011 witnessed an expansion of the all-powerful Politburo to 15 members. The new composition of the Politburo consists of nine reelected members and six new officials. Headlining the committee is Nguyen Phu Trong , General Secretary, who is expected to play a pivotal role in tackling macro instability.

Another political appointment expected in May 2011 at the National Assembly election will be Nguyen Van Binh, who is reported to take over the governorship of the SBV. He is currently the Deputy Governor of the SBV and will replace the incumbent, Nguyen Van Giau. Many analysts expect Nguyen Van Binh's leadership to pilot SBV into a new direction and create more independence for the Central Bank.

Pro-growth rhetoric subsides after the 11th National Party Congress

At the closing of the Party Congress, the government noted concerns of Vietnam's current economic situation. Amid inflationary pressures and trade imbalance, policymakers are beginning to rethink the pro-growth ideal, with an eye to balance macro concerns.

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Key Economic Indicators

Key Economic Indicators	2006	2007	2008	2009	2010	2011f
National Accounts, Populations & Employment [1]						
GDP growth *(% year on year)*	8.2%	8.5%	6.2%	4.5%	6.7%	7%
Nominal GDP (bn)	US$60.9	US$71.1	US$90.3	US$93.2	US$103.9	US$117.2
GDP per capita	US$724	US$835	US$1,041	US$1,068	US$1,178	US$1,312
Private Consumption *(% year on year)*	8.30%	10.80%	9.20%	4.00%	6.00%	6.60%
Private Consumption (% of GDP) [2]	63.30%	64.80%	67.30%	66.30%	64.50%	64.80%
Government consumption *(% of GDP)* [2]	6.00%	6.10%	6.10%	6.30%	6.20%	6.50%
Gross Investment *(% of GDP)*	36.80%	43.10%	40.90%	38.10%	38.80%	38.40%
Industrial production *(% year on year)* [3]	16.00%	17.10%	14.60%	7.60%	14.00%	16%
Gross domestic saving *(% of GDP)*	36.50%	33.30%	29.00%	30.10%	29.80%	30.30%
Population *(millions)*	84.4	85.3	86.1	87.2	87.8	88.7
Unemployment rate *(yearend)*	4.80%	4.60%	5.00%	6.00%	5%	4.70%
Prices [1]						
Consumer price index, average *(% year on year)*	7.50%	8.30%	23.10%	6.70%	9.10%	8.30%
Consumer price index, year-end *(% year on year)*	6.70%	12.60%	19.90%	6.50%	11.75%	14%
Fiscal Data [1]						
Government fiscal balance(% *of GDP)*	-0.40%	-1.90%	-0.90%	-8.90%	-5.90%	-4.30%
Government primary fiscal balance *(% of GDP)*	-8.10%	-7.70%	-5.90%	-11.10%	-8.30%	-6.70%
Government expenditure *(% of GDP)*	29.10%	30.60%	29.80%	35.60%	32.80%	31.50%
General government debt *(% of GDP)*	28.70%	28.70%	29.00%	26.70%	26.90%	27.20%
External Accounts [3]						
Exports (bn)	US$39.8	US$48.6	US$62.9	US$56.6	US$71.6	US$87.8
Exports *(% year on year)*	22.7%	22%	29.40%	-9.7%	26.5%	22%
Imports (bn)	US$42.6	US$58.9	US$80.4	US$68.8	US$84	US$96
Imports *(% year on year)*	22.10%	38.30%	28.10%	-14.70%	22%	14.20%
Trade balance (bn)	(US$2.8)	(US$10.4)	(US$12.3)	(US$8.3)	(US$10)	(US$9)
Current account balance (bn)	(US$0.2)	(US$7.0)	(US$9.2)	(US$6.3)	(US$7.8)	(US$6.8)
Current account balance *(% of GDP)*	-0.3%	-9.8%	-10.3%	-6.8%	-7.9%	-6.3%
Disbursed FDI[3] (bn)	US$4.6	US$8	US$11.5	US$8	US$11	US$ 12.5
Foreign Debt & Reserves [1]						
Foreign debt *(year-end)* (bn)	US$19.1	US$23.1	US$28.4	US$36.5	US$41.7	US$47.7
Public (bn)	US$14.1	US$15.5	US$16.5	US$17.9	US$20.3	---
Private (bn)	US$1.6	US$3.8	US$4.2	US$4.4	US$4.7	---
Foreign debt *(% of GDP)*	31.6%	32.6%	32.5%	39.5%	38.3%	40.2%
Foreign exchange reserves *(year-end)* (bn)	US$11.5	US$21.0	US$23.0	US$16	US$13.4	US$13.8
Financial Markets [2]						
Broad money supply *(M2, % year on year)*	33.6%	46.1%	20.7%	26.2%	25.3%	21%
Domestic credit *(% year on year)*	25.4%	53.9%	27.6%	45.3%	28%	24.8%

1. Source: International Monetary Fund, October 2010
2. Source: Economist Intelligence Unit, February 2011
3. Source: General Statistics Office, December 2010
4. Source: Asian Development Bank, August 2010

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