Vietnam: a V-shaped recovery ahead

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HOW HAS THE REALITY OF THE POST-SEPTEMBER 2008 WORLD ECONOMY IMPACTED VIETNAM'S YOUNG, MARKET-ORIENTED ECONOMY, AND WILL VIETNAM'S RECOVERY BE 'V-SHAPED' AND OUTPERFORM THE WESTERN INDUSTRIALISED NATIONS AS WELL AS ITS SOUTHEAST ASIAN NEIGHBOURS?

As the 19th Century British Prime Minister, Benjamin Disraeli, once said, "There are lies, damn lies, and statistics". In order to get a true sense of how Vietnam is fairing, it is necessary to actually examine the economic statistics and put them into context. In doing so, it will become clear as to how government policies and fiscal stimulus, strong domestic growth and international interest are all contributing to Vietnam's V-shaped economic recovery.

Despite what appears to be weak economic data in the first half of 2009, Vietnam's economic growth is actually very much intact – having experienced its Q2 2008 to Q3 2008 mini balance of payments crisis and the world economic crisis as a mere bump in the road, with continued economic resurgence likely in the coming months and years. Indeed, unlike the expected continued stagnation of the developed world's economic growth, Vietnam's command-style economy is starting to show positive recovery signs.

Vietnam appeared to start 2009 in the doldrums – its young fragile economy seemingly wrecked by the burst of the world's economic bubble. Foreign direct investment (FDI) was down 80%. The Ho Chi Minh City stock exchange VN-Index was down to 235 in February 2009 – almost 1,000 points from its 2007 historic high. Residential real estate sale prices were down 40% in Ho Chi Minh City and Hanoi. January-to-July 2009 exports were down 10% and international tourist arrivals were down 19%, with GDP growth slashed from 6.5% in 2008 to a projected 3.9% for 2009.

Although these statistics seem to mark the end of Vietnam's rapid economic growth, it is important to remember that these numbers are compared to the breakneck growth statistics of 2008, which were somewhat of an anomaly. The 2009 results to-date actually not only

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show a strong recovery in many sectors, but also show a very favourable trend when compared to the 2006 to 2007 period, in line with a more sustainable and realistic long-term growth expectation for Vietnam.

Domestic demand and the economy

Over-leveraging and mortgage shenanigans have not changed the basic fundamentals of Vietnam's domestic situation in terms of demographics and market emergence. Vietnam still has a young and motivated population of 86 million, whose personal wealth and spending are on the rise. The Vietnamese are investing in the local stock market, manufacturing goods for the local and world community, buying consumer goods and services, and buying into the abundant real estate opportunities throughout the country.

One of the main factors fuelling the economy forward is personal consumption. There are few other places in the world where personal consumption is up 20% year-on-year (yoy) for the first half of 2009, spurred by aggressive government fiscal and social stimulus implemented in January 2009, which included tax cuts, interest rate subsidies and increased lending through state-owned banks. In addition, domestic industrial production rebounded with a positive 10.6% growth year-on-year in August 2009. A domestic-led recovery, much like the one China is experiencing, has also been helped by a general sense of local optimism about Vietnam's future – a feeling of economic hopefulness that, around the world, is in short supply. The strength of domestic demand is certainly in contrast to the current shortfall in aggregate demand of consumers and companies that many Western economies or heavily export-dependent countries are experiencing. The WTO-driven easing of restrictions on foreign retail and distribution is also notable, as the opening of Vietnam's market to more outside market forces and products has added to the positive drivers of recovery.

The stock market has recovered to its current mid-500 range. This resurgence is mostly credited to domestic investors who see Vietnam's recovery outweighing international fears and, to some extent, the US$22bn stimulus lending to businesses leaking into the stock market. The recent listing of additional shares of the local bank giant, Vietcombank (the first major IPO of the year), and the expected listing of Eximbank and another 47 companies, are seen as positive signs of recovery in the stock market. Likewise, increased transparency and governance should mean more sustainable growth in an asset class still very sensitive to short-term speculation and inflated prices.

Stock market rallies in Vietnam are typically followed by rallies in the real estate market as local investors recycle their gains once they estimate valuations have peaked. So it comes as no surprise to see a rebound occurring in the real estate market as well – again with some leakage from government stimulus-related corporate lending facilities. Unlike the 2007 explosion in the real estate market, which was very largely speculation-driven, this rally has been much more moderate. Actual real pent-up demand in the system for improved housing appears to be driving the market and real-need buyers have been flocking to recently-launched residential projects throughout the country, including beach-front holiday homes. The hospitality, residential and retail sectors will, thus, continue to have the most potential for sustained long-term growth, with Vietnam's population growing in numbers and wealth, and urbanising at a rapid rate – presages a real need for housing, vacation destinations and shopping outlets.

Meanwhile, in the already supply-constrained retail market, with the easing of restrictions on foreign participation, the lack of available space will only intensify. Just compare the HCMC retail market which has only 429,402 square metres of space for a population of 11 million, to a city like Manila which has 4.69 million square metres for 11.5 million people, and it is easy to see exactly how small and how much potential this segment has.

International influences and impact

A global crisis of the degree we have witnessed in the last year means that slower GDP growth across the globe is somewhat of a foregone conclusion. Thus, the real test is to what extent that slowdown manifests in each economy, and whether that economy goes into a negative-growth recession or merely slows an already rapid pace. In Vietnam's case, it is definitely the latter and, in fact, it has already seen an uptick from its lower growth, rising to 4.5% yoy in Q2 2009, up from 3.1% in Q1 2009, with even higher estimates for the second half of the year. If anything underscores the resilience and potential of Vietnam, this is certainly it.

Foreign direct investment numbers which, at first glance, appear so dismal, in reality, are telling a very different story. Committed FDI, indeed, has dropped by over 80% yoy, but the total committed FDI of US$10.4bn for the first eight months of 2009 is still on track to surpass 2006 (US$12bn) and encroach on 2007 (US$20bn) – as, historically, most large commitments tend to come in the last quarter of the year. More immediately relevant to the real economy, the disbursed FDI (money that has actually been spent and injected into the economy) of US$6.5bn through August still surpasses 2007's US$4.6bn and much more absorbable by the domestic economy than 2008's US$11.5bn, a significant contributing force to that year's runaway inflation and asset price bubble. A more moderate FDI inflow, along with a cooling of credit expansion, is bringing financial flows back down to a level that Vietnam's economy can more easily absorb.

At the same time, exports are still a drag on growth, having fallen 18.9% yoy in August. Exports have been up dramatically over the past few years and even though the recent figures compare negatively to 2008, they remain nearly 20% higher than in the first half of 2007. Also on the positive side, certain sectors like rice, clothing and electronic components are seeing positive growth. Concerted efforts to boost intra-regional trade with Vietnam's neighbours, including new infrastructure and connectivity but also relaxation of import procedures, have led to increased regional commerce, thus, partially compensating for a drop of exports to the US and Europe, making Vietnam's buoyant export sector less reliant on an economic recovery in the West.

Vietnam is also starting to sign trade agreements with Middle Eastern, African and South American countries, creating new export opportunities for future growth. Even more importantly, we also see another positive development stemming from lower export figures in combination with increasing domestic spending. Lagging foreign demand for goods has forced many Vietnamese firms to tap into the local domestic market while, simultaneously, streamlining their operations and cost structures. Long term this will prove to be a crucial learning experience for these firms that had previously only concentrated on foreign markets and low value-added production – as they are now realising the potential in having Southeast Asia's third largest population as their own domestic base and the benefits of going up the production value chain with this impressive demographic.

Government policy

The Vietnamese government's domestic stimulus package has been a key factor in reducing the impact of, and hastening the recovery from, the worldwide meltdown. Because Vietnam's economic reality check from the excesses of the world financial bubble came at the end of Q2 2008, when the rest of the world's economy imploded at the end of Q3 2008, Vietnam had already begun to apply discipline and inflation-cooling measures to its economy. Though unintentional in a way, the precautions, interventions and protections the government had already put in place not only provided the economy with a strengthened backbone to help resist the intense pressures of the global downturn, but also gave the economy a head start over countries that reacted only after the world economy declined. In addition, much like China, its command-style centralised economy enabled the government to implement short-term stimulus measures very effectively, ordering domestic state-owned banks to facilitate lending, while also compelling local industrial state-owned enterprises to resume production ahead of a recovery in domestic demand.

The interest rate subsidy programme, personal income tax abatement and loosened monetary policy have been the cornerstones of the Vietnamese stimulus plan. Thanks to the stimulus plan, investment in basic construction and infrastructure from government spending is up 33%. This spending is crucial, as Vietnam's infrastructure, unless improved, will hinder its longer-term progression towards future development and higher levels of FDI. The stimulus plan has aided consumer confidence and has helped fuel the domestic market, whose importance we have already shown.

Industry-by-industry, new changes are making it easier and more appealing to do business in Vietnam. In the important real estate market, such changes include allowing qualified foreigners to buy real estate, establishing real estate trading floors to increase transparency, and simplifying property titles to avoid confusion over ownership. Similarly, effective changes extend across all parts of the economy, from stricter lending laws to giving the central bank more autonomy in its lending practices – Vietnam is aggressively instituting the changes necessary to allow the economy to run more smoothly. These changes yield growth opportunities across all industries – and are already contributing to the current V-shaped recovery.

Risks

One should keep in mind that there is a risk that the initial signs of economic recovery and the moderate rally in the stock and real estate markets morph into a run-away speculative buying binge – yielding artificial growth in the real estate sector or the stock market, like 2007 – with unrealistic asset prices. However, the government is working to avoid another boom-bust cycle and many banks have upped their requirements for granting loans, even though, at times, relationships still trump economic realities. A prolonged global recession could also threaten Vietnam's economic recovery as it is still reliant on FDI and portfolio inflows to finance its trade deficit. Along with asset inflation, real inflation is back with a 3.5% price increase August year-to-date, although far away from the September 2008 high of 27.9%. Clearly the domestic economy will continue to experience some modest price pressures and, as imports recover, interest rates will have to rise to keep inflation in line with sustainable economic growth. With the resurgence of inflation, we expect some moderate depreciation of the local currency. Even though reluctantly, the State Bank of Vietnam (SBV) has sanctioned a widening of the USD/VND trading band and continues to privilege stability even though the grey currency and the NDF markets have already factored in a further devaluation of the currency. The SBV has kept the base rate at 7% for eight consecutive months to achieve the GDP growth target of over 5% in 2009, and control the inflation, and it remains on the watch for rising inflationary pressures.

Conclusion

Much like China's turnaround, Vietnam's recent economic growth numbers have shown a surprise on the upside. Vietnam, having rapidly and successfully pushed through its stimulus package, is likely to continue to outperform most economies in the world and in Asia. The current economic statistics and numbers are pointing to a more realistic growth. This is not to say that Vietnam will not stumble on the path of recovery in the coming months and years, as it still faces issues such as the downside risk in its capital allocation efficiency. But with a growing and motivated population, foreign interest in Vietnamese investments and goods, a government dedicated towards economic growth and reforms, and a rapidly growing and more influential private sector, Vietnam has a bright future. The V-shaped recovery is a reality – and Vietnam is back on the path to sustained long-term development, with much better prospects than many of its neighbours.

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