To slow or not to slow

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With the increasing uncertainty regarding the US outlook and the fact that the US remains a key destination for Vietnam's exports – around 20 per cent of total exports are shipped to the States – the tendency would be to temper growth expectations for the new tiger. We however beg to differ and expect Vietnam to expand by 8.5 per cent in 2008, following on from above 8 per cent growth since 2005.

So where is all this impetus coming from? First, although exports to the US have collapsed over the last few years, overall exports have held up reasonably well. This has been on account of strength in exports to Europe and Japan. Admittedly this poses a risk in 2008 as both Europe and Japan are beginning to show signs of weakness in addition to the increasing possibility of a slowing US consumer. Fortunately for Vietnam, the likes of China and Australia have been sucking in more of its goods, something we expect to continue in the period ahead. The other point worth noting is that the bulk of Vietnam's exports are basic in nature with low income elasticity. What this means is that even if consumers in US, Europe and Japan were to reduce spending, the actual negative impact on Vietnam's exports would be limited.

On the domestic side things are looking fairly upbeat. Household spending has been growing at an average annual rate of 7.5 per cent over the last few years. There is little reason to expect spending to slow substantially given rising income levels and negative real interest rates. Fiscal policy has also been expansionary as the government addresses the infrastructure bottlenecks plaguing the country whilst overall investment is growing in the region of 10 per cent or so. In fact we think investment is bound to pick up momentum consistent with the massive amount of foreign direct investment committed to the country. What is also worth noting is that the domestic economy is quite independent from the external sector.

Chart 1: Total exports holding up fairly well despite US slowing...

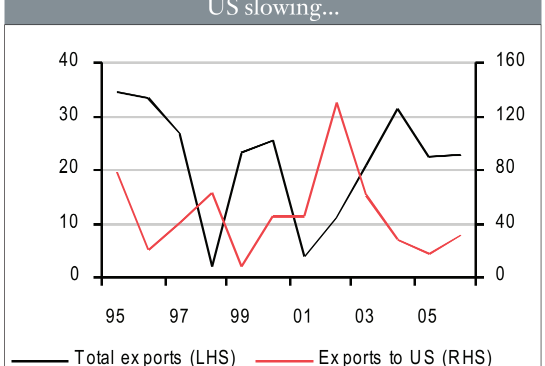
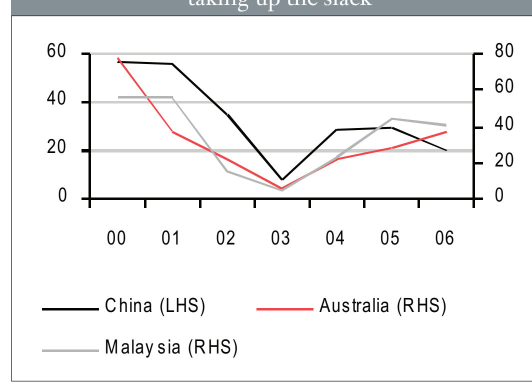


Chart 2: ...with China, Australia and Malaysia taking up the slack



Exports: slowing or not?

Unfortunately we do not have the country wise data for 2007, but we do know that total exports expanded by 22 per cent over the year. This suggests that even if exports to the US weakened, as data from regional economies suggests, shipments to other countries have clearly come to the rescue.

So what are these 'other' countries? Europe and Japan, which suck in 20 per cent and 14 per cent of total exports, respectively. Shipments to these countries have been averaging 20 per cent y/y over the last few years providing support to overall exports.

Additional impetus to export growth has come from the rising importance of China (10 per cent of exports), Australia (8 per cent of exports) and to a lesser extent Malaysia (3 per cent of exports). In chart 2 we have plotted a 3-year moving average of year-on-year export growth for each of these countries. Again the point being that shipments picked up quite substantially from 2003, allowing overall exports to remain underpinned.

So far so good. The question going into 2008 obviously is whether Vietnam's exports will hold up in the face of a slowing US consumer given the softening housing market and credit crunch. On top of it Europe and Japan are also expected to slow in 2008.

Fortunately for Vietnam the bulk of its exports are basic in nature such as textiles & garments, footwear, fishery products, crude oil – all of which tend to have low income elasticity. What this means is that even if consumers in US, Europe and Japan were to reduce spending, the actual negative impact on Vietnam's exports would be limited.

Based on this we are expecting exports to expand by around 18 per cent in 2008, which is slower than the above 20 per cent growth the country has been clocking over the last few years, but in no way is it disastrous.

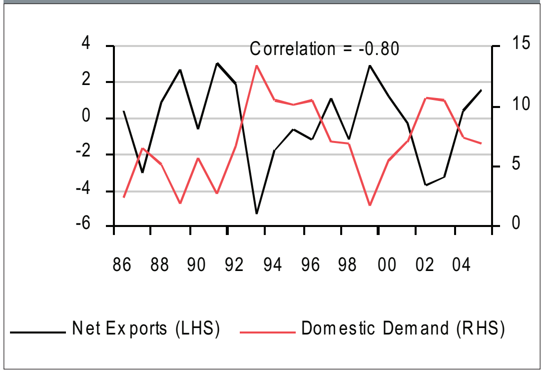
Domestic demand: stronger by the day

Turning to the domestic economy, consumption spending by households has increased quite sharply over the last few years, consistent with the rising income levels. Anecdotal evidence suggests that the labour market is quite tight, especially for professionals, suggesting that wage gains will remain supportive of spending. The wealth affects from the booming property market and to a lesser extent the equity market also remain broadly favourable. As such we are looking for household spending to increase by 7.6 per cent in 2008 following on from 7.5 per cent growth over the last few years.

The other components of domestic demand, namely gross fixed capital formation (GFCF) and government spending have also been very supportive of growth. Government spending has been averaging 8 per cent y/y since 2003. A lot of it is related to salaries & wage increases, which goes onto to support the point about stronger household consumption. But increasingly development spending such as expressways, port/ airport development etc. is also taking priority with the government.

On the investment side, although things have slowed recently, capital formation in the range of 10 per cent or so isn't really that bad. In fact we think that investment is actually going to pick up in the period ahead, consistent with the massive amount of foreign direct investment committed to the country.

Chart 3:
Mirror images?



The other point worth highlighting is that contrary to what one might expect there appears to be no apparent lead from exports to the domestic economy. In chart 3 we have plotted the ppts contributions from exports and domestic demand to overall growth. What we see is that the correlation between the two series is actually -0.80, suggesting that if the external sector were to slow the domestic economy can serve as a strong buffer. The rationale for this probably drives from the fact that policy remains loose in the country with monetary aggregates growing at 35-40 per cent y/y and credit growth running at around 70 per cent y/y or so. Real interest rates are also negative with inflation at around 16 per cent y/y.

Overall growth outlook

So what does all this mean for growth in 2008? With US, Europe and Japan slowing there will be some drag on exports, though the impact will be mitigated by the rising importance of China, Australia etc. and the fact that the bulk of Vietnam's exports are basic in nature. On the domestic side things are looking quite upbeat with household spending and investment expected to show strong prints. Overall then we are looking for the economy to expand by 8.5 per cent in 2008 following on from above 8 per cent growth since 2005. F

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