# Mizuho Insights: Vietnam

**Economics & Strategy | Asia ex-Japan**

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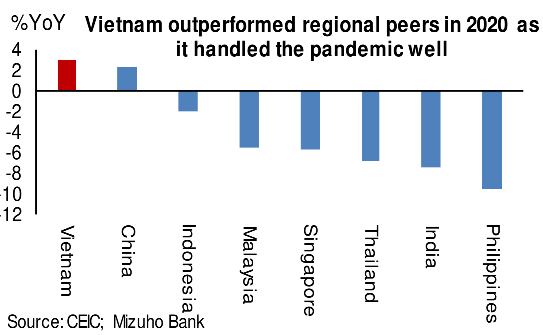
## 2021 Outlook: Resilient But Not Immune

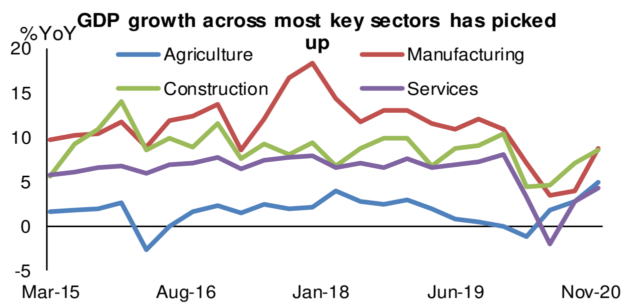
*__In a nutshell:__ Although growth in Vietnam slowed in 2020 relative to its historical average, it was stand out compared to regional peers. The authorities contained the pandemic in a swift and controlled manner leading to a soft landing rather than a crash. We expect more of the same this year, with the economic recovery picking up steam and returning growth to the 7% handle. There will be little need for aggressive monetary or fiscal policy stimulus. That said, with COVID-19 cases resurging and the vaccine drive yet to kick off, the risks to our forecasts are squarely skewed to the downside.*

**Resilient compared to regional peers**

**Vietnam's economy grew the fastest in Asia ex-Japan, and one of the fastest in the world, in 2020** as a testament to the authorities' effective handling of the COVID-19 pandemic (Figure 1). According to the IMF, Vietnam's success in containing COVID-19 offers a roadmap for other developing countries, in that the authorities recognised the real threat from COVID-19 early, raised awareness about it and stepped up containment measures in a cost effective manner. All this while receiving a public opinion buy-in with public sector and military support[1].




Source: CEIC; Mizuho Bank




Source: CEIC; Mizuho Bank

By industry, GDP growth in all key sectors picked up from Q2 2020, when a strict lockdown was across the country (Figure 2). In some sectors such as construction, growth in Q4 had almost returned to pre-pandemic levels. On the demand-side, government spending supported growth through 2020 but was unable to offset weak private consumption and investment spending. As such, anaemic domestic demand conditions led to import compression and a higher net exports contribution to headline growth.

**2021 started off on strong footing with most monthly indicators showing solid improvements.** In particular, January industrial production growth picked up to 22.2% YoY from 9.5% in December. We think this rise is not only a statistical bump given the moving Lunar New Year holidays (i.e. in January in 2020 and in February in 2021) but also

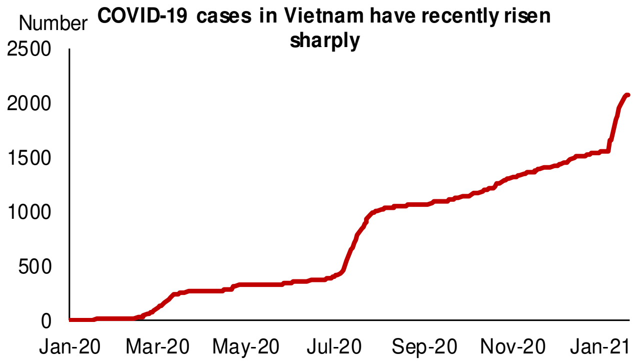
[1] https://www.imf.org/en/News/Articles/2020/06/29/na062920-vietnams-success-in-containing-covid19-offers-roadmap-for-other-developing-countries

reflective of a more genuine improvement in demand – underscored by better trade and retail sales for the month.

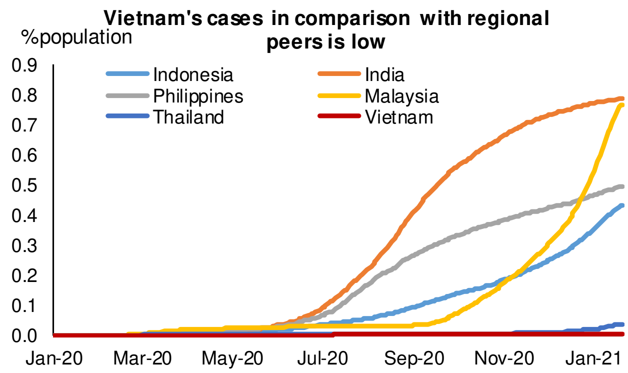
**Not out of the woods yet**

**This early resilience, however, is already being put to test** following a sharp increase in COVID-19 infections in late January/early February (Figure 3). The latest spread originated in the northern province of Hai Duong and spread to Hanoi as well as other parts of the country. The quinquennial party Congress had to be cut short by a day in early February and social restrictions have been imposed including limitations on domestic and international travel, school closures and cancellation of Chinese New Year related festivities.

**Moreover, Vietnam's vaccination drive is yet to begin.** The government only approved the AstraZeneca's vaccine on 30 January and expects the first doses of the vaccine to be given in Q1. Vietnam is also eligible to buy vaccinations from the COVAX programme, a global vaccine alliance, but the timeline on procurement is not definite.



Source: Bloomberg; Mizuho Bank



Source: Bloomberg; Mizuho Bank

**Even so, Vietnam continues to be much better placed to handle the pandemic** given the government's preparedness regarding additional outbreaks (for example, authorities have stated that up to 10,000 tests could be carried out in one day[2]) and the relatively low case count in proportion to the population, especially when compared to regional peers such as Malaysia and India (Figure 4).

We, therefore, continue to expect that a relatively strong economic recovery is on the cards this year. **Our forecast is for GDP growth to bounce back to 7.0% this year from 2.9% in 2020.** Admittedly, repeated (albeit localised) COVID-19 infections and a slow vaccination program could prove to be significant headwinds. The risks to our forecast is unambiguously titled to the downside. **That said, barring shock waves of COVID-19 and a prolonged nationwide lockdown, we expect GDP growth this year will be at least 5%-5.5%.**

**Aggressive fiscal or monetary policy support is not warranted**

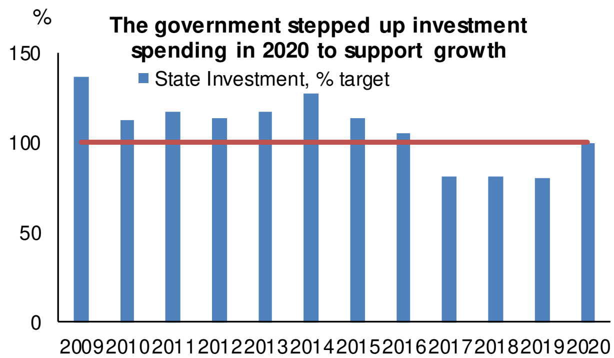
**The support from fiscal and monetary policy will continue this year in the same targeted and prudent manner as in 2020.** Last year, the government estimated that the fiscal deficit could widen to beyond 5.5% of GDP, although the actual deficit is reported to be lower at 4% of GDP[3], and introduced a gamut of tax and social protection measures

[2] https://www.reuters.com/article/us-health-coronavirus-vietnam-cases-idUSKBN29X353

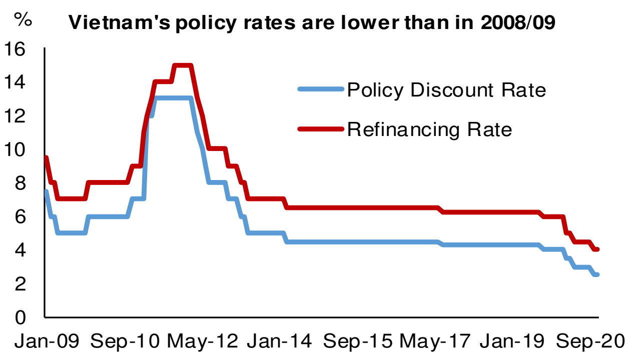
[3] https://e.vnexpress.net/news/business/economy/vietnam-fiscal-deficit-lower-than-projected-4218425.html

to cushion against the blow from the pandemic.

**Of particular note was the government's focus in boosting productive investment expenditures.** After a few years of falling behind on its target, the government disbursed nearly 100% of total budgeted investment spending last year. This focus will remain steadfast even in 2021 (Figure 5). Beyond this, outright expansionary fiscal policy might not come into play this year, unless there is a rampant spread of the virus forcing more stringent lockdowns.



Source: CEIC; Mizuho Bank



Source: CEIC; Mizuho Bank

**From a monetary policy perspective, the State Bank of Vietnam has additional wiggle room to support the economy this year with headline inflation falling into negative territory.** The shortages of pig supply (following mass culling after contracting the African swine flu) resulted in a sharp rise in food inflation in late 2019 and early 2020. This has created favourable base effects for inflation in Q1 2021. However, after lowering the policy discount rate by 150bp and refinancing rate by 200bp in 2020 to below GFC lows (Figure 6) and providing ample liquidity/credit support, **we expect no further action from SBV this year against the backdrop of improving growth.**

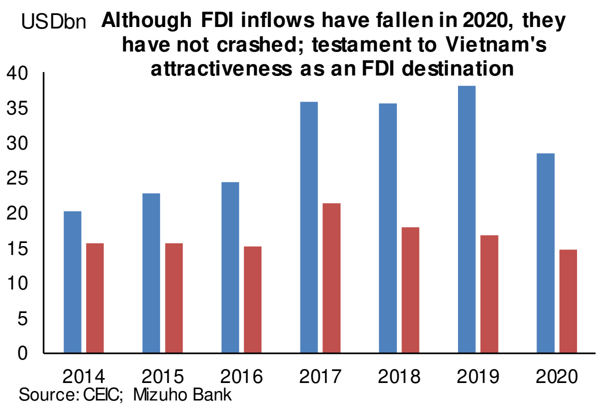
**Longer-term outlook is still promising**

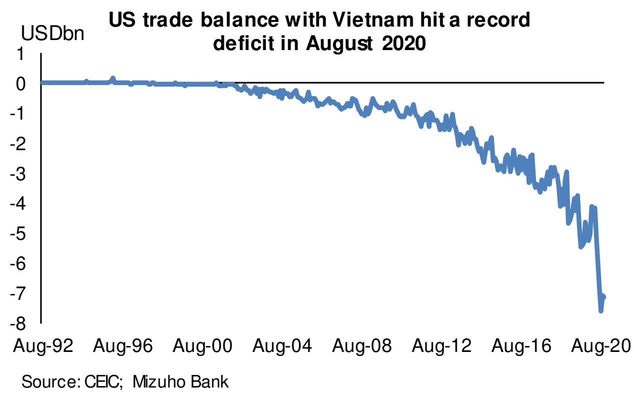
As the economy recovers from the pandemic, the focus will shift back to longer-term growth prospects and structural reforms. **In this regard, Vietnam's longer-term growth prospects remain strong – we expect GDP growth to average 6.8% from 2022-2025.**

For one, **even in the face of the pandemic, the government has forged ahead with important Free Trade Agreements with the EU and UK**, which will help built a deeper market for Vietnamese exports. Importantly, the signing of the Regional Comprehensive Economic Partnership (RCEP) has further opened up major global economies to Vietnamese exports, at a time when supply chains have been reconfigured in Vietnam's favour following US-China trade tensions.

Second, the **political outlook looks stable, in sharp contrast to many countries in the ASEAN region including Myanmar and Thailand.** The re-election of Nguyen Phu Trong, for an unprecedented third time, as the head of the Communist Party of Vietnam (CPV) ensures that the focus on growth and corruption eradication stick. Moreover, at the five yearly congress, the CPV approved an ambitious economic blueprint which, among other things, targets higher private sector participation and "complete restructuring" of State Owned Enterprises.

While the laundry list of further reforms includes easing bureaucratic hurdles, reducing corruption, cleaning up the banking system as well as supporting domestic SMEs; Vietnam remains a competitive destination for FDI (Figure 7).




**VND: Not likely to shed the 'currency manipulator' label**

**Against a weak USD backdrop, we expect the VND to appreciate at a modest pace.** The US Treasury's labelling of Vietnam as a 'currency manipulator' will continue to have a limited impact on the VND given that many of the reasons behind the label are due to more structural factors (see Box 1). The most obvious of which is the expanding trade deficit between US and Vietnam on account of Vietnam's manufacturing advantages (Figure 8). That said, Vietnamese authorities would rather not have the tag and will look to better relations with the new Biden administration in due course.

| | Q4 2020 | Q1 2021 | Q2 2021 | Q3 2021 | Q4 2021 | Q1 2022 |
|---|---|---|---|---|---|---|
| **GDP (% y/y)** | 4.5% | 7.0% | 8.6% | 7.2% | 6.0% | 6.2% |
| **CPI (% y/y)** | 1.4% | 0.2% | 1.7% | 2.7% | 2.3% | 2.6% |
| **Policy Rate (%)** | 4.00% | 4.00% | 4.00% | 4.00% | 4.00% | 4.00% |
| **USD/VND*** | 22500 - 23700 | 22600 - 23500 | 22500 - 23400 | 22500 - 23500 | 22400 - 23500 | 22300 - 23500 |
| | 23100 | 23170 | 23000 | 23100 | 23000 | 22950 |

Note: Values in black are historical whereas those in blue represent forecasts.

* Point forecast is for end-period.

**Box 1:** **US-Vietnam Uneasy Truce on Trade**

Our **view that the Biden Administration is far more favourable for Vietnam**, for the obvious reason that Vietnam is **spared the vagaries of Trump-style zero-sum game tirade on bi-lateral trade imbalance, is unchanged**. ***But*** it would be complacent not to recognise this as an **uneasy relief rather than an unconditional resolution from latent trade risks**.

### Immediate Relief …

**Countries with > $40bn US bi-lateral trade**

| Country | Bi-lateral Trade $bn | Goods Surplus vs. US* $bn |
|---|---|---|
| China | 660 | 310 |
| Canada | 617 | 24 |
| Mexico | 612 | 96 |
| Japan | 218 | 57 |
| Germany | 184 | 62 |
| Korea | 131 | 20 |
| UK | 127 | -9 |
| France | 89 | 15 |
| India | 88 | 22 |
| Italy | 78 | 30 |
| Taiwan | 76 | 25 |
| Netherlands | 74 | -18 |
| Brazil | 71 | -13 |
| Ireland | 68 | 56 |
| Switzerland | 63 | 49 |
| Singapore | 60 | -1 |
| Vietnam | 59 | 58 |
| Malaysia | 52 | 29 |
| Belgium | 59 | -11 |
| Thailand | 44 | 22 |

Expanded List under new Criterion on bi-lateral

12 Largest bi-lateral Trade Partners

Trade Surplus (vs. US) of at least $20bn

* Jul 2019 - Jun 2020

**US Treasury Report on FX (December 2020)**

| US Treasury Conditions to Assess Currency Manipulation | | |
|---|---|---|
| 1 | Trade surplus vs. U.S. is more than US$20bn | |
| 2 | C/A surplus exceeds 2% of GDP (previously 3%) | |
| 3 | Persistent (6-mths) one-sided intervention (FX reserve build-up >2% of GDP) | |
| Currency Manipulator | All three Conditions Met | Vietnam, Switzerland |
| "Monitoring List" (Typically involves 2 out of three conditions being met; with the sole exception of China) | Conditions (1) & (2) met | Germany, Japan, Korea, Italy, Malaysia, Taiwan, Thailand |
| | Conditions (1) & (3) met | India |
| | Conditions (2) & (3) met | Singapore |
| | Only Condition (1) but because of the disproportionally large share of US goods deficit | China |

Taiwan, Thailand & India were just added to the Monitoring List in the December Report

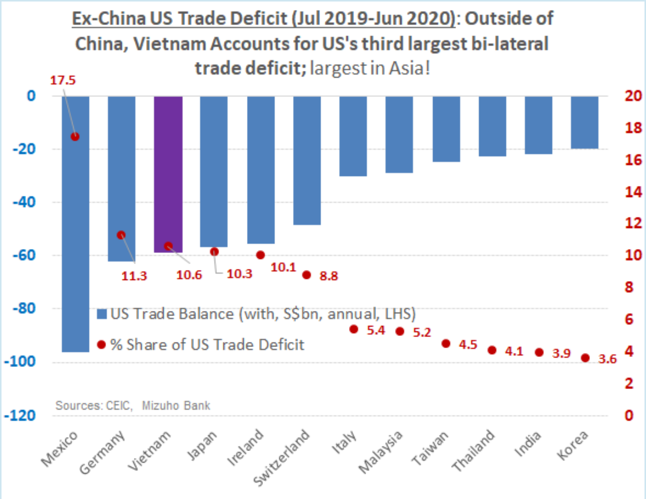
Vietnam and Switzerland have been escalated from the "Monitoring List" to be declared as" Currency Manipulators"

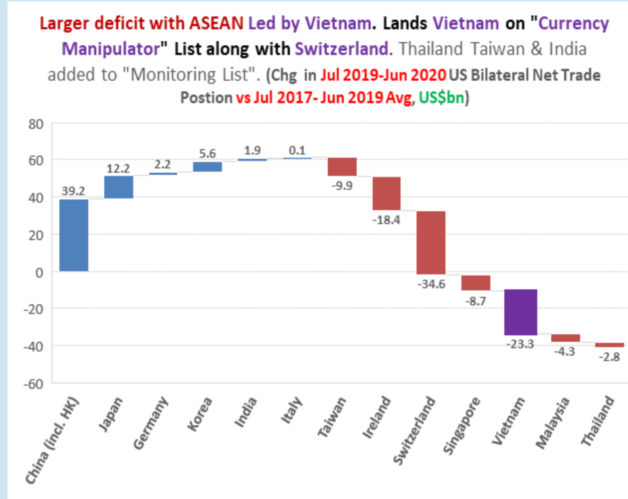
First things first. The **Biden Administration is justifiable cause for relief** as far as Vietnam diplomats and trade officials are concerned; having had to walk on eggshells with a **predictably unpredictable Trump Administration** that could **with little warning escalate trade antagonism**. The case in point being the **December 2020 US Treasury Report that labelled Vietnam as "Currency Manipulator"**, **which**, while does not necessarily need to descend into, **opens the doors to, punitive tariffs**. The **zero-sum bottom-line approach to bi-lateral trade by the Trump Administration's iteration of "America First"**, regardless of strategic considerations, meant that **Vietnam's potential to gains from supply-chain reconfiguration as a result of US-China conflict** was **exposed to not only risks of collateral damage to global demand, but a cascading clamp down on supply-chain migration**.

And so, the **Biden Administration brings with it immediate relief** from the vagaries (at times tyranny) of a reckless, shoot from the hip "America First" policy under Trump and his trade hawks. Not only because **Biden's approach will be one of multilateralism rooted in trade accords and rules**. But crucially because **Biden is better placed to understand the trade-off and allowances required to gain the strategic advantage** (against China) of allies in Asia. At least until manufacturing capacity in the US is broadened and deepened.

### … But Lingering "Risks

**But this relief** must be appreciated **in the context that US' large and widening trade deficit with Vietnam is necessary compromise tolerated by the US, not an equilibrium trade position cherished**. Point being, the increasing focus on the **perils of growing twin deficits in the US** taken alongside **the rapid ascend of Vietnam up the value chain** means that at the margin, **Vietnam will be seen an emerging direct competitor to US manufacturing** (which has a fairly wide spectrum of value-add).




In turn, the **US Treasury will be less inclined to give Vietnam a free pass unequivocally and indefinitely**. Especially given that **Vietnam's combination of its absolute trade surplus with the US** and the **pace at which the imbalance has blown out** render it a major risk to US trade position. In fact, there is **no guarantee that the Biden Administration will be in a rush to relieve Vietnam of its "Currency Manipulator" label** given the **bona fide need to assess the merits of the case** as well as the **political calculus involved in undoing Trump-era "tough" policies on trade**. And even if more serious rivalries based on technological dominance is quite a few years away, the issue of **major competitors such as China, Japan, Korea and even Taiwan setting up manufacturing base in Vietnam to circumvent US Treasury scrutiny on bi-lateral trade imbalances** means that the **US could perceive these to be backdoor mercantilism**. Consequently, the US could start **paying closer attention to Vietnam, applying pressures accordingly if it deems fit**. In other words, **proxy competitive trade policies channeled via Vietnam** as well as **Vietnam's ascendancy as a manufacturing hub in Asia (in its own right)** are developments that **may not be able to deflect geo-political ramifications** that exist in a climate of prolonged US-China tensions; as the two super powers battle it out for domination on many dimensions.

### Near-term Benefits from US-China Conflict Overwhelm

The good news though is that in the **near-term Vietnam continues to be the beneficiary of supply-chain reconfiguration driven by two overarching trends** that result in massive investments into its manufacturing sector. First is the **relocation of supply-chains** out of China, which had started with lower value-add manufacturing (e.g. apparel, footwear) even before the US-China "trade war" emerged; but has since intensified to include more upstream and higher-value manufacturing. Second is the **increasing demand to invest in deliberate (over-)capacity/redundancy** given the need to mitigate higher risk of supply-chain disruptions. On both accounts **Vietnam is well-placed as a destination for manufacturing firms** given its **low cost of labour** and a relatively well-placed labour force **alongside China-type policies to enhance connectivity** that is **critical to replicate a desirable manufacturing eco-system** not unlike China (although on a very different scale and expertise). Put differently, the **road to divesting away from China features Vietnam prominently** as a tried and tested solution. And so **as the world gets past pandemic uncertainties** and **readies for a more coordinated approach to China** by Biden's Administration, which involves deepening alliances elsewhere in Asia, **Vietnam appears well placed for ascendancy led by manufacturing investments** in the near-term; so long as it remains vigilant to the precarious geo-political environment that could persist.

### VND is the Canary & Bugbear

For now, the **VND remains in equal parts the canary in the coal mine and the bugbear with regards to Vietnam's vulnerabilities to trade antagonism**. Point being, the **lack of VND appreciation** (up ~0.7% since end 2019 compared to ~8% gains in CNY, 2>4% gains in KRW, ~2.5% gain in JPY), in contrast to other Asian currencies despite its stellar trade gains and growth out-performance, is a **bugbear for the US Treasury**. And **for any de-escalation of tensions (with the US Treasury), some degree of VND appreciation may be a good start**. And in turn, **US Treasury rhetoric/pressures on VND in the next report could also be a canary** (in the coalmine) to indicate the potential for more drastic trade action against Vietnam.