Bloomberg Business

Vietnam Growth Masks Weak Local Firms in 2-Speed Economy

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November 9, 2015 — 5:00 AM ICT

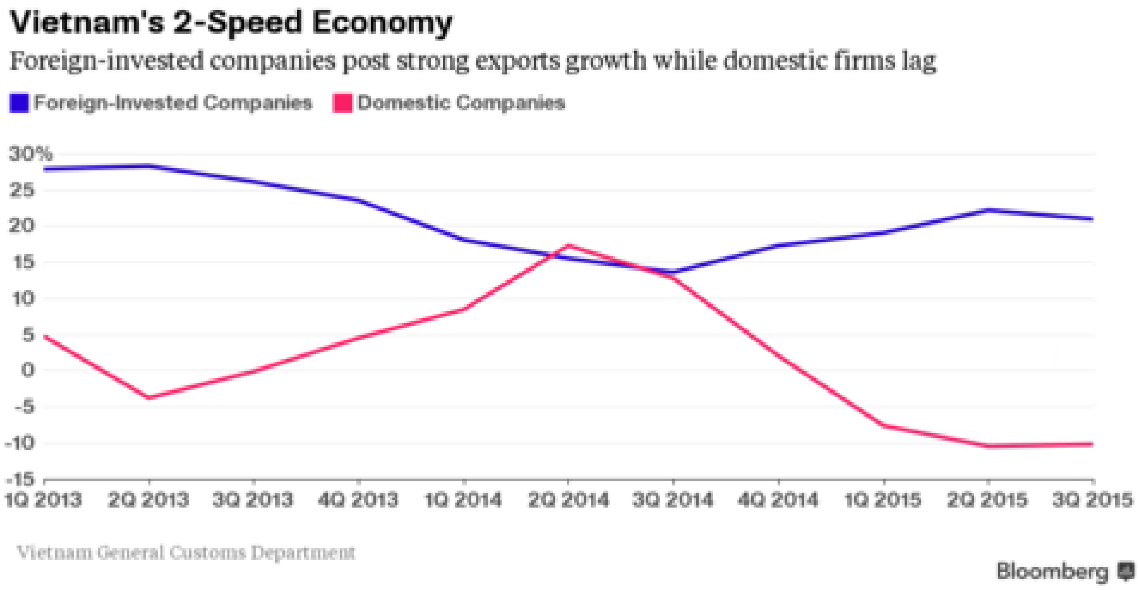
- Foreign-invested companies dominate exports as local firms lag
- Weak domestic sector a risk to country's long-term growth

Vietnam's export-driven economy is set to grow at its fastest pace in eight years in 2015 and it's foreign firms in the country that are riding the wave, leaving local companies lagging far behind.

Foreign-owned businesses shipped 70 percent of Vietnam's total exports so far this year, up from 44 percent five years ago, raising risks for the economy should any of those companies pull out. While the foreign sector posted exports growth of 21 percent in the third quarter from a year earlier, domestic companies saw a 10 percent decline, figures from Vietnam's customs department show.

The divergence in export success between foreign and domestic firms is creating a two-track economy that would be vulnerable to a slowdown should foreign companies move their operations elsewhere in search of cheaper labor. The dichotomy is similar to that experienced by some of Vietnam's neighbors in the early years of their industrialization drives. It is also complicated by a banking restructuring aimed at lowering bad debts, which has left many Vietnamese companies without access to capital, making it harder for them to compete internationally.

"The hollowing out of domestic firms is a worrying sign for Vietnam's future, as its main competitive edge remains cheap labor and land," said Trinh Nguyen, Hong-Kong based senior economist for emerging Asia at Natixis SA. "It will hurt long-term growth. This is the easy way out and if the government is not taking steps now to improve productivity then when wages rise, Vietnam will lose out."



Two-Track Economy

Vietnam Prime minister Nguyen Tan Dung last month raised the forecast for GDP growth in 2015 to at least 6.5 percent from a target set in November 2014 of 6.2 percent. If realized, growth will be the fastest since 2007.

The country's exports are led by computers, electronic products, garments and footwear. Foreign companies, including Samsung Electronics Co., dominate these sectors and accounted for 99 percent of the $34.3 billion in exports of computers and electronic goods between January and September this year. They also contributed 67 percent of garments, textiles and footwear exports worth $25.7 billion in the same period.

Vietnam's local companies posted a stronger share of agriculture and seafood exports, but these industries have been stymied by plunging commodity prices. The Bloomberg Commodity Index of 22 raw materials dropped in August to its lowest since 1999.

"Vietnamese companies are seeing export difficulties as the international prices of commodities, agricultural and seafood products have fallen," said Nguyen Van Nen, chairman of the government office, at a briefing Oct. 29. Intensified competition in international markets also hurts domestic businesses' exports, he said.

Countries like China and Malaysia, which developed manufacturing bases before Vietnam, show that local companies can catch up over time.

“China relied on FDI companies for quite some time, and then, starting in the late 1990s-early 2000s its domestic sector was picking up and over time has become more and more important to the economy and to exports,” said Sandeep Mahajan, the World Bank’s lead economist in Vietnam.

TPP Winner

For now, Vietnam is seen as the biggest winner of the recently signed Trans-Pacific Partnership deal, which could boost the nation’s gross domestic product 11 percent, or $36 billion, in a decade and push up exports by 28 percent over the same period. Vietnam’s economy is forecast to grow at a faster pace than the average for countries in the Association of Southeast Asian Nations through 2017, according to the World Bank.

The benchmark VN Index fell 0.1 percent to 611.99 at the midday break in Ho Chi Minh City trading. The gauge has gained 12 percent this year.

Vietnam’s medium-term growth prospects will be significantly enhanced if the TPP is ratified by participating countries, according to Fitch Ratings Ltd., which affirmed Vietnam’s BB- rating last week.

"It’s a pretty enviable position for a country of Vietnam’s development level," Andrew Fennel, associate director of sovereign ratings at Fitch in Hong Kong, said of the TPP benefits. "This export-led model is a model many countries have pursued. Just because the domestic supply chain at the moment in Vietnam is not strong enough, that doesn’t mean long-term it wouldn’t be. It’s probably going to take some time."

Samsung Investment

Samsung Group is Vietnam’s biggest foreign investor, having spent $14.2 billion in the country as of August, according to a report by Dau Tu newspaper posted on the Foreign Investment Agency’s website. Samsung accounted for 18 percent of the nation’s exports in 2014, according to a government website.

“Foreign companies invest in Vietnam to take advantage of cheap labour," said Trinh. "When a lot of firms invest, eventually it puts upward pressure on wages. When wages rise and Vietnam doesn’t have other comparative advantages, these labor intensive manufacturers will go to countries that offer cheaper wages.”