

Vietnam at a glance

Growth hiccup

- ▶ GDP slowed to 5.1% y-o-y in Q1 2017 from 6.8% previously, but it is expected to accelerate in the coming quarters
- ▶ Although export growth was weak in March, the manufacturing PMI survey points to continued strength in activity
- ▶ Despite higher costs of energy, health care and education, low food inflation is keeping price pressures in check

GDP takes a knock

Not exactly a strong GDP print. Growth in Vietnam slowed to 5.1% y-o-y, the slowest in three years. There are many factors that weighed on activity. To start with, there were weather disruptions that curtailed agricultural output. Then, construction growth slowed markedly during the quarter. Although, mining and quarrying has been ailing for some time now, the recent drop in coal prices likely intensified the drag from this sector. This is because coal layers, which are easier to access, are increasingly getting depleted, raising the cost of extraction. Until recently, robust manufacturing masked these shortcomings. However, in Q1 2017, manufacturing growth stumbled, as a leading phone maker stalled production, dragging down electronics production at large.

The impact was also felt in exports. Shipments of phones and spare parts, the country's biggest export revenue earner, declined by 24.3% y-o-y in March. However, we expect exports to rebound soon, helped by new product launches and a gradual revival of global demand, which is reflected in the sustained increase in overseas orders in PMI surveys. In the March survey, the rate of growth in new export orders was the fastest in 2017 so far. Additionally, manufacturers remained strongly confident that output will increase over the coming 12 months, thanks to expectations of higher new orders and business expansion plans. Importantly, a near-record increase in employment bodes well for the sector as it hints at optimism that workloads will continue to expand in the near term at least. The manufacturing industry therefore is likely to put the economy back on track in the quarters to come.

Elsewhere in the economy, inflation is gradually easing, even in the face of higher energy prices and increased costs of healthcare and education, owing to muted food inflation.

ECONOMICS VIETNAM

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GDP growth: under pressure

Q1 GDP growth slowed to a three-year low of 5.1% y-o-y. Amid a slowdown across the board, the drag from mining and quarrying worsened during the quarter, probably due to a combination of a recent drop in coal prices, higher natural resources tax (which was implemented on 1 July 2016), declining output from mature oil fields, as well as higher production costs due to the depletion of coal layers, which are easier to access. This was offset by robust manufacturing growth, albeit with lesser fervour than seen in previous quarters, partly because Samsung Electronics Co. had cut production of smartphones. A drop in Samsung's output in Vietnam contributed to a 10.7% contraction in exports of phones and parts, dragging down electronics production (*Bloomberg*, 29 March 2017).

Table 1: GDP by industry

	% y-o-y				Ppt contribution to GDP			
	Jun 16	Sep 16	Dec 16	Mar 17	Jun 16	Sep 16	Dec 16	Mar 17
GDP	5.6	6.6	6.8	5.1	5.6	6.6	6.8	5.1
<u>Agriculture, Forestry and Fishery</u>	0.1	2.5	3.0	1.9	0.0	0.4	0.5	0.2
Agriculture	-0.2	2.1	2.2	1.4	0.0	0.2	0.3	0.1
Forestry	4.0	6.9	5.9	4.2	0.0	0.1	0.0	0.0
Fishery	0.7	2.6	5.1	3.3	0.0	0.1	0.2	0.1
<u>Industry & Construction</u>	7.6	8.1	7.4	4.6	2.5	2.7	2.6	1.6
Mining and Quarrying	-2.8	-5.1	-5.6	-9.1	-0.2	-0.4	-0.6	-0.7
Manufacturing	11.9	13.1	13.6	9.3	1.9	2.1	1.9	1.6
Electricity and Gas	10.1	12.8	10.6	8.6	0.4	0.5	0.4	0.4
Water Supply, Waste Management	8.5	3.6	10.1	6.9	0.1	0.0	0.1	0.0
Construction	8.9	8.0	11.5	4.8	0.5	0.5	0.8	0.2
<u>Services</u>	6.6	7.0	7.8	6.4	2.3	2.8	3.0	2.6
Wholesale, Retail Sales & Motor Vehicles	7.8	9.0	8.2	7.4	0.6	0.8	0.8	0.8
Transportation & Storage	5.3	6.4	7.4	6.0	0.1	0.2	0.2	0.2
Accommodation & Food Service Activities	8.7	2.8	12.4	6.0	0.3	0.1	0.4	0.3
Information & Communication	8.5	9.2	7.2	7.7	0.1	0.1	0.1	0.1
Financial, Banking & Insurance Activities	6.2	8.6	8.4	7.8	0.2	0.6	0.6	0.3
Real Estate Activities	3.2	4.2	4.9	3.4	0.2	0.2	0.2	0.2
Professional, Scientific & Tech Activities	7.0	7.0	7.2	6.8	0.1	0.1	0.1	0.1
Administrative & Support Service	6.5	5.5	8.8	7.2	0.0	0.0	0.0	0.0
Party, Public Administration, Organization	7.0	7.3	7.1	6.6	0.2	0.2	0.2	0.2
Education & Training	7.0	7.4	7.2	6.8	0.2	0.2	0.2	0.2
Human Health & Social Work Activities	7.3	7.6	7.4	7.0	0.1	0.1	0.1	0.1
Arts, Entertainment & Recreation	6.7	7.5	7.7	6.6	0.0	0.1	0.1	0.0
Other Service Activities	6.5	6.5	6.6	5.9	0.1	0.1	0.1	0.1
Households Activities	6.8	7.8	7.7	6.5	0.0	0.0	0.0	0.0

Source: CEIC, HSBC

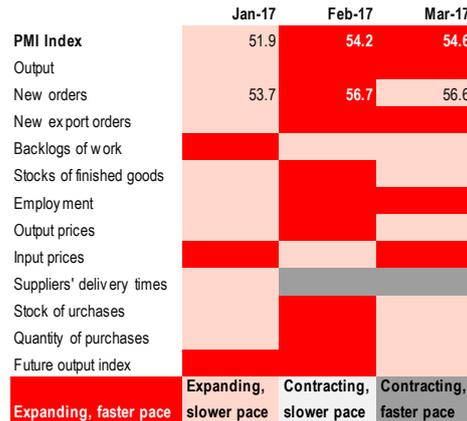
Other activity data: mixed signals

Until 2016, Vietnam's strong economic growth was propelled by manufacturing and exports. But recent data shows that, while the manufacturing sector remained resilient, exports were hit hard in March as shipments of its key component – phones and spare parts – contracted sharply.

PMI. Operating conditions of the manufacturing sector continued to improve through March. At 54.6, the headline PMI was slightly higher than the February print (54.2) and the strongest since May 2015. Output and new export orders accelerated during the month, while overall new orders grew at a little slower pace. Higher workloads led to the fastest gain in employment since September 2016. Backlogs of work continued to expand, albeit at a slower pace.

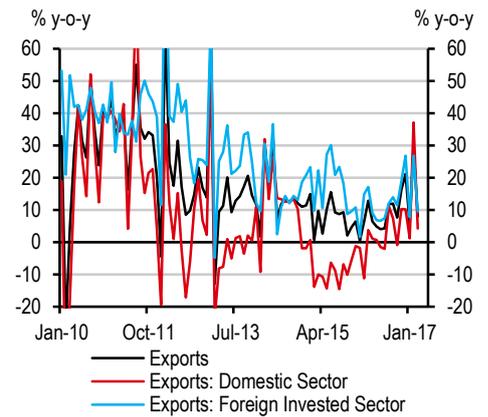
On the price front, the gains in input prices quickened to the sharpest pace in almost six years amid higher prices of oil and other raw materials and currency weakness. However, higher input costs were passed on to clients, only partly, as charge inflation (increases in output prices) rose at a slower pace, implying a squeeze in margins. This is reflected in the future output index, which, although still at a high level, receded slightly from its peak in February.

Chart 1: Manufacturing on firm ground



Source: Marlit, HSBC

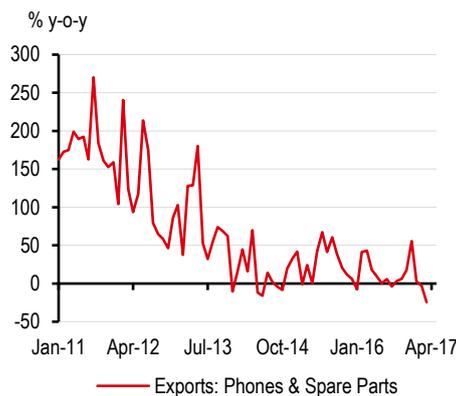
Chart 2: Exports failed to impress



Source: CEIC, HSBC

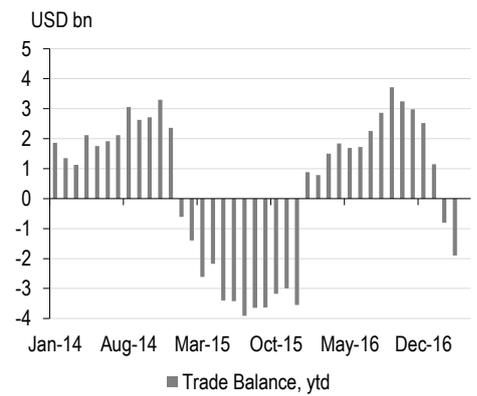
Trade. In sync with the sustained expansion in overseas order books, as was seen in recent PMI reports, exports grew by 8.0% y-o-y in March, following about 30% export growth in the previous month. The slowdown from the peak in February was broad-based, with both domestic and foreign invested sectors slowing sharply. The lacklustre export performance was due to a record (24.3% y-o-y) contraction in exports of phones and spare parts, the country's biggest export item. Meanwhile, import growth slowed but remained strong at 21.0% y-o-y in March, deepening the trade deficit.

Chart 3: The laggard



Source: CEIC, HSBC

Chart 4: Trade deficit widened in March

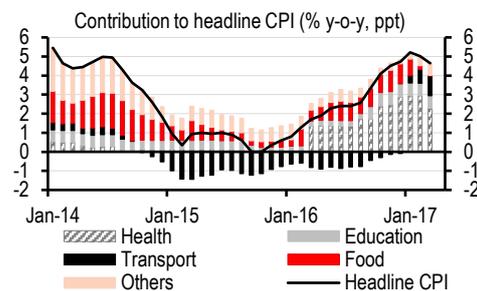


Source: CEIC, HSBC

Inflation: cooling gradually

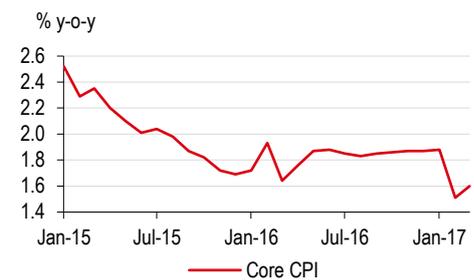
CPI. Headline inflation eased further to 4.6% y-o-y in March from 5.0% previously. About half the increase (2.3ppt) was contributed by increased costs of health care services, owing to the government's scheduled hike of medical and educational service fees. The transport component, which had been in deflation for over two years until December 2016, grew by 14.6% y-o-y during the month due to higher energy prices. Meanwhile, core inflation rose a touch to 1.6% y-o-y (from 1.5% previously). Broadly speaking, receding food inflation is keeping overall inflation in check.

Chart 5: Inflation is cooling



Source: CEIC, HSBC

Chart 6: Underlying price pressures remain subdued



Source: CEIC, HSBC

However, the General Statistics Office (GSO) expects a higher monthly increase in CPI in April on the back of slight rises in food, beverage and garment prices. Some provinces may also raise school fees in line with the government's roadmap.

Not too worried

All considered, we think that the slowdown in GDP growth in Q1 is only a minor setback and that the manufacturing sector has the potential to lift growth in the coming quarters.

Having said that, the GDP print highlights the economy's sensitivity to manufacturing cycles, especially high tech. To broaden growth drivers and, as such, help reduce the volatility of economic output, further reforms would help, especially with regard to state-owned enterprise efficiency and the creation of fiscal buffers.

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