## **COVID-19’s Economic Impact on Vietnam**

By **Michael Kokalari, CFA** *Chief Economist* **Huyen Tran** *Research Manager*

One month has elapsed since the novel Coronavirus (now re-named **“COVID-19”**) first came to light, so we now have enough concrete information and granular data to make well-educated estimates of the economic impact of COVID-19 on Vietnam.

There are a few reasons to believe that the impact of COVID-19 on Vietnam’s economic growth in 2020 will be worse than most expect, due to its impact on the country’s tourism sector (circa 12% of GDP), and on its manufacturing sector (circa 20% of GDP). That said, COVID-19 (like the trade war) will ultimately be a powerful catalyst to prompt the movement of factories from China to Vietnam, and a Moody’s report published last week predicts that this will ultimately boost Vietnam’s annual GDP growth by 2%pts.

In addition, the negative impact of COVID-19 on Vietnam’s stock market will be tempered by massive liquidity injections by the world’s central banks. Recall that in 2017, the **European Central Bank’s** USD1 trillion of Quantitative Easing in the lead up to the French and Italian elections (in addition to USD1 trillion from the rest of the world’s major central banks) helped drive a near 50% increase in the **VN-Index** because about half of the ECB’s newly printed money left Europe, and much of it flowed into Frontier and Emerging Market stock markets¹.

Finally, we believe Vietnam’s government can easily offset some of COVID-19’s **economic impact** on the country by ramping up **infrastructure spending** which is obligatory for the country’s long-term economic growth. This type of spending would provide an immediate boost to the economy, although it has been moribund for the last 1–2 years due to certain endogenous issues².

### **COVID-19’s Worse-Than-Expected Economic Impact on Vietnam**

Vietnam’s **Ministry of Planning and Investment (MPI)** has essentially estimated³ that COVID-19 will reduce Vietnam’s 2020 GDP growth by –0.8%pts to **6%** this year (down from 7% GDP growth in...

### **Footnotes:**

¹ *The caveat to this benign view about the outlook for stock prices in Vietnam this year is that “safe haven” demand for US Dollar-denominated assets (i.e., US Treasury bonds) is pushing up the value of the US Dollar, and a strong Dollar is bad for Emerging Market stock markets. Note that over the last few weeks, both the value of the USD and the price of gold have increased, which is clear evidence of “Safe Haven” demand for the Dollar, given that these are usually inversely correlated.*

² *The government’s weak spending on infrastructure projects over the last two years has helped drive the yield on 10-year Vietnam Government Bonds to below 3% versus 6.6% in Indonesia (which has an investment grade credit rating, unlike Vietnam), because the government raised a significant amount of money that was earmarked for infrastructure projects but then deposited much of the unspent funds into the commercial banks (which then bought VGBs), and because net VGB issuance fell by about 25% last year.*

³ *The MPI estimated a range of 2020 economic metrics in the case that the COVID-19 is fully contained by the end of Q1, and in the case that the outbreak abates by the end of H1, but we think it’s very unlikely that COVID-19 will be contained before the end of H1.*

2019), Standard Chartered cut its 2020 GDP growth forecast by 0.4%pts last week, and various local analysts and economists have published estimated reductions in Q1 growth only varying from -0.4%pts to -1%pts.

We think the above-mentioned estimates of the impact of COVID-19 on Vietnam’s 2020 GDP growth are too optimistic, and expect a -1.5%pts reduction in 2020 GDP growth (and possibly more) if the government does not take sufficient steps to at least partially offset the drag on the economy from COVID-19.

One piece of evidence that supports our view is the fact that Thailand downgraded its 2020 GDP growth forecast by 1.2% pts last week, given that Thailand has a similar risk exposure to COVID-19 as Vietnam because:

1. Tourism contributes about 12% of Thailand’s GDP, with one-third of its tourist arrivals from China, which is almost identical to Vietnam, and
2. Manufacturing contributes 25% of Thailand’s GDP, which is a bit higher than ~20% in Vietnam, but **Thailand’s manufacturing sector is less dependent on imports from China**, partly because automobile manufacturing represents a significant portion of Thailand’s manufacturing sector and the country has developed a cluster of local auto parts suppliers.

### **COVID-19’s Impact on Vietnam’s Tourism Sector**

According to Vietnam’s General Statistics Office (GSO), tourism accounts for 7% of Vietnam’s GDP, but if the figure is calculated to include the indirect contribution of tourism (from tourists shopping in local stores, eating in restaurants, etc.), the actual contribution is closer to **14%**.⁴

**Vietnam’s tourism arrivals are currently down 50–60%** due to COVID-19, according to the GSO, so occupancy rates at tourist-oriented hotels and resorts are currently around 20%, versus the 80% that would be more typical for this time of year according to lodging industry executives  
 (the overall hotel occupancy rate is currently down to 30–50%, in our understanding).

In addition, Johns Hopkins University has compiled a list of airports outside of China that are at risk of being the most affected by the COVID-19 outbreak which includes  
 **HCMC’s Tan Son Nhat International Airport.** Meanwhile, Vietnam Airlines is slashing the number of flights it operates to Korea, and we understand that the US Centers for Disease Control and Prevention (CDC) is considering issuing a travel advisory for US citizens who intend to travel to Vietnam.

*Tourist Arrivals have Surged in Recent Years* (Chart shows a steady rise in tourist arrivals in Vietnam from 2005 to 2019, peaking at 18 million in 2019)

**Source: GSO**

⁴ Figures around 14% have been informally quoted by various government officials in the past, which are collaborated by the fact that last year 18 million tourists visited Vietnam, which has a population of 97 million.

Medical outbreaks tend to last around six months, with the maximum economic impact in the first three months⁵, so we expect **Vietnam’s tourist arrival numbers to rebound later in the year** after the virus is contained.

Also, Asian countries including Thailand suffered a comparable plunge in tourist arrivals during the initial phase of the SARS epidemic, but Asia-wide tourist arrivals ultimately fell by 10% in 2003, so we expect Vietnam's tourist arrivals to drop 5–10% this year, after having grown 16% last year, and 23% CAGR over the last five years. That 5–10% drop in tourist arrivals would equate to a circa ~1%pts **reduction in Vietnam’s GDP growth this year**.

### **COVID-19’s Impact on Vietnam’s Manufacturing Sector**

We estimate that manufacturing contributes 20% to Vietnam's GDP, although the official figure is around 16%.

We mentioned above that Vietnam’s government expects **COVID-19 to reduce the country’s GDP growth** by -0.8%pts this year, and that Standard Chartered cut its 2020 GDP growth forecast -0.4%pts last week. These two forecasts were based in part on expectations by both of **2.3%pts and 3.3%pts reductions respectively of Vietnam’s manufacturing growth this year**, from 11.3% in 2019 to about 8% in 2020. We believe that both of those assessments are realistic, but we estimate that a -**2.3%pts reduction in Vietnam’s manufacturing output growth equates ceteris paribus to a -0.5% hit to the country’s GDP growth**.

COVID-19 hits manufacturing output by inhibiting factories from being able to source the inputs they need to make their products, and by preventing employees from coming to work. Both factors are major issues in China, but in Vietnam’s case, only the former is **a major impediment to the country’s manufacturing sector**. As we understand the current situation, Vietnam’s entire workforce is essentially back to work, versus only 30% of **China’s workforce**. That said, we are also aware of Chinese-owned factories in which Vietnamese workers are very concerned to be in the physical presence of their Chinese supervisors (there have even been reports of some strikes at those FDI plants).

Regarding the ability of firms to source the inputs they need in order to manufacture products, at least one-third of the inputs required by Vietnamese factories come from China, according to various sources, including the OECD, so **COVID-19-induced supply chain disruptions are likely to put a major dent in Vietnam’s manufacturing output growth this year**.

#### **Infographic Section (Summary)**

**Nearly 40% of Vietnam’s Manufacturing Inputs Come From China** **How Coronavirus Can Infect Global Supply Chains** *Share of all imports of intermediate products coming from China* (World map with color-coded legend showing 0–35% range)

**Source:** OECD TIVA, Bloomberg Economics  
 **Source:** Bloomberg, February 22, 2020

⁵ *During the SARS epidemic, the maximum number of news stories published about SARS occurred 2–½ months after the first story was published.*

In order to get a better understanding of how this is likely to impact **Vietnam’s** leading manufacturing firms in the months ahead, we spoke with procurement managers, operations managers and country heads of foreign-invested companies, and came to the following conclusion about the inventory levels of production inputs that these firms hold (i.e., how long it will be before COVID-19 prompted supply chain disruptions start to meaningfully reduce production).

Based on those discussions, we have concluded that the producers of low value-added products (garments, furniture, etc.) typically keep 2-3 months of production inputs on hand, the makers of medium value-added products (auto transmissions, airplane wings, etc.) keep 1-2 months of production inputs on hand, and the producers of high-value electronics products have just 2-4 weeks of the components needed to make mobile phones, digital cameras, and so on because of the high cost of financing an inventory of those expensive components.

Since China’s government has more-or-less signalled that it is preparing to encourage the country’s workers to go back to work about 1-2 months later⁶, it is likely that production inputs will start flowing from China to Vietnam again about two months later, which in turn means that the producers of medium and high value-added producers (which now account for about half of Vietnam’s manufactured products) will be most affected by the COVID-19 outbreak.

Next, according to a plethora of research about COVID-19 from very credible scientific and medical sources around the world, it appears that this virus is much more infectious than has been publicized in the mainstream media. However, those studies also indicate that thankfully, COVID-19 is probably much less deadly than widely feared.

If China does prematurely call an end to the outbreak so that its workforce can return to work in order to **ramp up production at the nation’s factories**, it is very unlikely that production will get back to normal until well into H2, because, according to the CDC, about 15% of those that catch the virus will either get very sick and then recover or possibly suffer worse consequences from catching COVID-19. **That partial incapacitation of China’s workforce would lead to a reduced availability** of manufacturing inputs from China to factories in Vietnam, which would in-turn dampen the local manufacturing sector’s ability to resume its normal level of production.

### **COVID-19’s (Eventual) Benefit to Vietnam**

Much has been made over the last year about the fact that the US-China trade war is prompting companies to move their factories from China to Vietnam. We believe that once COVID-19 concerns subside (most likely in H2), it will serve as an even more powerful catalyst than the trade war in prompting companies to move their factories to Vietnam, because of the stronger psychological impact that supply chain will have on corporate executives.

In the case of the trade war, the imposition of tariffs has forced corporate executives to make assessments about how much of the costs attributable to the new tariffs can be passed on to the end consumers of their products, how much can suppliers be asked to cut the prices of inputs they supply to the firm, and how much profit the firm itself will ultimately need to sacrifice because of the

⁶ *China’s top medical expert Dr. Zhong Nanshan, who was instrumental in that country’s handling of the SARS epidemic, said last week that new COVID-19 infections in China are now peaking, and that the outbreak could be contained by April. However, he also provided new scientific information suggesting the opposite – that the virus will likely continue to spread – implying that he had been prompted to suggest a possible end of the current outbreak by end-April.*

tariffs. That is a painful decision, but not as agonizing as companies not being able to source sufficient inputs to actually produce their products. Last week, Apple Inc., which is arguably one of the best run companies in the world, essentially guided that it does not know when it will be able to ramp up the full production of its products again.

Our view that while COVID-19 will cause significant economic impact in Vietnam this year, it will ultimately be beneficial to the country's economic development, is not widespread yet. Investors, policy makers, and local businesspeople are currently (and understandably!) focused on the immediate impact of this medical outbreak. However, there are some signs that others are starting to take notice of this possible outcome. Two weeks ago, a senior fellow at the influential Milken Institute commented that the crisis will “underscore to all of China's trading partners the value of diversification away from China”, and he went on to say that COVID-19 is speeding up the dismantling of US firms’ sourcing from China even faster than the trade war did.

Finally, we mentioned above that Moody's expects a 2%pts boost to Vietnam's annual GDP growth rate, which is attributable to firms moving their factories from China to Vietnam, prompted by both the trade war and the COVID-19 outbreak, although the analyst who authored the report acknowledged that it is not clear how long it will take for enough factories to move from China to Vietnam in order to make that significant boost to Vietnam’s annual economic growth.⁷

## **Conclusion**

At the time of writing, stock markets around Asia plunged as new reports of COVID-19 outbreaks from South Korea and Italy have spooked investors. It remains to be seen how this global medical crisis plays out; in Vietnam, the last confirmed victim of COVID-19 was reported recovered, and there have been no new cases reported for several days. Nevertheless, we believe the short-term impact will be fairly significant. From a longer-term perspective – and assuming no substantial escalation of the crisis – Vietnam will benefit as companies further accelerate moves to diversify their manufacturing operations away from China.

### **Disclaimer**

© 2020 VinaCapital Fund Management JSC (VCFM). All rights reserved. This report has been prepared and is being issued by VCFM or one of its affiliates for distribution in Vietnam and overseas. The information herein is based on sources believed to be reliable. With the exception of information about VCFM, VCFM makes no representation about the accuracy of such information. Opinions, estimates and projections expressed in this report represent the current views of the author at the date of publication only. They do not necessarily reflect the opinions of VCFM and are subject to change without notice. VCFM has no obligation to update, amend or in any way modify this report or otherwise notify a reader thereof in the event that any of the subject matter or opinion, projection or estimate contained within it changes or becomes inaccurate.

Neither the information nor any opinion expressed in this report constitutes an offer, or an invitation to make an offer, to buy or to sell any securities or any option, futures, or other derivative instruments in any jurisdiction. Nor should it be construed as an advertisement for any financial instruments. Officers of VCFM may have a financial interest in securities mentioned in this report or in related instruments. This research report is prepared for general circulation and for general information only. It does not have regard to the specific investment objectives, financial situation or particular needs of any person who may receive or read this report. Investors should note that the prices of securities fluctuate and may rise and fall. Past performance, if any, is no guide to the future.

Any financial instruments discussed in this report may not be suitable for all investors. Investors must make their own financial decisions based on their independent financial advisors as they believe necessary and based on their particular financial situation and investment objectives. This report may not be copied, reproduced, published, or redistributed by any person for any purpose without the express permission of VCFM in writing. Please cite sources when quoting.

**Footnote**:  
 ⁷ *The Moody’s report also mentioned the possibility that the US could impose tariffs on imports from Vietnam, but we continue to believe this is not a major issue for Vietnam because of the important geopolitical issues are currently buttressing the US-Vietnam relationship.*