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Research Brief | Vietnam

Role as a global manufacturing hub will fuel growth

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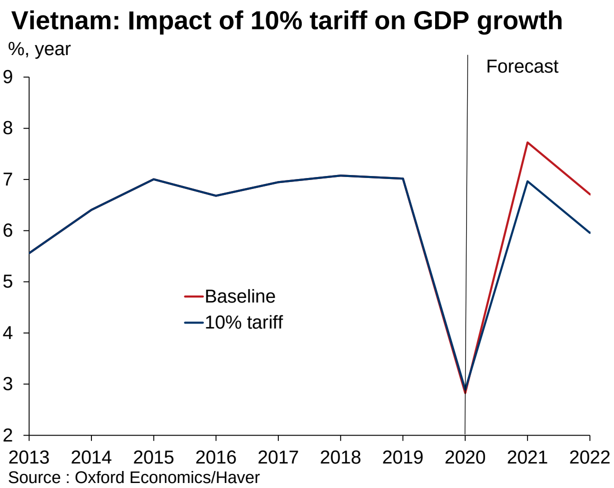
- **Vietnam's transformation into a global manufacturing hub over the past decade helped it outperform most economies in 2020 and further strengthened its share of global electronics and manufacturing exports. We forecast these trends will continue over 2021 and beyond.**
- **Supported by robust FDI we estimate that Vietnam will account for around 4% of global electronics exports in 2025. This could be even higher if emerging logistical bottlenecks in Vietnam are eased by higher infrastructure investment.**
- **Higher tariffs on exports to the US are a risk after the US designated Vietnam a currency manipulator in December. We estimate that a 10% tariff on textiles, telecommunications, computers, and furniture exports to the US (US$40.3bn) would cut GDP growth to an average of 6.4% over 2021-2022 versus our baseline of 7.2%. GDP levels would be US$98bn lower by the end of 2025.**
- **For now, we think the US doesn't have the appetite to further disrupt its own companies' supply chains. We also believe Vietnam's strategic importance in countering China's influence in the region will prevent any widespread action.**

Vietnam was one of only a few economies globally to grow in 2020. A strong recovery in export-orientated manufacturing fuelled a 2.9% GDP increase. Indeed, goods exports in US$ terms were up 6.9% in 2020, a moderation from 8.5% growth in 2019, but still a solid achievement given world trade in US$ terms fell 7.8%.

Vietnam also further strengthened its world market share to 1.6% of goods exports in 2020, up from 1.4% in 2019 and 0.5% in 2010, as a substantial rise in foreign direct investment (FDI) has increased the country's role in global manufacturing supply chains.

Figure 1: Tariffs on Vietnam's exports to the US could push GDP growth 0.8ppts lower over 2021-2022



A 10% tariff on four of Vietnam's top export sectors to the US – textiles, computers, telecommunications, and furniture – would cause GDP to be US$98bn lower by end-2025

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Part of Vietnam's recent export outperformance also reflects some temporary factors. In particular, its successful containment of coronavirus enabled the manufacturing sector to normalise faster than most other countries in the region (**Figure 2**). As such, Vietnam was able to take full advantage of the work-from-home-related global boom in demand for computers, other electronics, and furniture. These tailwinds will likely fade this year as an easing in restrictions will allow production in other countries to normalise. We also think last year's demand for computers and furniture is unlikely to be repeated. That said, we believe Vietnam's exports will continue to outperform most others in the region this year and beyond (**Figure 3**).

Bounce in world trade and electronics

We expect Vietnam's export manufacturing sector will be buoyed by a rebound in world trade this year. Indeed, as coronavirus-related restrictions are rolled back and vaccines become more widely available, we forecast world trade in real terms will surge nearly 10% this year. This is in part because of the generous $1.9tn US stimulus package, which will also likely bolster US demand for Vietnamese exports.

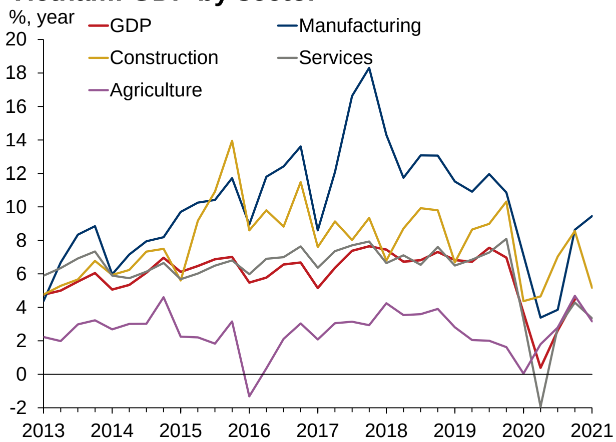
Moreover, our industry colleagues expect the electronics sector to grow by 6.4% in 2021, up from 2.8% last year, supported by telecommunications equipment relating to upgrades to 5G infrastructure. We believe Vietnam will benefit from this rise in global demand for electronics because its participation in global supply chains has increased significantly over the past five years following a surge in FDI (**Figure 4**).

FDI did fall 25% in 2020 as the pandemic caused a 42% collapse in global FDI flows. However, this was preceded by very strong growth. In 2019, Vietnam accounted for 1%, or US$16.1bn, worth of global FDI inflows, more than Malaysia and Thailand combined. FDI to the manufacturing sector also rose 11% annually over 2014-2019.

Winner from US-China trade tensions

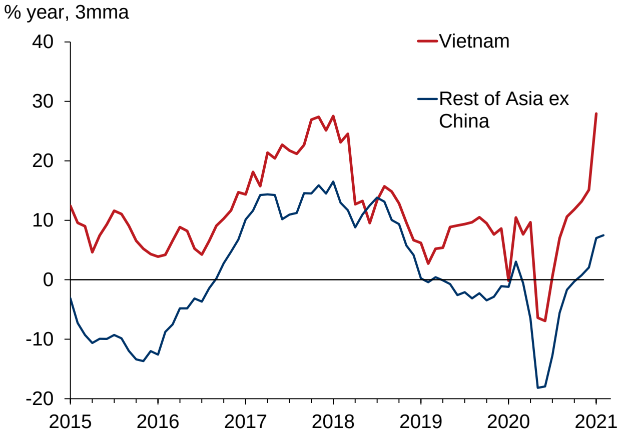
The rise in US-China trade tensions since 2018 and the imposition of large import tariffs on China by the US has further enhanced Vietnam's attractiveness as a destination for FDI, with a notable increase in inflows from China and a surge in US consumer demand. US imports shifting away from China and a faster normalisation of production post-lockdowns saw Vietnam's exports to the US grow nearly 26% in 2020 and its share of US imports rise to 2.7%, up

Figure 2: Some sectors are already back above pre-coronavirus levels



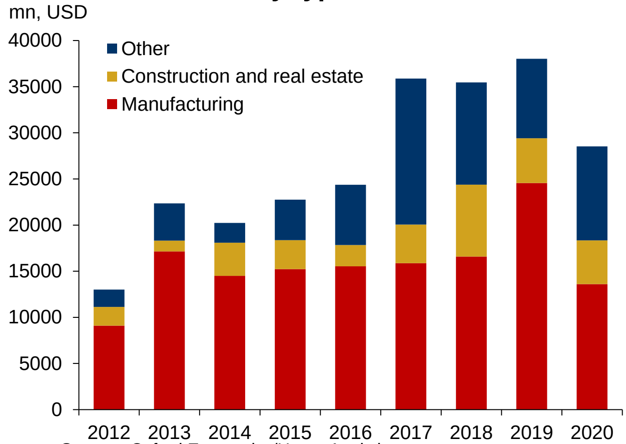
Source : Oxford Economics/Haver Analytics

Figure 3: Vietnam has outperformed most other countries in the region



Source : Oxford Economics/Haver Analytics

Figure 4: FDI into the manufacturing sector, notably electronics, has risen strongly



Source : Oxford Economics/Haver Analytics

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from 1.9% in 2017. In comparison, despite a strong increase in exports to the US last year, China's share of US imports was still around 2.6ppts lower than before tariffs were imposed in 2018 (**Figure 5**).

China's share of computer and electronics-related exports to the US have been hit particularly hard since the start of the trade war, falling around 13ppts, with Vietnam experiencing the largest gain in market share (up 4ppt), followed by Taiwan. That said, China continued to supply more than two-thirds of US imports of these goods.

Interestingly, the fall in China's exports of final computer and electronic goods to the US did not lead to a sharp decline in China's demand for electronic intermediate goods. Indeed, China's imports of machinery and goods from Vietnam, which includes intermediate goods, rose 31% annually on average between 2018 and 2020 (**Figure 6**). The ongoing demand for these goods likely reflects some Chinese firms shifting production and assembly to Vietnam to save on labour costs and avoid higher US tariffs.

Vietnam is an attractive destination for FDI

We expect China to continue its efforts to move up the manufacturing value-added chain and expand its domestic consumer market. We also think Asia-oriented supply chains will continue to adjust in coming years and believe Vietnam is well placed to benefit from these trends.

Indeed, we expect Vietnam will remain an attractive destination for global FDI inflows in the medium term, given its attractive labour dynamics, close proximity to China, and favourable trade and FDI policies. As such, we estimate that Vietnam's share of global electrical exports will continue to rise, accounting for around 4% of global electronics exports by 2025 (**Figure 7**).

This market share could be even higher, but we believe one factor will limit the upward trend in Vietnam's global electronics exports share, at least over the next few years: the emergence of supply bottlenecks around key ports serving industrial clusters. Projects to ease this problem will require foreign investors. But even if funding is secured, these infrastructure upgrades will take time.

Higher US tariffs are still a risk…

As previously highlighted, one dark cloud on the horizon is

Figure 5: Vietnam has benefitted from a drop in exports from China to the US since 2018

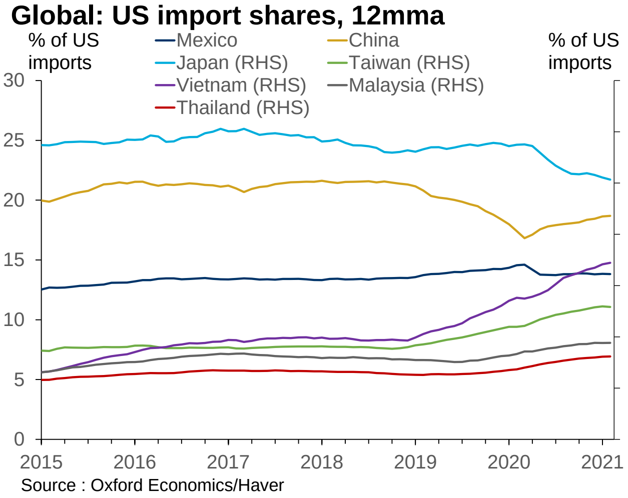


Figure 6: A shift in China's production has contributed to a rise in Vietnam's share

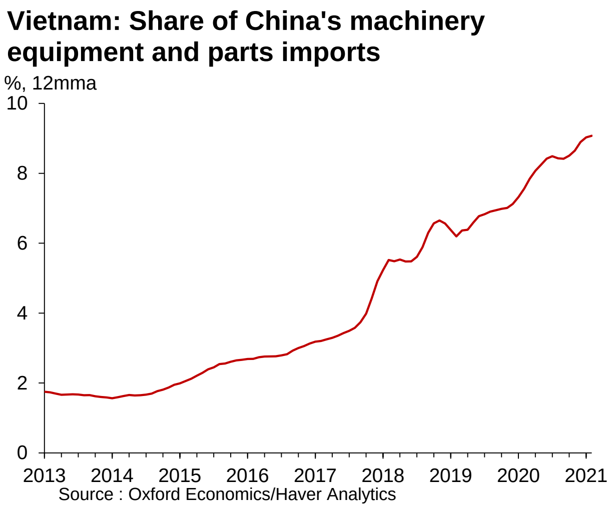
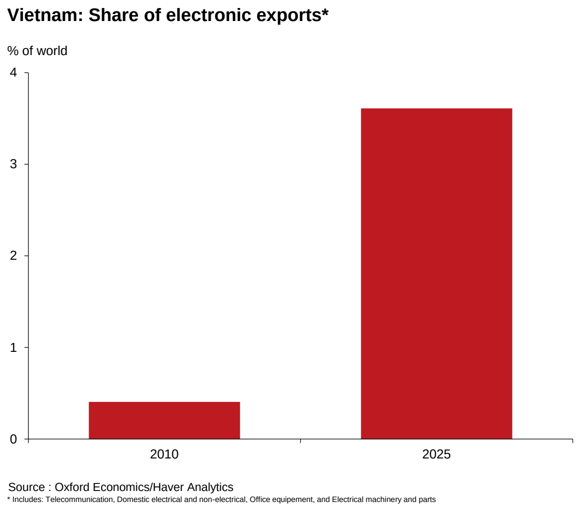


Figure 7: Vietnam will increase its share of global electronics exports to nearly 4% by 2025



the prospect of punitive tariffs on Vietnamese exports to the US. The US Treasury designated Vietnam a "currency manipulator" in its latest [US Treasury Semi-Annual Currency report](), citing not only the large bilateral deficit. It also noted that Vietnamese authorities have undertaken large-scale and protracted FX market intervention, which saw its foreign reserves increase sharply and the "undervaluation of the dong on a real, trade-weighted basis" (**Figures 8** and **9**).

…but US action is unlikely for now

Officially, being labelled a currency manipulator results in bilateral negotiations aimed at taking steps to limit any perceived unfair advantage created by FX interventions.

However, while some Vietnamese products, such as timber, may face higher tariffs, we do not expect any widespread action from the US. Some evidence shows that the US has little appetite to further disrupt its companies' supply chains. In fact, the Office of US Trade Representative recently concluded their own investigation into Vietnam's exchange rate policy. Although it found that the dong (VND) was undervalued, it indicated it would not take any specific actions at this time, suggesting the US doesn't want to impede the supply chains of domestic companies.

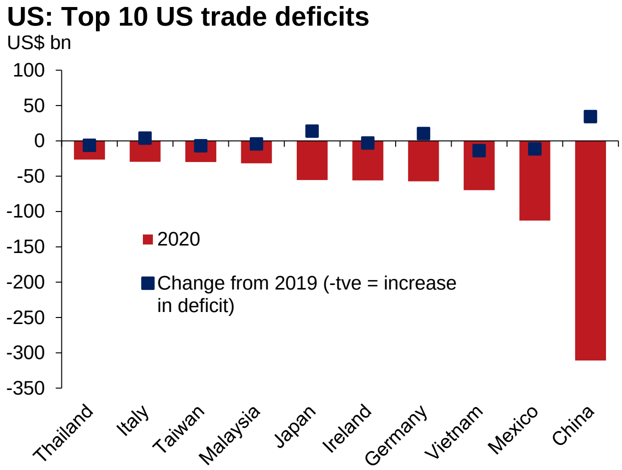
Vietnam is also an important US strategic ally for countering China's influence in global trade and the region, which the US is likely to consider before undertaking any significant action against Vietnamese exports.

That said, we expect Vietnam will undertake a conciliatory approach given the US accounts for 25% of its exports. Vietnam has already shown a willingness to buy more American airplanes and liquid natural gas (LNG), and has increased surveillance on Chinese goods crossing the border and being marked as "Made in Vietnam." Moreover, the State Bank of Vietnam has reduced the frequency of its FX intervention, with the VND likely to track the movement of its peers more closely.

The impact on growth if tariffs are raised

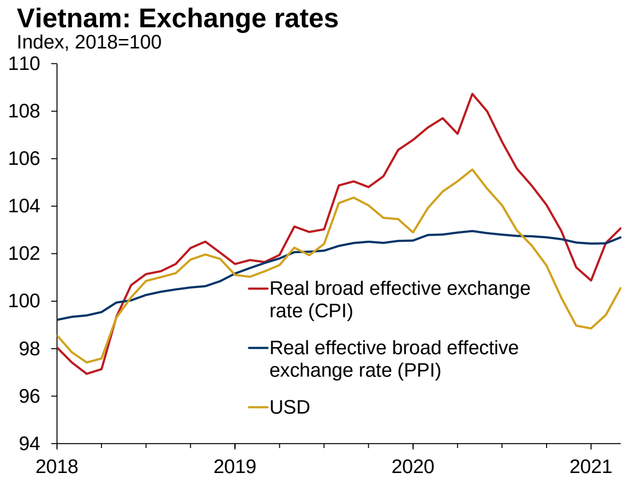
Using our Global Economic Model, we estimate that in the unlikely case that the US were to raise tariffs by 10% on four of Vietnam's top export categories to the US – textiles, computers, telecommunication, and furniture – valued at US$40.3 billion (or 52% of its total exports to the US), Vietnam's GDP growth would slow to around 6.4% annually in 2021-2022 versus 7.2% in our baseline (**Figure 10**).

Figure 8: The US bilateral trade deficit with Vietnam widened to US$69.8bn in 2020



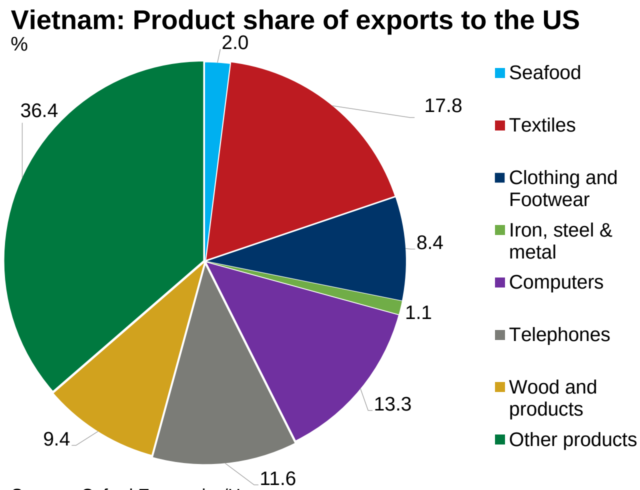
Source : Oxford Economics/Haver Analytics

Figure 9: Some contention as to whether Vietnam's currency is undervalued.



Source : Oxford Economics/Haver

Figure 10: Around 52% of exports to the US could be at risk of higher tariffs, based on 2020 fiures



Source : Oxford Economics/Haver