



# Vietnam: Tail of the Dragon

April 2018

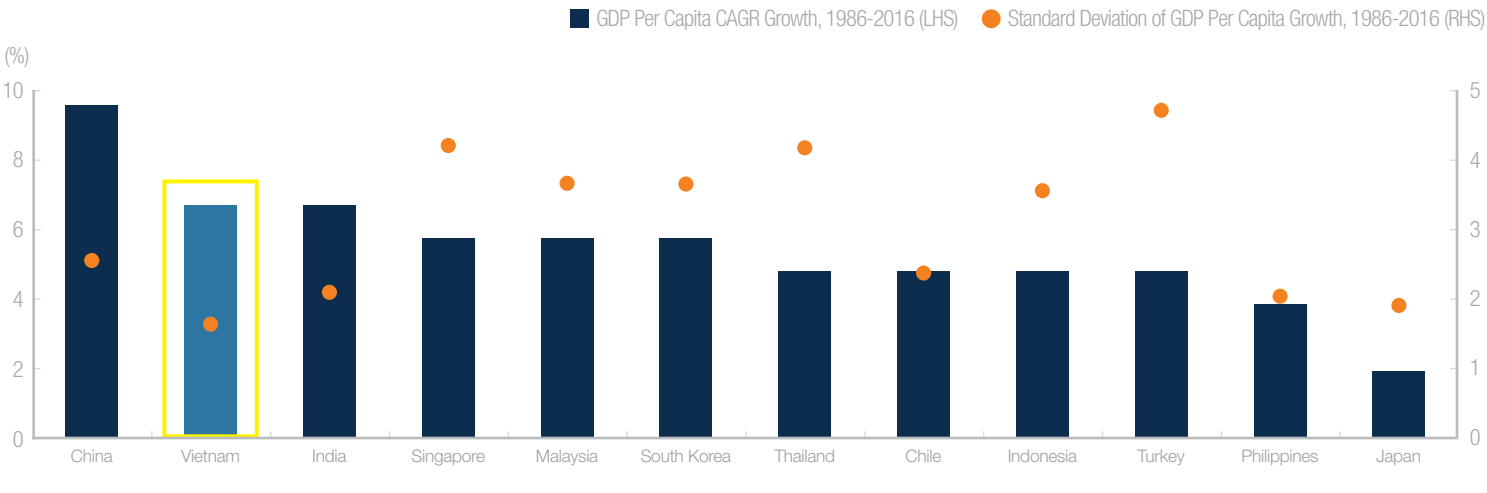
China and India attract the lion’s share of attention for global investors seeking Asian investment opportunities. For the uninitiated, Vietnam may call to mind images of terraced rice fields, conical hats, and pho rather than capital markets. However, savvy global investors are increasingly focused on this Southeast Asian country’s vast investment opportunities.

Vietnam is one of the fastest-growing economies in Asia, supported by a young and literate population of nearly 93 million people<sup>1</sup>, relative political and economic stability, and strong

foreign direct investment (FDI). When running a long-run historical analysis of economic growth over three decades, Vietnam arises as one of the world’s fastest-growing economies on a compound annual growth rate of over 6% (CAGR) with one of the lowest standard deviation of growth rates. This begs the question as to whether Vietnam will emerge as the next major growth story in the region. After closer examination, we believe that Vietnam is well on its way to becoming one of the most vibrant economies in the region as the tail of the proverbial Sino Dragon over the next decade due to a confluence of compelling attributes and factors.

### Rapid and Stable Growth

Source: World Bank, Mirae Asset Global Investments (2018)



<sup>1</sup> World Bank (2016), Accessed in 2018

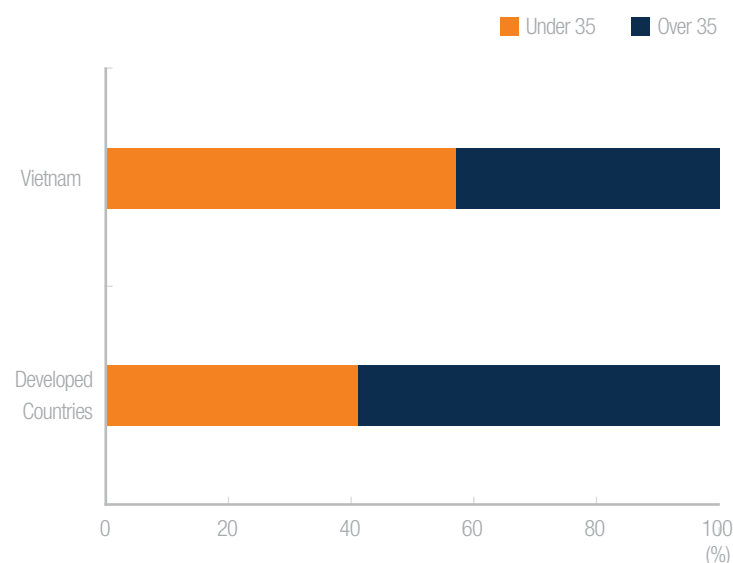
## Structural Advantages: Youth and Education

Vietnamese are a young and bright bunch, with a great number attending tertiary education. Since the turn of the millennium, Vietnamese tertiary enrollment ratios have tripled from approximately 10% to over 30%. Teenage students emanating

from Vietnam consistently rank among the best-performing in mathematics, reading, and science in the world as per the Programme for International Student Assessment (PISA).<sup>2</sup>

### Majority of Vietnamese are Under 35

Source: UN, Department of Social Economic and Social Affairs, World Population Prospects (2017 Revision), Accessed in 2018



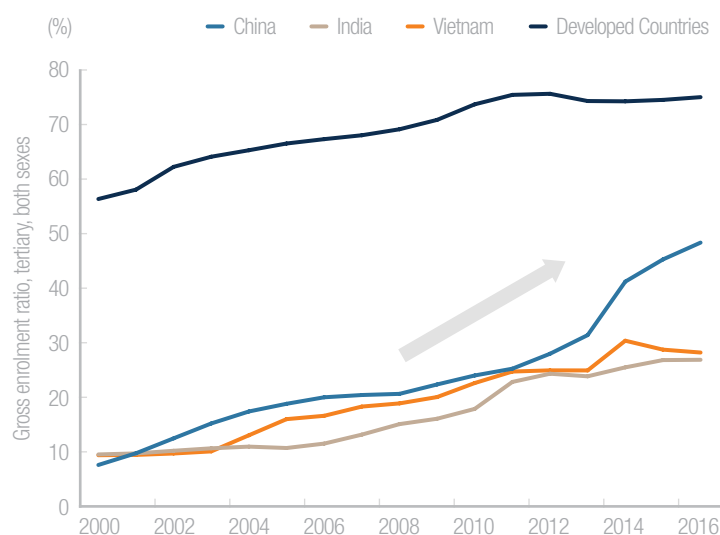
Note: The category "developed countries" equates to "high-income countries"

### Manufacturing that Attracts Foreign Direct Investment

One of the key drivers for the country's growth has been Foreign Direct Investment (FDI). Since 2010, Vietnam's manufacturing sector has been a key attraction for FDI, as opposed to real estate in years prior. Foreign businesses often are attracted to the country's large pool of skilled, low-cost labor and its proximity to global supply chains. In particular, IT manufacturing FDI is booming, thanks to Korea, Japan and Taiwan's desire to diversify their manufacturing outside of China. This trend is expected to persist as China's total labor cost continues to rise. Unemployment in the country has fallen from 10% 25 years ago to low single digits currently.

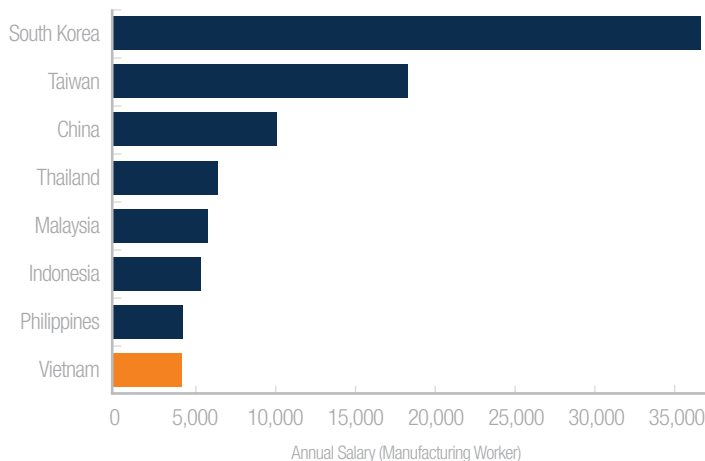
### Rising Enrollment into Higher Education

Source: UNESCO Institute of Statistics (Accessed in 2018)



### Vietnamese Wage Competitiveness

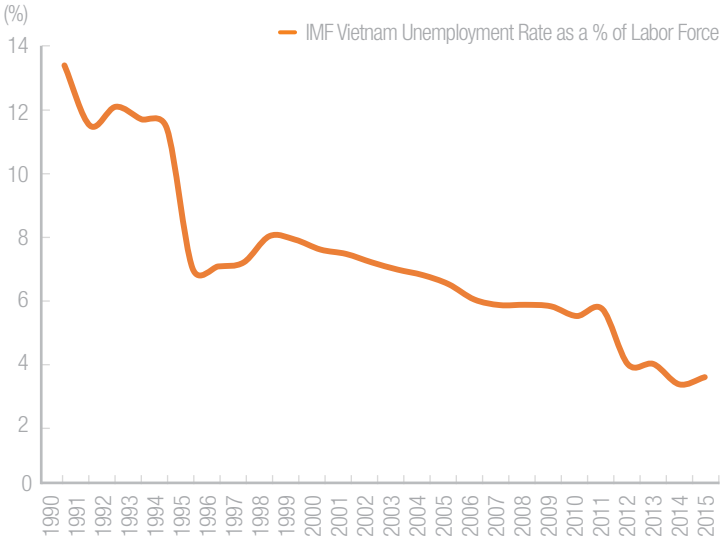
Source: JETRO (FY 2016), Mirae Asset Global Investments (Accessed in 2018)



<sup>2</sup> OECD PISA Scores (2015), Accessed in 2018

## High Rates of Employment

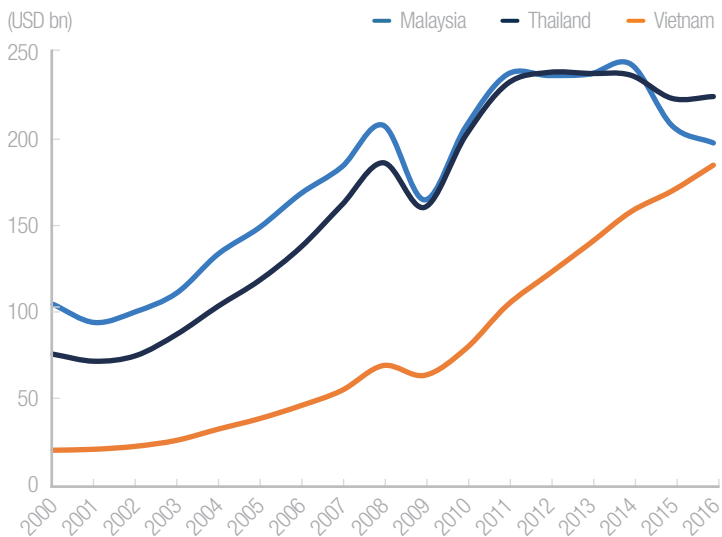
Source: Bloomberg, IMF (2018)



The country has prioritized signing free trade agreements with key trading partners (e.g. Japan, EU and Korea) as a matter of important policy, surpassing neighbors in a host of trade measures. There are no less than 17 FTAs implemented or in negotiation as of the time of writing.<sup>3</sup> These agreements have propelled outbound trade since the turn of the Millennium, and most notably since the Great Financial Crisis in 2008, whereas ASEAN neighbors have seen exports level off.

## Overtaking Neighbors in Outbound Trade...

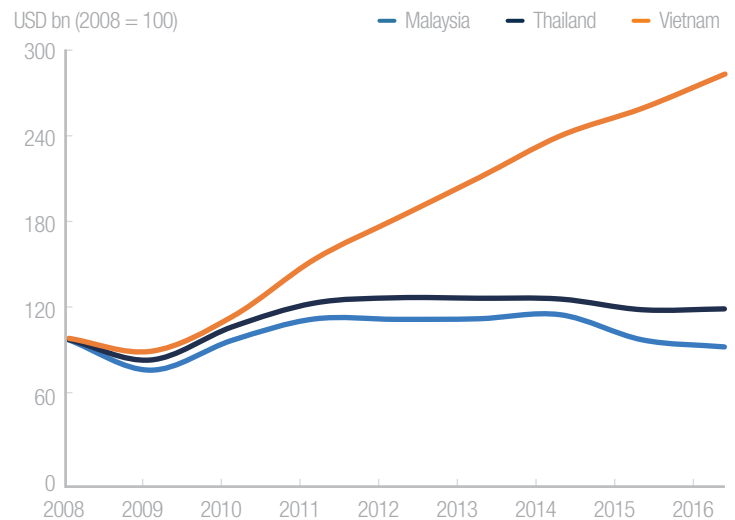
Source: World Trade Organization, Mirae Asset Global Investments (2017)



While these trends are encouraging, Vietnam has to tread a fine line as the majority of originating merchandise trade emanates from China while the United States is the largest consumer of

## ...as Post-Crisis Exports Surge

Source: World Trade Organization, Mirae Asset Global Investments (2017)

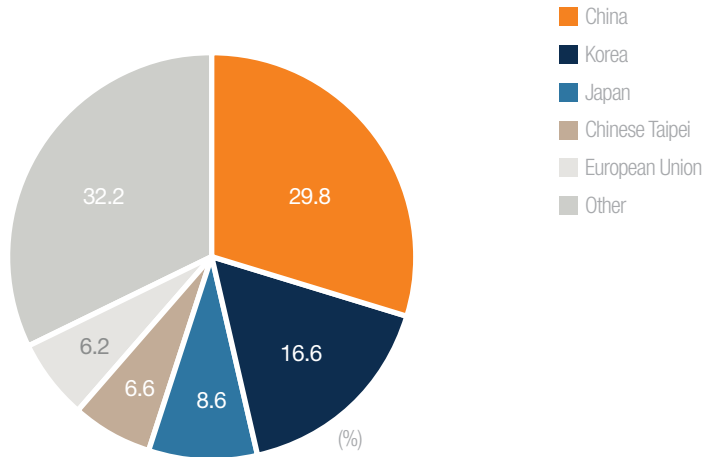


exports. Given superpower frictions, Vietnamese leaders will have to carefully manage positioning and dialogue to ensure that important trade relationships are not derailed.

<sup>3</sup> Asia Development Bank, Asia Regional Integration Center (Accessed in March 2018)

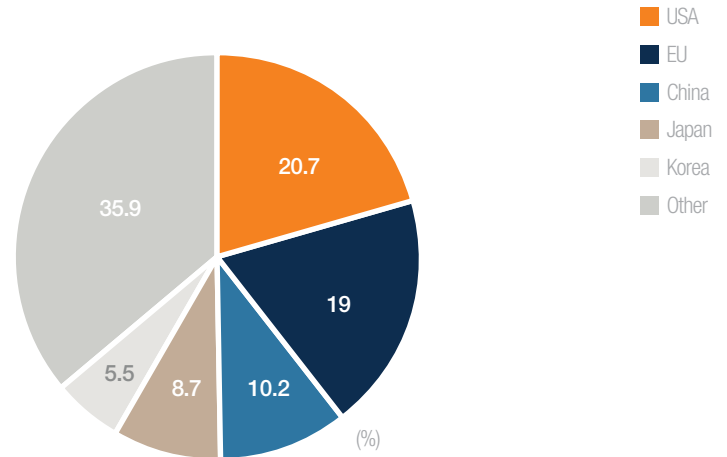
### Merchandise Trade by Origin (2015)

Source: World Trade Organization (Accessed in 2018)



### Merchandise Trade by Destination (2015)

Source: World Trade Organization (Accessed in 2018)

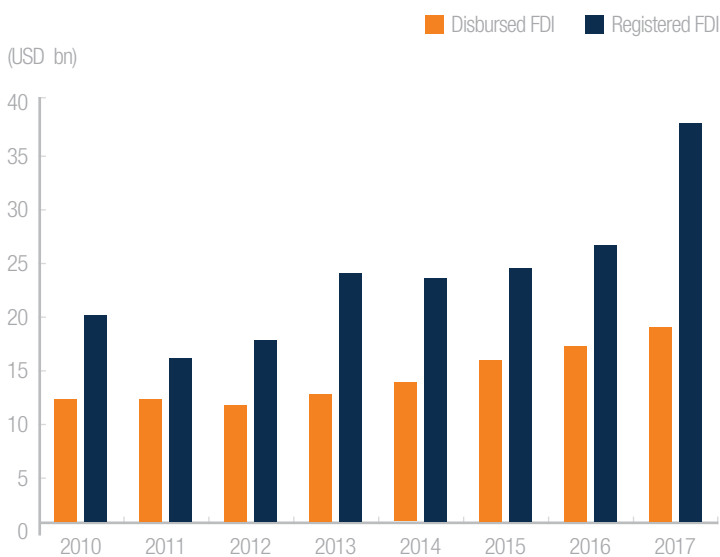


Beyond the trade equation, Vietnam is on track towards building a globally competitive manufacturing hub on a positive feedback loop of significantly higher foreign direct investments (FDI) on a sequential and regionally comparative basis. This foreign capital catalyzes infrastructure investments, such as roads, ports, and

urban mass transit systems for even greater manufacturing-related inflows. Tellingly, Vietnam has risen 14 places to No. 68 in The World Bank's "Doing Business 2018" rankings<sup>4</sup> with the most reforms globally in the past 15 years alongside Indonesia (39 reforms).<sup>5</sup>

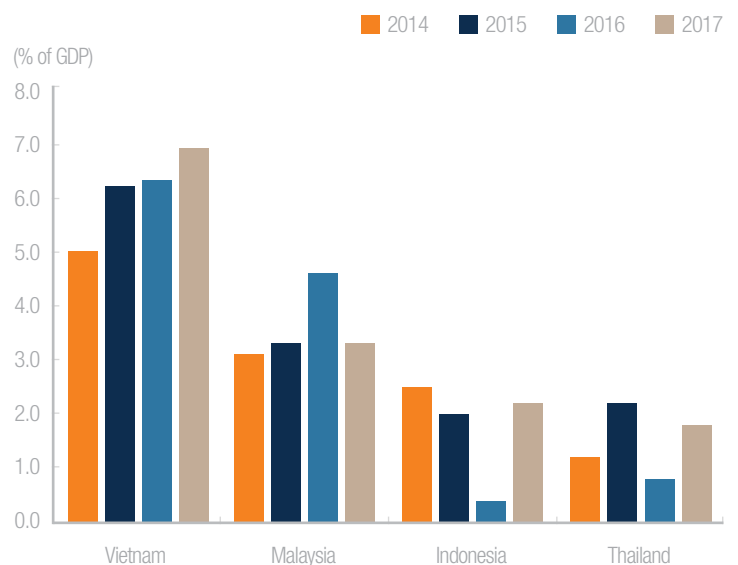
### FDI Historical Trend

Source: Viet Capital Securities (2017)



### Regional Comparative FDI

Source: CLSA (2017)



<sup>4</sup> World Bank Doing Business (2018)

<sup>5</sup> Vietnam Briefing, "Vietnam rises 14 places in the World Bank's Ease of Doing Business Rankings" (November 2017)

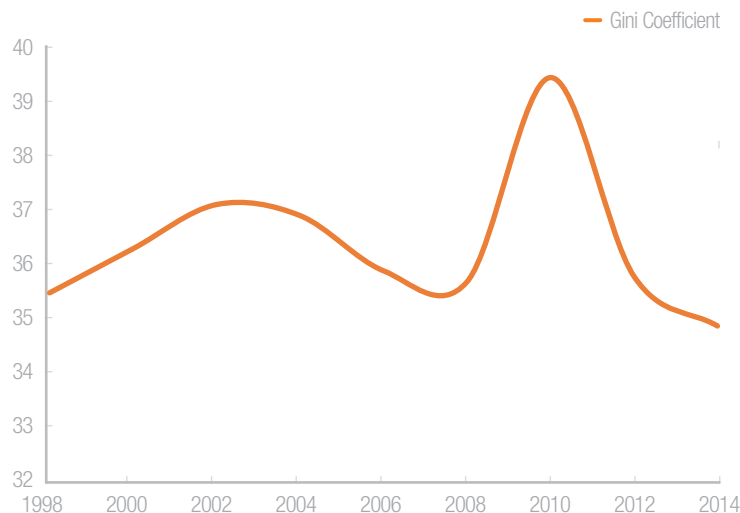
### Trickle Down to Consumption

Not only has Vietnam's growth been resilient and steady thanks to a supportive external makeup, but it has also been inclusive for the population, as demonstrated by a restrained Gini coefficient. The poverty rate, as measured in the percentage of households making less than \$1.90 a day, fell from more than 40% in the late 1990s to merely 2% in 2014 (latest available data). The surge of manufacturing-led FDI is lifting the economy as a whole, and more importantly alleviating poverty and improving welfare. In

a single generation, Vietnam has gone from one of the world's poorest countries to leapfrogging into middle-income status, as per capita income was US\$ 1,260<sup>6</sup> in 2011. As millions are lifted out of poverty into the consuming middle-class, consumption is a beneficiary from the positive trickle-down effect, with key sectors benefiting in consumer staples & discretionary-related industries (e.g. modern grocery retail and jewelry) and healthcare.

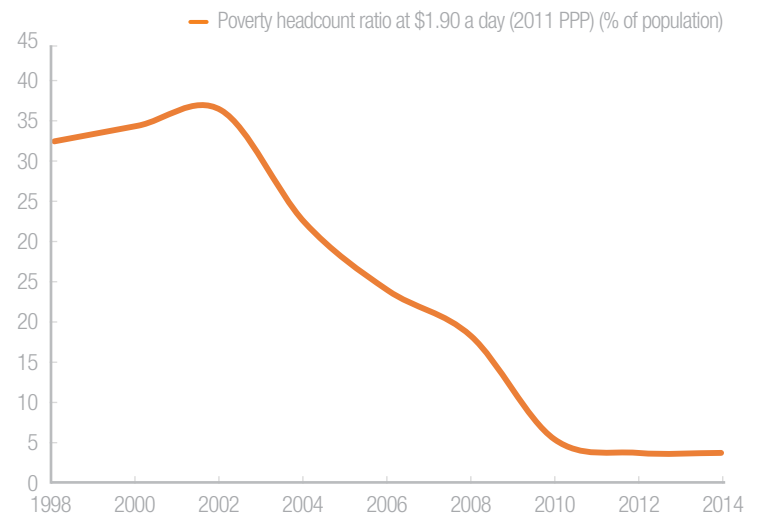
### Equitable and Inclusive Economic Growth

Source: World Bank, Mirae Asset Global Investments (2018)



### Sharp Reduction in Poverty

Source: World Bank, Mirae Asset Global Investments (2018)



### Bright Future, Bigger Cities

Sentiment around consumption draws from an extraordinary sense of enthusiasm towards the future opportunities that free markets afford. An overwhelming majority of the population favors the free market system and Vietnamese are among the

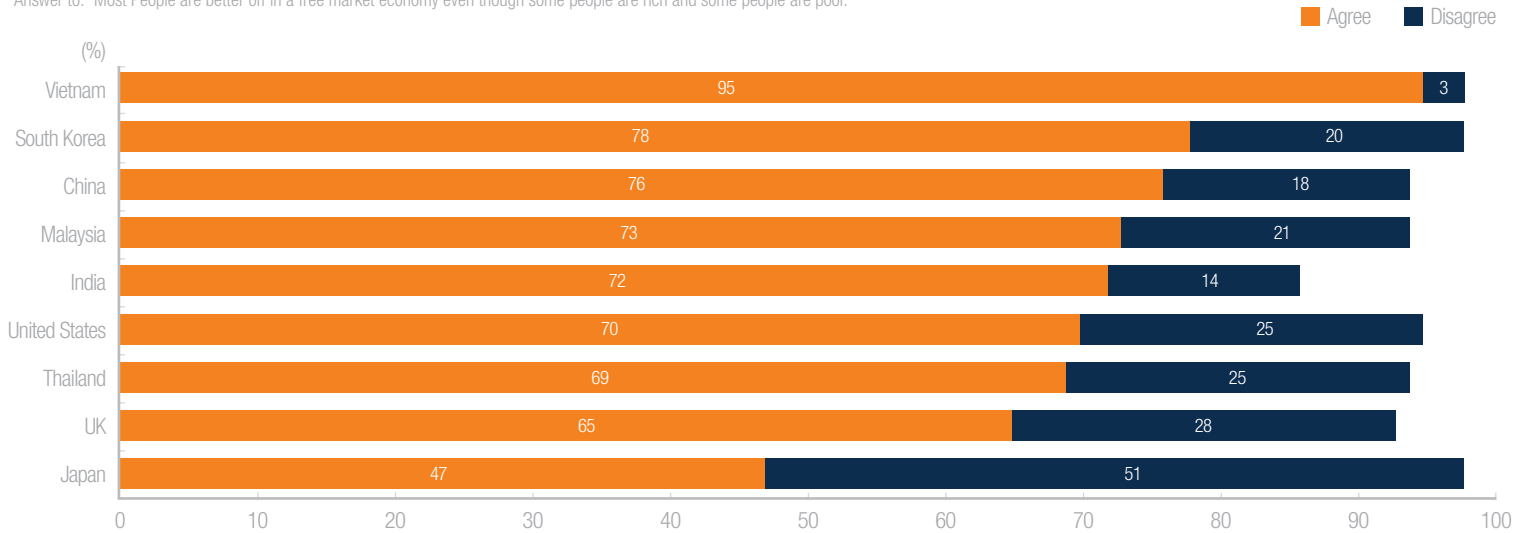
most optimistic about their children's future. These feelings of goodwill are noteworthy as they translate into greater consumer spending, and more confidence among company management, the government, and investors.

<sup>6</sup> World Bank, "Vietnam: Achieving Success as a Middle-income Country" (2013)

## Embracing the Invisible Hand of Capitalism

Source: Pew Research (2014), Global Attitudes Survey, Accessed in 2018

Answer to: "Most People are better off in a free market economy even though some people are rich and some people are poor."

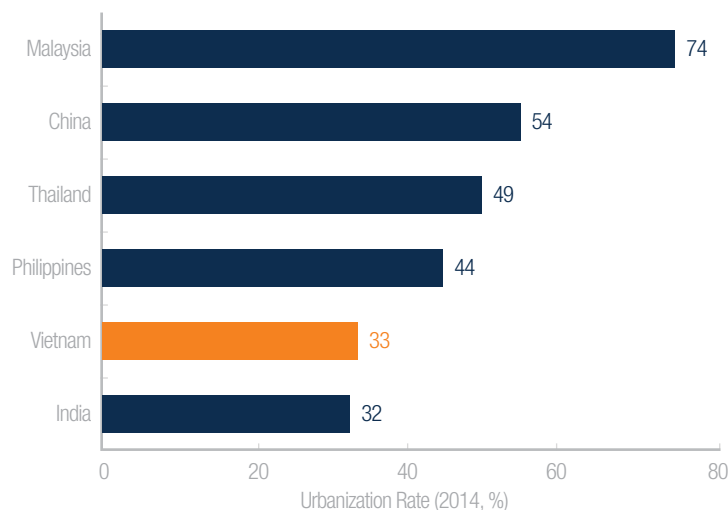


Vietnam is also at a relatively nascent stage of urbanization. As the population migrates into urban clusters it will unlock further productivity and value. According to Credit Suisse, each five-percentage-point gain in the share of citizens living in urban areas

yields a 10% increase in per-capita economic activity.<sup>7</sup> This is a multi-decade undercurrent in a country of more than 90 million, representing a widespread transformation that will benefit all segments of society.

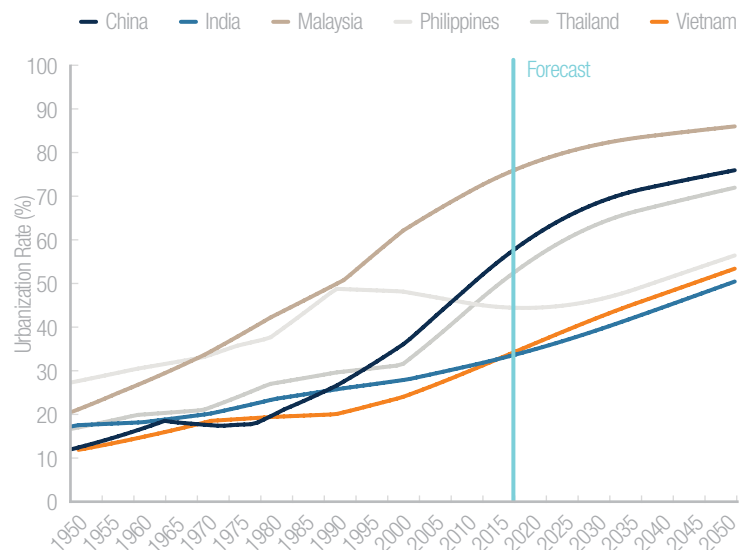
## Urbanization Today...

Source: United Nations Population Division, World Urbanization Prospects (2014 Revision), Mirae Asset Global Investments, Accessed in 2018



## ...And Tomorrow

Source: United Nations Population Division, World Urbanization Prospects (2014 Revision), Mirae Asset Global Investments, Accessed in 2018



<sup>7</sup> Credit Suisse, Emerging Market Research Institute

### Learning From Bubbles: Macro Conditions Have Improved

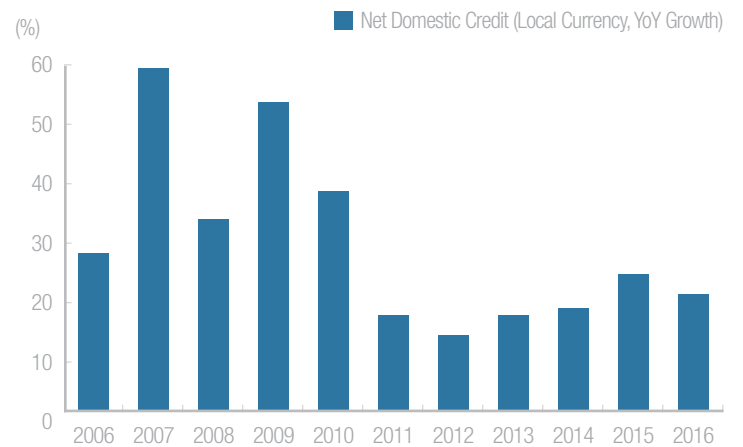
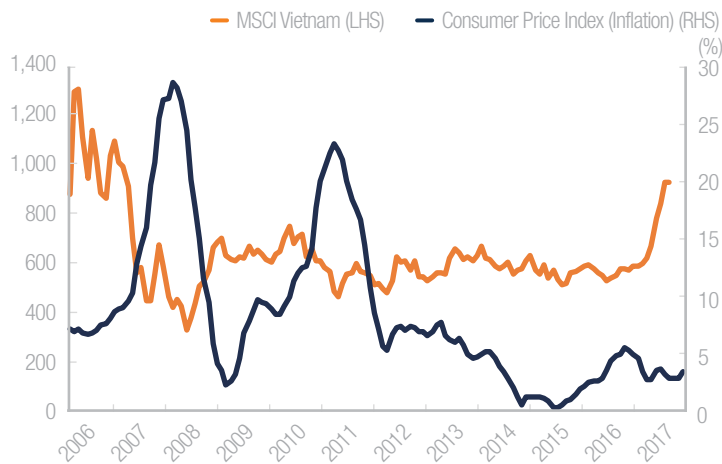
A key question foreign investors need to consider before investing in a “frontier market” like Vietnam is macroeconomic and social stability. Historically, Vietnam’s growth has been characterized by boom and bust cycles. Massive credit growth led to asset bubbles, which later collapsed as credit growth pushed up inflation. The government overstimulated the economy in 2009-10, after the global financial crisis, which caused more than 25% inflation in 2011, and a 25% depreciation of the Vietnamese dong

over 2009-11. This changed after 2012 when the government adopted policies that encouraged more macro-economic certainty and predictability.

Better policy conditions should translate into a stable Vietnamese dong, normalized monetary policy, and an overall healthy and stable macro environment. This certainty should encourage capital expenditures and investments from businesses and open the wallets of consumers.

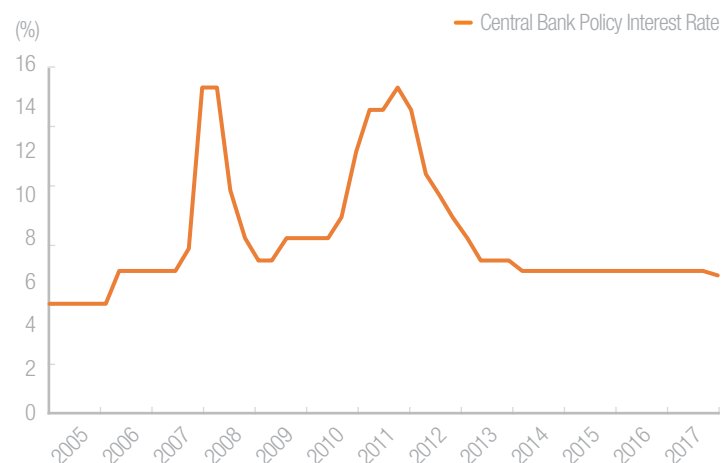
### Asset Bubbles – Unlikely to Repeat

Source: Bloomberg, World Bank, Mirae Asset Global Investments (2018)



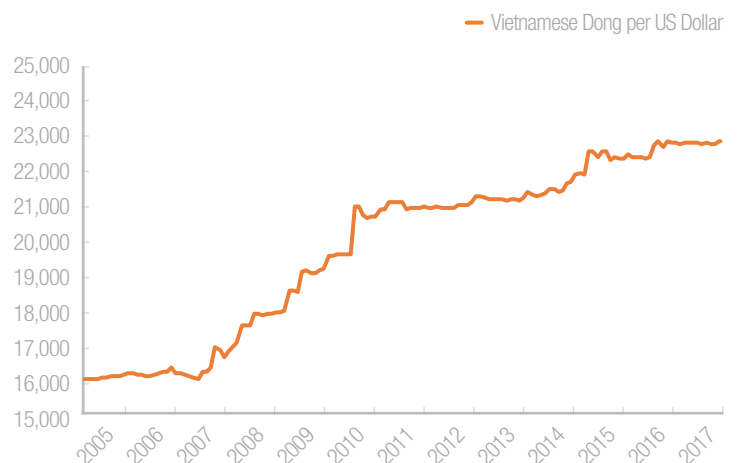
### Calmer Waters for The State Bank

Source: Bloomberg, Mirae Asset Global Investments (2018)



### Range-Bound Vietnamese Dong

Source: Bloomberg, Mirae Asset Global Investments (2018)

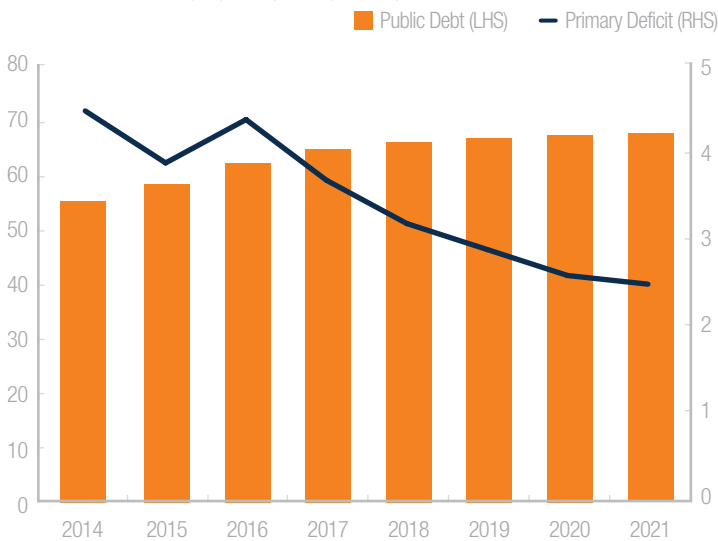


While public finances and fiscal management remain a weakness for the government, public and general government debt are lower relative to peers while fiscal deficits have come down considerably in recent years to around 3% of GDP.<sup>8</sup> Curbs on

further expenditures will be essential to bringing down the public debt going forward. The current account is affected by import volatility, to the detriment of trade, and is a closely monitored metric by the government and investors alike.

### Stabilized Government Debt

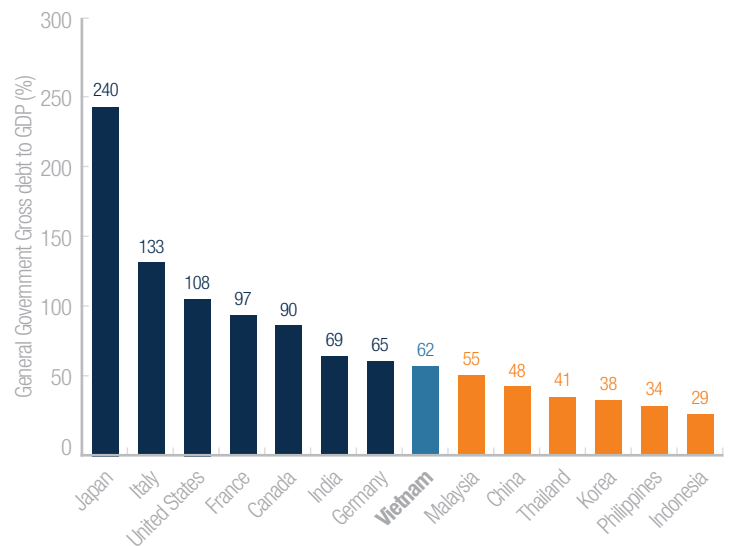
Source: IMF Vietnam Country Report, July 2016, (% of GDP)



A sustained level of FDI will sufficiently buttress economic growth and foreign reserves and offer some headroom to current account pressures. Moreover, inflows from foreign direct investors give us confidence that this is a manageable situation for Vietnamese authorities.

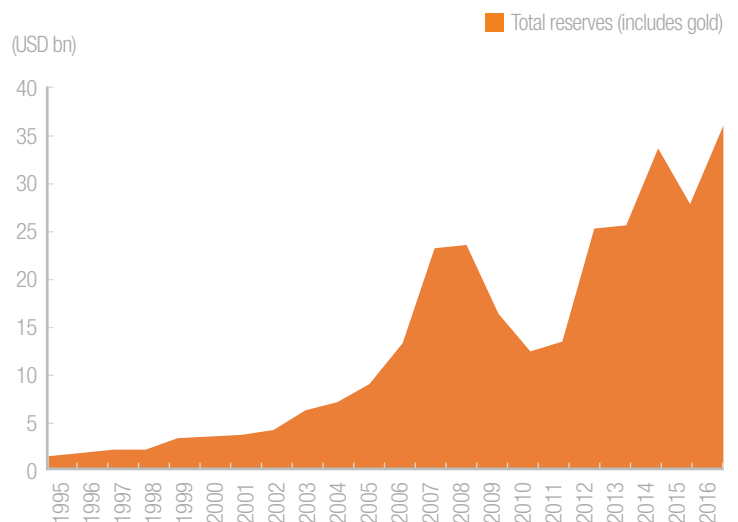
### Comparatively Low Government Debt to GDP

Source: IMF (2017), Accessed in 2018



### Foreign Reserves Touching New Peaks

Source: IMF, Mirae Asset Global Investments (Accessed in 2018)

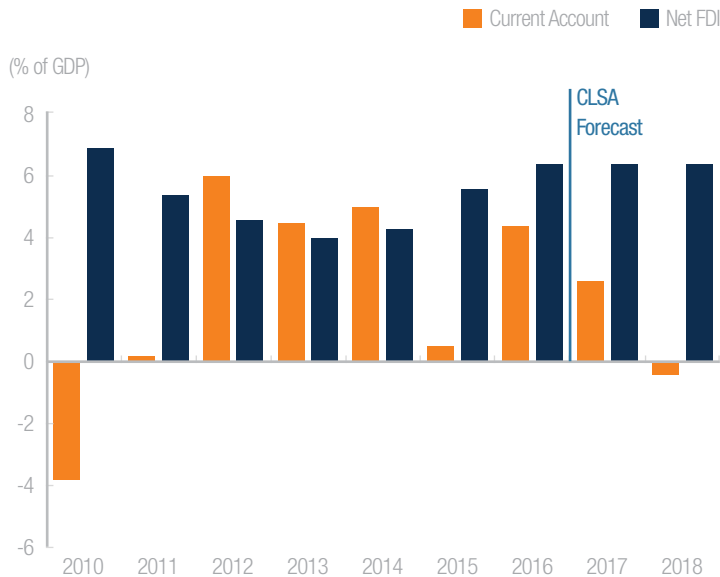


<sup>8</sup> IMF World Country Report (July 2016)



## FDI Flows Offsetting Current Account

Source: CLSA (2016), Mirae Asset Global Investments (2018)

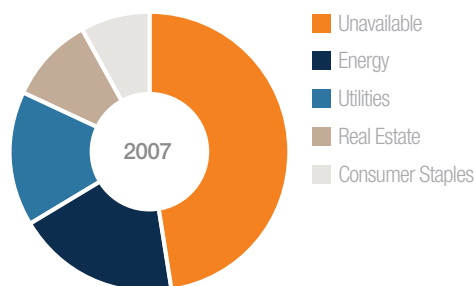


## An Embryonic Equity Market Full of Life

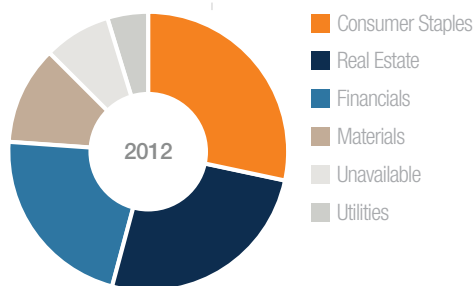
The market capitalization of MSCI Vietnam has rocketed up to US\$ 18 billion from US\$ 2.7 billion over a decade ago, while the number of constituents has crept up from seven in 2007 to 15 in 2017. While this remains an arguably small slice of emerging markets – the MSCI Emerging Markets Index is over US\$ 5.8 trillion and comprised of 846 constituents<sup>9</sup> as of January 2018 – we argue that the economics will feed through into a growing equity market pie as the Vietnamese economic engine rolls on and companies service a wealthier consumer. As companies go public with enhanced earnings, foreign investors will seek them out in order to participate in the Vietnamese growth story.

## MSCI Vietnam: Increasing Market Size, Depth, and Diversity

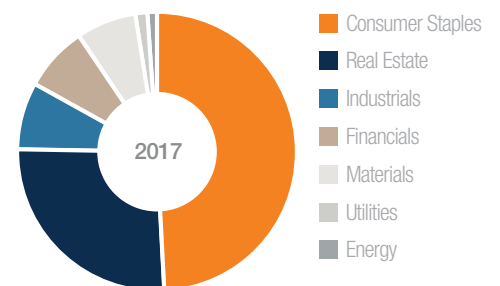
Source: FactSet, Mirae Asset Global Investments (2018)



Market Capitalization: **US \$ 2.7 bn**  
Constituents: **7**



Market Capitalization: **US \$ 2.3 bn**  
Constituents: **9**



Market Capitalization: **US \$ 18.0 bn**  
Constituents: **15**

<sup>9</sup> MSCI (January 2018)

## Capital Allocation, Infrastructure Expansion, and Productivity Growth

The World Bank Group estimates that one unit of capital in the Vietnamese private sector generates three times the amount of revenue compared to SOEs.<sup>10</sup> The export composition of the country has shifted remarkably over the past decade, from commodities to computers, electronics, textiles, garments, and phone components, constituting a healthy mix that bodes well for the country over the medium-term. On a long-term horizon, investments in human capital are certainly warranted and would yield considerable dividends and upside in offshore segments of data, IT, and business process outsourcing, to name a few. Infrastructure such as roads and ports should be improved to lower logistic input time and monetary costs. Furthermore, it is imperative that the country prepare for higher value-added services by better equipping the country with technology capabilities.

## Riding the Tail of the Dragon

There are two ways in which investors may ride the Vietnamese tail of the dragon: ride the beta wave or capitalize on market inefficiencies for alpha. Whereas many countries are hard pressed to realize their inherent potential, Vietnam excites us as the country is coming into its own through reform, market liberalization, an embrace of free trade, favorable demographics, consumer and business optimism, and predictable macro-economic and social policies. While there are undoubtedly risks in terms of geopolitics (e.g. South China Sea) and the global trade landscape (e.g. protectionism), Vietnam's favorable track record suggests that the structural developments are here to stay and will only become more significant in the future.

## Value Chain Evolution in Exports

Source: CLSA (2016)

Vietnam's Top Ten Exports (% of Total)	2008	2014	2016 to July
Phones & Spare Parts	0	16	20
Textiles & Garments	15	14	14
Computer, electronics	4	8	10
Footwear	8	7	8
Wooden products	5	4	4
Aqua products	7	5	4
Coffee	3	2	2
Rice	5	2	1
Crude Oil	17	5	1
Rubber	3	1	1

“ Vietnam excites us as the country is coming into its own through reform, market liberalization, an embrace of free trade, favorable demographics, consumer and business optimism, and predictable macro-economic and social policies. ”

<sup>10</sup> World Bank, Private sector holds key to Vietnam's future economic success (2014)

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