Flashnote

3 October 2017

HSBC Global Research

Vietnam at a glance

Growth above expectations

ECONOMICS
VIETNAM

- Vietnam's 3Q GDP grew at an impressive pace of 7.5% y-o-y (prev: 6.4%) and 6.4% YTD y-o-y (prev: 5.7%)
- Meanwhile, the manufacturing PMI indicates further strengthening of growth, climbing to 53.3 in September (prev: 51.8)
- Headline CPI bottomed out, rising 3.4% y-o-y in September due to higher healthcare and oil prices (prev. 3.4%)

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Growing in rarefied air: Vietnam's economy expanded 7.5% y-o-y in 3Q17 to reach 6.4% YTD y-o-y, just short of the government's full-year target of 6.7%. This marks the first time since 2010 that Vietnam exceeded the 7% growth threshold, fuelled by a continued rise in exports and industrial production. Higher tourist arrivals, FDI, and agricultural production also provided an additional lift to growth. With the most recent reading, we revise up our GDP forecast to 6.6% in 2017 and continue to expect growth of 6.4% in 2018 (see: *Asian Economics Quarterly: Takin' it down a notch*).

Less heavy-lifting for policymakers: The strong 3Q print also eases any pressure on the government and the State Bank of Vietnam (SBV) to provide additional stimulus for the economy, which poses its own risks. Growth should remain robust in 4Q as manufacturing, tourism, FDI, and agriculture all continue to expand. Given the recent trend, we expect both tourism and FDI to exceed last year's figures.

PMI showing clear horizons: Vietnam's manufacturing sector just contributed its highest level to growth in at least 10 years. Moreover, the most recent PMI indicates that this momentum is likely to improve as the year comes to a close. The September PMI expanded to 53.3 from 51.8 in the previous month, fuelled by higher new orders and employment, thus supporting our view that Vietnam's growth will remain robust as the year ends.

Prices are looking up: Higher oil and healthcare prices have lifted inflation for two months in a row, stemming six consecutive months of cooling prices. Notably, transport prices rose 6.7% y-o-y in September from 5.7% in August, while healthcare costs continue to rise at a fast clip (42.4% y-o-y) from the government's healthcare subsidy reforms. We expect headline CPI to average 3.5% in 2017 and 2018.

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Soaring above expectations

In 7th heaven

Vietnam has soared above our expectations. The economy grew at a staggering 7.5% y-o-y in 3Q from 6.4% in the previous quarter. On a YTD y-o-y basis, growth reached 6.4% from just 5.7% in the first half of the year, putting the government closer to reaching its 6.7% target for 2017.

While we noted the upside potential for growth in 2H, leading us to revise up our full-year forecast from 6.0% to 6.2% (See: *Asian Economics Quarterly: Takin' it down a notch*, September 2017), the 3Q print still came as a surprise. Vietnam is now tracking ahead of our full-year growth expectations and the *Bloomberg* consensus of 6.3%. And with leading indicators still robust, we now revise our growth forecast to reach 6.6% by year-end.

A continued rise in exports and industrial production were some of the primary drivers of growth, as the strong tech cycle in 2Q persisted throughout the third quarter. Exports grew 22% y-o-y in 3Q (the same as the previous quarter), led by higher shipments of phones and electronic components, while industrial production grew by an average of 10% y-o-y from 8% in 2Q. Moreover, agricultural production and foreign direct investment (FDI) have picked up handsomely since the first half of the year, further lifting growth.

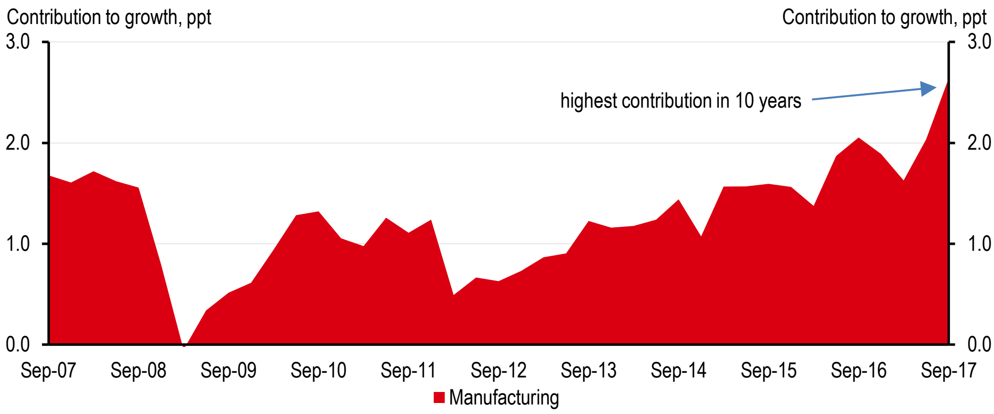
The composition of growth in 3Q showed that the majority of the Vietnamese economy continues to perform well, with the exception of the mining sector. We have previously noted that this "mining drag" has marginally slowed the country's growth over the past few quarters and has negatively affected government revenues (See: *Vietnam at a glance: Back in stride*, July 2017) (Table 1).

Table 1: Vietnam's economy firing on all cylinders (for the most part)

	% y-o-y				Ppt contribution to GDP			
	Dec 16	Mar 17	Jun 17	Sep 17	Dec 16	Mar 17	Jun 17	Sep 17
GDP	**6.8**	**5.1**	**6.4**	**7.5**	**6.8**	**5.1**	**6.4**	**7.5**
Agriculture, Forestry and Fishery	3.0	1.9	3.0	2.9	0.5	0.2	0.6	0.4
Agriculture	2.2	1.4	2.3	1.8	0.3	0.1	0.4	0.2
Forestry	5.9	4.2	4.4	5.7	0.0	0.0	0.0	0.0
Fishery	5.1	3.3	6.1	5.9	0.2	0.1	0.2	0.2
Industry & Construction	7.4	4.6	7.2	9.5	2.6	1.6	2.4	3.2
Mining and Quarrying	-5.6	-9.1	-7.6	-4.7	-0.6	-0.7	-0.6	-0.3
Manufacturing	13.6	9.3	12.2	15.9	1.9	1.6	2.0	2.6
Electricity and Gas	10.6	8.6	7.4	8.8	0.4	0.4	0.3	0.4
Water Supply, Waste Management	10.1	6.9	6.7	10.4	0.1	0.0	0.0	0.1
Construction	11.5	4.8	12.0	7.3	0.8	0.2	0.6	0.5
Services	7.8	6.4	7.5	7.7	3.0	2.6	2.7	3.1
Wholesale, Retail Sales & Motor Vehicles	8.2	7.4	6.8	9.9	0.8	0.8	0.6	0.9
Transportation & Storage	7.4	6.0	10.1	7.2	0.2	0.2	0.3	0.2
Accommodation & Food Service Activities	12.4	6.0	11.4	9.7	0.4	0.3	0.4	0.4
Information & Communication	7.2	7.7	6.3	6.6	0.1	0.1	0.1	0.1
Financial, Banking & Insurance Activities	8.4	7.8	9.1	7.3	0.6	0.3	0.4	0.5
Real Estate Activities	4.9	3.4	4.3	4.2	0.2	0.2	0.2	0.2
Professional, Scientific & Tech Activities	7.2	6.8	6.8	7.1	0.1	0.1	0.1	0.1
Administrative & Support Service	8.8	7.2	5.7	7.1	0.0	0.0	0.0	0.0
Party, Public Administration, Organization	7.1	6.6	7.1	7.6	0.2	0.2	0.2	0.2
Education & Training	7.2	6.8	7.5	7.4	0.2	0.2	0.2	0.2
Human Health & Social Work Activities	7.4	7.0	7.5	7.7	0.1	0.1	0.1	0.1
Arts, Entertainment & Recreation	7.7	6.6	7.4	7.5	0.1	0.0	0.1	0.1
Other Service Activities	6.6	5.9	6.1	6.8	0.1	0.1	0.1	0.1
Households Activities	7.7	6.5	7.3	7.1	0.0	0.0	0.0	0.0

Source: CEIC, HSBC

Chart 1: Manufacturing contribution to growth at a 10-year high



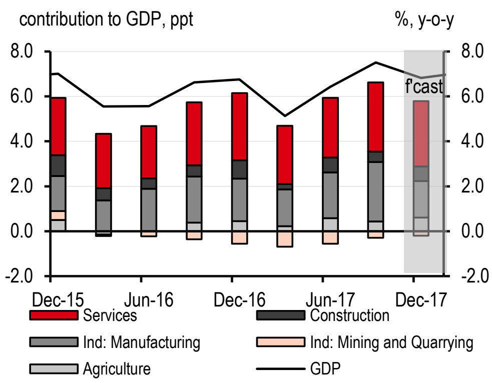
Source: CEIC, HSBC

On a positive note, however, the manufacturing sector's contribution to growth has steadily climbed since the beginning of the year to reach its highest level in at least 10 years (Chart 1). This is attributable to the expansion of Vietnam's export industry over the years, particularly in the production of clothing, apparel, and electronics. The services sector has also progressively added to growth, which attests to the country's strengthening domestic consumption. We expect manufacturing to remain robust in 4Q, albeit slowing slightly from a marginal drop in electronics exports, while services should remain steady on the back of strong tourist arrivals (Chart 2).

Additional Lift: Tourism, FDI, and Agriculture

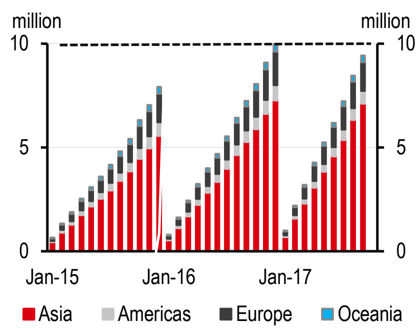
Tourism has been especially robust this year, growing 30% y-o-y YTD in September, due in part to higher visitor arrivals from Asia and Europe. In fact, Vietnam is now tracking to exceed 10 million visitors for the second consecutive year (Chart 3). This was partly driven by a visa – waiver scheme that the Vietnamese government granted to five European countries since 2016, namely: France, Germany, Italy, Spain, and the U.K. Not surprisingly, tourist arrivals from Europe have grown 21% y-o-y YTD as of September, in addition to a 35% increase in arrivals from Asia. Arrivals from Asia primarily come from China (41%) and South Korea (24%), with South Korean tourist arrivals increasing 51% y-o-y YTD, partly reflecting South Korean companies' increased FDI interests in Vietnam (Chart 5). Strong tourism has helped lift Vietnam's services industry, particularly the growth of its accommodation, transportation, and food services sectors.

Chart 2: Manufacturing and services should remain robust in 4Q



Source: CEIC, HSBC

Chart 3: Tourist arrivals tracking to exceed 10mn for the second consecutive year



Source: CEIC, HSBC

Meanwhile, FDI also jumped sharply in 3Q and should continue to trickle in toward the end of the year. FDI (in terms of new registered capital) is up 30% YTD y-o-y as of 3Q17 to reach USD14.5bn. As a comparison, new FDI in 2016 totalled just over USD15bn, which suggests that this year's numbers should easily surpass last year's, given that there is still one more quarter to go. Japan, Singapore, and South Korea have topped FDI commitments to Vietnam so far, contributing around 70% of all registered capital year-to-date. Meanwhile, South Korean companies have won the lion's share of approved FDI projects to date with 594 projects approved (32%), followed by Japan with 277 (15%). Given recent trends, we expect both tourism and FDI to exceed last year's figures and sustain the country's high growth toward the end of the year.

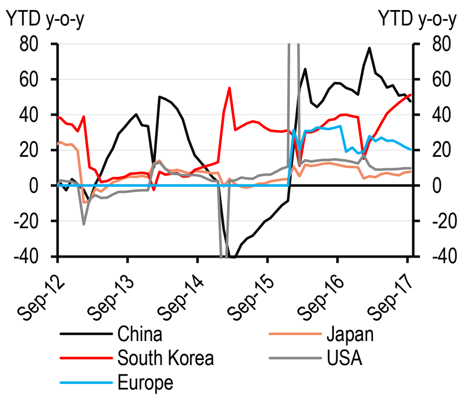
Lastly, the country's agricultural sector has picked up steam, as we expected. Rice and vegetable exports grew by an average of over 50% y-o-y in 3Q and should continue to be robust in 4Q, barring any inclement weather, to offset last year's drought. Food prices also appear to have bottomed out, which bodes well for farmers' income in the coming months.

A lighter baggage

More importantly, the strong 3Q print eases the load on the government and the State Bank of Vietnam (SBV) to enact further stimulus measures that might exacerbate risks in the economy. In July, the SBV cut its policy rate by 25bp to 6.25%, alongside simultaneous cuts to various other rates, in a bid to boost growth. Moreover, Vietnamese Prime Minister Nguyen Xuan Phuc in August called for an increase in the credit growth target from 18% to 21% to further incentivize private consumption and investment. We have noted that while credit-driven growth is not necessarily a problem given the rising role of private consumption and non-state investments, it may also create new risks for the banking sector if new credit is placed in less productive industries (See*: Vietnam at a glance: More credit to drive growth*, September 2017).

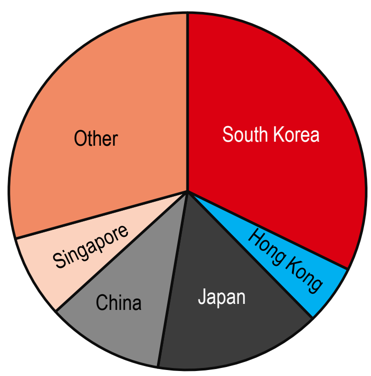
In addition, reaching (or at least getting close to) the government's 6.7% growth target this year makes it less likely that the country would exceed the National Assembly's mandated debt-to-GDP limit of 65%. According to the Finance Ministry, public debt will reach a record high of 64.8% of GDP in 2017-2018 before gradually falling in subsequent years, assuming growth remains around 6.7% (*VietnamNet*, 2 June 2017). Of course, there remain risks that growth in 2018 would be subpar, especially if global trade drastically cools off, but at least the risks for this year have been tempered. We expect growth to reach 6.4% in 2018.

Chart 5: Tourist arrivals from South Korea have grown the most YTD…



Source: CEIC, HSBC

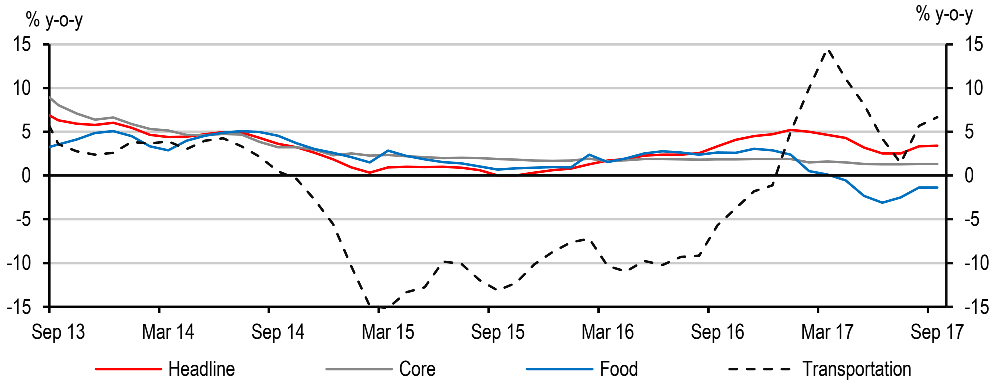
Chart 6: …while South Korean companies have the lion's share of approved FDIs



Source:CEIC, HSBC

Looking up: CPI and PMI

Chart 7: Prices have firmly bounced back and are rising across the board



Source: CEIC, HSBC

Oil prices advancing

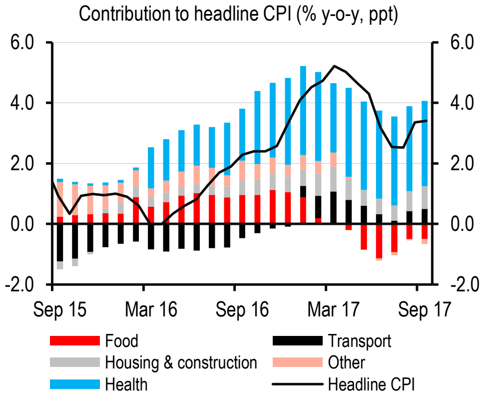
Consumer prices rose 3.4% y-o-y in September, the same as last month's reading, driven partly by a continued rise in oil prices. Global crude costs rose by more than 10% in September due to higher demand and output cuts from OPEC and Russia. This reflected higher transport prices in Vietnam, which rose 6.7% y-o-y in September from 5.7% in the previous month. Meanwhile, food prices have risen for the third consecutive month on a sequential basis, leading to a coordinated bounce back in prices across the board (Chart 7). Moreover, higher healthcare prices continue to be primary contributor to the rise CPI and should continue to be so as the government ramps up reforms to healthcare subsidies (Chart 8).

Clear skies from PMI

Meanwhile, the PMI expanded at a faster pace of 53.3 in September (prev. 51.8), signalling further improvement to the country's growth profile as the year comes to a close. Most PMI indicators saw a faster pace of expansion from the previous month, most notably: output, new orders (both internally and externally), and employment. In particular, the output index hit a five-month high of 53.3 in September, while the employment index is at a six-month high of 53.5.

A continued rise in backlogs of work and three months of consecutive contraction in the stocks of finished goods also indicate capacity pressures from higher new orders, which are partly being fulfilled by a drawdown in inventories. The latest PMI thus supports our view that Vietnam's growth will continue to remain robust as the year ends.

Chart 9: Healthcare prices remain the primary contributor to inflation



Source: CEIC, HSBC

Chart 10: September PMI reach 5-month high

	Jul-17	Aug-17	Sep-17
PMI Index	51.7	51.8	53.3
Output			
New orders	52.5	53.6	55.2
New export orders			
Backlogs of work			
Stocks of finished goods			
Employment			
Output prices			
Input prices			
Suppliers' delivery times			
Stock of purchases			
Quantity of purchases			
Future output index			
Expanding, faster pace	Expanding, slower pace	Contracting, slower pace	Contracting, faster pace

Source: IHS Markit, HSBC

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