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MARKET FOCUS

Vietnam, Southeast Asia's Rising Star, Still?

By Puay Yong Juay

Think of a Southeast-Asian rising economic star and Vietnam would definitely come to mind.

But with the current economic jitters plaguing the country, is the period of phenomenal growth that this Mekong Delta darling has been experiencing since it embarked on its 1986 Doi Moi Reforms, over?



Economy: Too Hot To Touch?

For the last seven years, Vietnam's economy has never failed to deliver an annual average of less than 7% growth. In 2007 it registered a spectacular 8.2% growth, the highest growth rate among all Southeast Asian economies.

But Vietnam's sterling economic performance is not likely to be repeated this year. Its economy is growing at the slowest pace since 2001. In the second quarter of 2008, it expanded by 5.6% (year-on year), the worst quarterly performance in eight years.

What is Causing the Economic Hiccup?

Runaway Inflation

Vietnam's rapid development, as shown by the following:

- robust credit growth of 54% in 2007;
- influx of foreign direct investment;
- loose monetary policy; and
- aggressive public spending;

has brought about inflationary pressures. As of July 2008, year-on-year inflation stands at 27%, and the recent 30% hike in petrol prices keeps the pressure high.

Large Trade Deficit

Vietnam has been experiencing a large trade deficit, fuelled by strong industrial activities, infrastructure development and heavy public project spending.

Global pressure on energy, commodity and food prices has also pushed Vietnam's trade deficit to a record high. In the first half of 2008, its deficit swelled to US\$15 billion, exceeding its 2007 trade deficit by US\$1.4 billion.

Government Intervention

The Vietnamese government has, over the past several months taken measures to curb the rising inflation. They include:

- **Cutting down public expenditure.** The government suspended various public projects to lower its spending. The June trade deficit of US\$1.3 billion is down from US\$2.85 billion in May. The July estimate is even lower at US\$700 million.
- **Increasing interest rate.** The government raised interest rates thrice this year to 14% and increased the reserve requirements for banks. As a result, credit growth fell from 54% in 2007 to an annualised rate of 19.9% in April 2008. The government is aiming to reduce credit growth to 30% in 2008.

These measures has helped cool down Vietnam's overheated economy but has, at the same time, caused a slow-down in the Vietnam stock¹ and property market².

Short-term Effects of Soaring inflation and Large Trade Deficit

Depreciated currency. Trade deficit pressures have forced the Vietnamese government to loosen its control over the Dong. A rapidly depreciating Dong, which lost an unprecedented 5% value this year, may affect business costs and may trigger a flight of capital and assets by locals who might not want to hold on to the Dong. These could possibly set off a cycle, which may further devalue the Dong.

Labour unrest. With rising inflation, current salary levels of Vietnamese workers are threatening to plunge below subsistence level. More than 300 worker strikes in the first quarter of 2008 show that industrial unrest is on the rise.¹

Healthy Growth in Promising Sectors

Despite this year's turbulent performance, the long-term economic outlook for Vietnam remains positive. Business dynamics in Vietnam have not changed, so economic pundits remain optimistic about Vietnam's growth potential.³

Economic activities have remained robust, buoyed by healthy export growth and high commodity prices. The country registered a rise of 35.8% in exports to \$30.6 billion, which helped reduce trade deficit to \$14.2 billion⁴.

In addition, promising sectors such as transportation, communication and tourism continue to show strong growth in 2008.⁵ Expected telecommunications, retail, distribution sector liberalisation in 2009 will also pull FDI.

Strong Investor Confidence

Despite the heart-racing changes that are taking place in Vietnam, I believe it will continue to attract the attention of foreign investors.

Amid economic challenges, FDI continues to flow into the country, and foreign donors have continued to pledge aid to Vietnam.

This year, in fact, Vietnam hit a record of \$45.3 billion in FDI, more than double the 2007 total⁶ and accounting for 65% of the country's GDP⁷.

Vietnam also topped 2008 A.T. Kearney Global Retail Development index as the most attractive destination for retailers, ahead of China and India.

Why is Vietnam an attractive location for manufacturing?

Good labour supply. The young and relatively well-educated Vietnamese labour force is known for their strong work ethic.

Political stability. Vietnam has an edge over other low-cost destinations such as Thailand and Malaysia, thanks to its political stability.

Industrial zones. Vietnam has 185 industrial zones to support the manufacturing sector.

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ASK THIS IADVISOR A QUESTION

1. Inflation and current market sentiments have also depressed the Vietnam stock market, which fell by more than 67% in June this year. Market plunged when government started to implement more prudent requirements on bank loans to securities companies and stock traders. The capitalisation of Ho Chi Minh City and Hanoi stock exchanges fell from above 40% of GDP in Mar 2007 to about 17% of GDP.
2. The Vietnam property market softens amid tighter regulation and higher cost of borrowing. Real estate prices in Hanoi and Ho Chih Minh have fallen as much as 60% since beginning of the year.
3. According to Business Monitor, Vietnam's GDP growth will bounce back to 7.5% in 2009 and work up to 8.5% in 2010. The report expressed confidence that Vietnam will continue to be one of the world's fastest growing economies in the next five years.
www.businessmonitor.com, *Economic Outlook - Q3 2008, Vietnam - Economic Activity* 10 Jun 2008
4. Vietnam Ministry of Foreign Affairs, *Vietnamese economy shows signs of recovery*, 22 July 2008.
5. Transportation, communication and tourism grew by 14.9% compared to 10.8% in 2007. According to US Commercial Service, March 2008, Vietnam's telecommunication industry is among the world's fastest growing markets. In 2007, the ICT sector growth rate was double the Asian average and triple the global average.
6. The Star Online, *Vietnam most successful in attracting investors*, 21 July 2008.
7. VietNamNet Bridge, *Vietnam still attractive to investors, says economic analyst*, 30 July 2008.