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Credit Insights:

Weak external demand will weigh on Vietnam's exports

Downside risks for Vietnam's economy and GDP growth target

Weak external demand will weigh on Vietnam's exports and economic growth; bank asset risks from weaker exports will be manageable

- » Q1 2023 GDP y-o-y growth rate slowed to 3.32%, from 5.9% in the previous quarter, driven primarily by a sharp decline in manufacturing sector output. The manufacturing sector – makes up 26.5% of total GDP output – contracted by -0.4% y-o-y in Q1 compare with 5.5% growth rate in the same period last year. The weakness in manufacturing sector is also reflected by the consecutive quarterly contraction in exports since Q3 2022. Export contraction has worsened considerably in Q1 2023 across all of Vietnam's key export products - Electronics, Textiles, Footwear, and Furniture products - and across most of the key export markets.
- » External demand has weakened amid rising inflation, tightening monetary conditions and slowing economic growth. Like Vietnam, other export-oriented countries like China, Mexico and Taiwan experienced similar decline in exports and new orders. Vietnam's Manufacturing Purchasing Manager Index (PMI) fell to 47.7 in March 2023; below 50 mark for the second time within the first quarter. This signals further weakness in new business and export orders and manufacturing outputs in the coming months.

Credit implications:

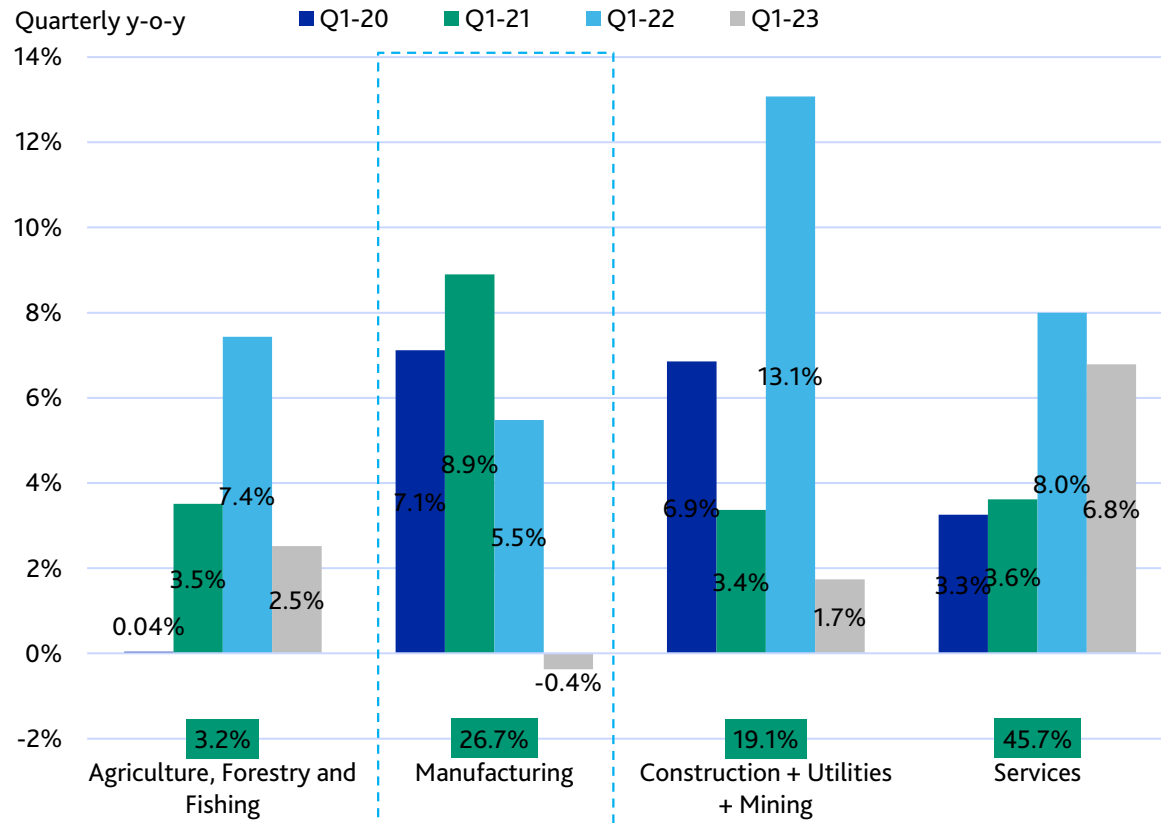
- » **Export-oriented firms:** The FDI sector accounts for over 75% of total export value, while local firms account for the remainder. We view the FDI firms to be more resilient than local firms due to their larger equity base and capability to maintain profit margins. On average, the equity of an FDI firm is VND105 billion, significantly higher than that of a domestic firm at around VND16 billion. In general, FDI firms have business advantages over local firms in terms of adoption of new technologies, economies of scale, higher productivity, and access to parent firms' network and markets.

We expect external demand to remain weak amid uncertainties in economic growth and central banks' efforts to curtail inflation. As such, Vietnam's manufacturing activity and export volume will likely be depressed over the course of 2023. As cash flows weaken, more firms will need to downsize and optimize operations to stay afloat. A prolonged decline in exports will also likely impact the cash flows and viability of firms in the supply chain, such as providers of raw materials and transportation services.

- » **Banks:** The decline in exports will be manageable for bank asset risks due to limited direct exposure. We estimate banks' exposure to export-oriented firms is about 3% of total banking system credit and mainly short-term loans to local firms backed by collaterals. FDI firms are primarily reliant on their parent firms for funding. We also view banks' direct lending to employees in the export sector to be limited.
- » **Economy:** Beyond the direct impact on exports, the weak external environment will pose downside risks for Vietnam's economy and its 2023 GDP growth target of 6.5% on a few fronts, namely its balance of payment position, investment flows and stability of the VND, new FDI inflows, stability of employment conditions and domestic consumption. In April, the authorities had embarked on a series of stimulus measures, including extension of tax payment dates, plan to cut value-added tax (VAT) by 2% points for 2023, providing credit packages for social housing development projects and selected preferential sectors. Government policy actions to spur public spending and investment, and channel funding to support sectors at risk will be key to support the economy over the course of 2023.

The manufacturing sector has become a drag on GDP growth in the first quarter of 2023

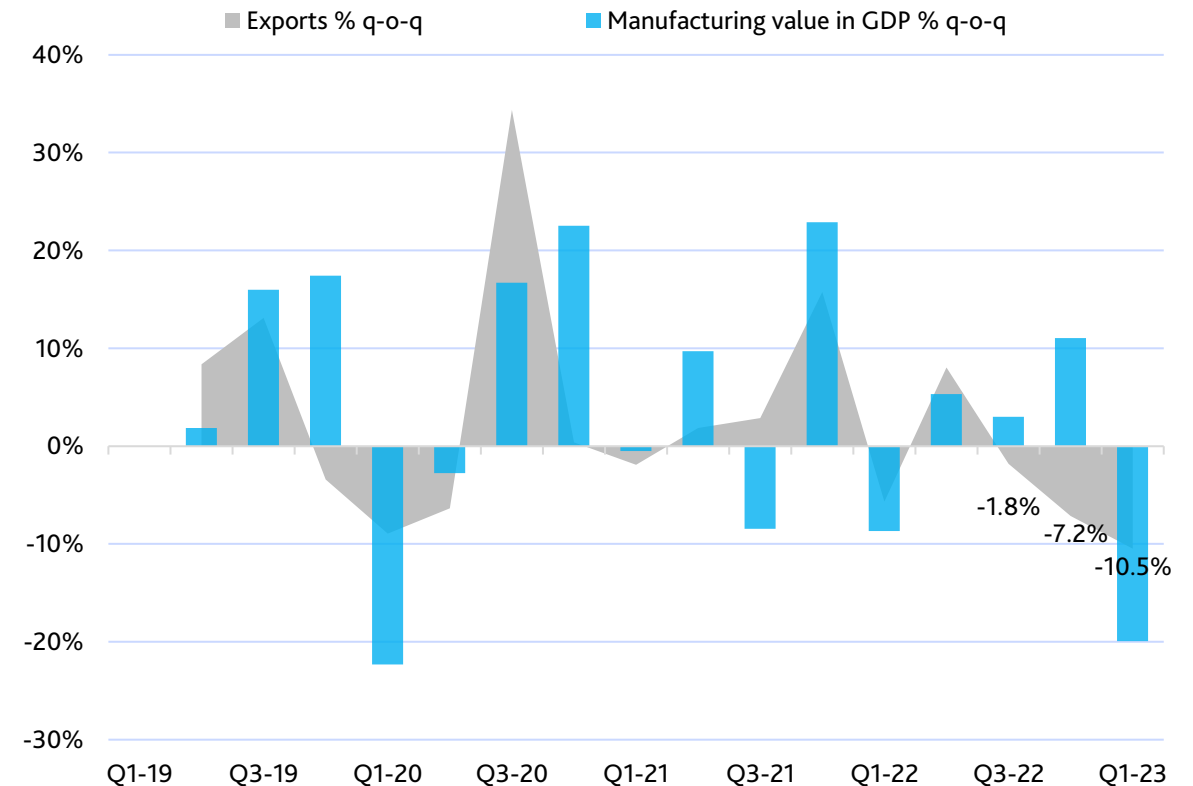
The manufacturing sector had an average growth rate of 7.8% over the past three years, but it experienced a sharp decline in the first quarter of 2023



Numbers in the green box present the contribution to GDP

Source: General Statistics Office (GSO), Vietnam Investors Service

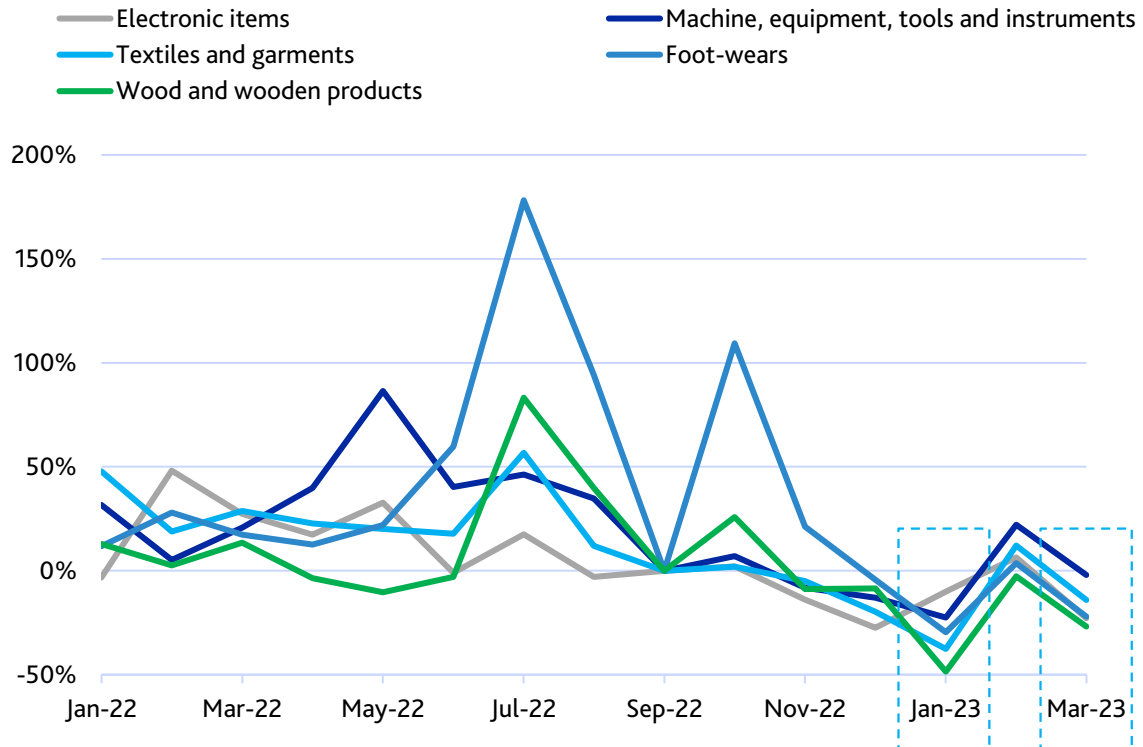
Exports were the key driver of growth in the manufacturing sector, but it has had three consecutive quarters of negative growth



Source: GSO, General Department of Vietnam Customs (GDVC), Vietnam Investors Service

All of Vietnam's key export products declined, driven by weak demand across its top 5 markets

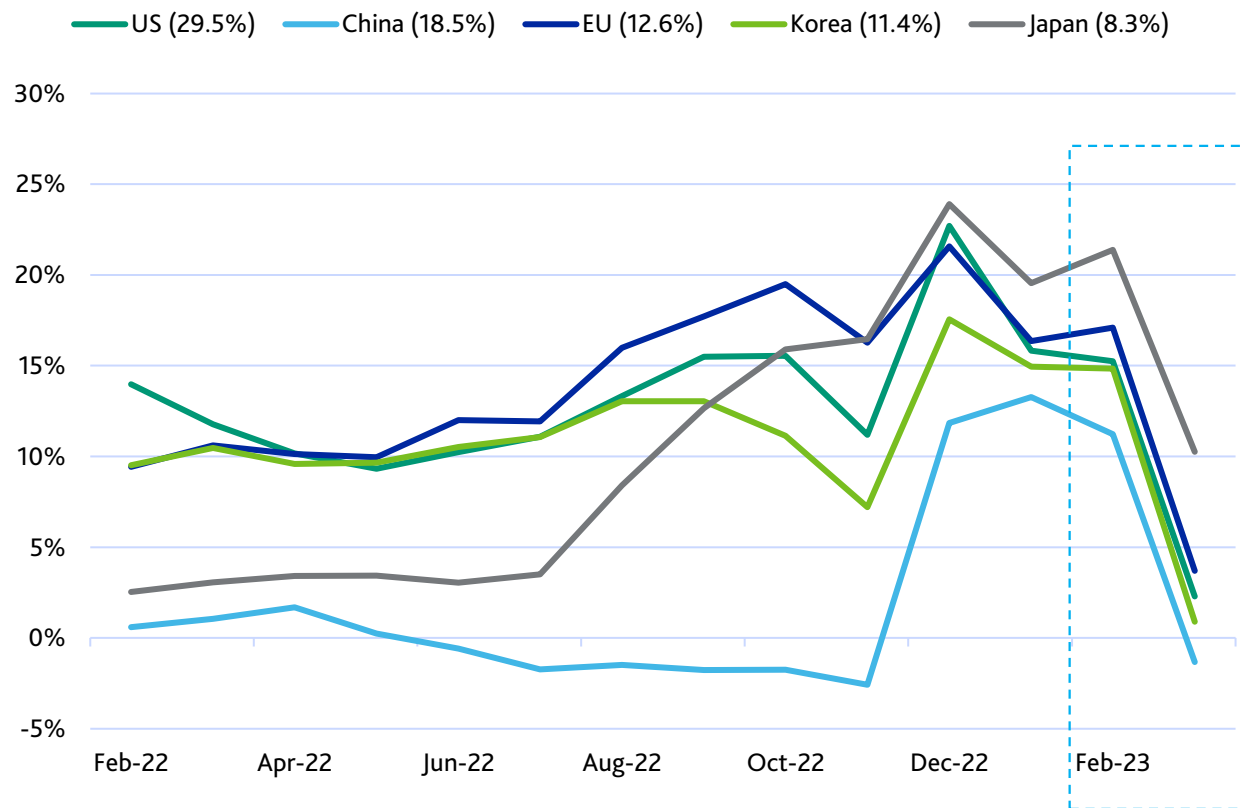
Top 5 important export products value decreased sharply in January and March – 2023 compared to the same period last year



The details % contribution of top 5 export products in total exports are presented in Appendix 1

Source: GDVC, Vietnam Investors Service

Top 5 markets of Vietnam exports (contributing 91% total exports) fell sharply in March-2023



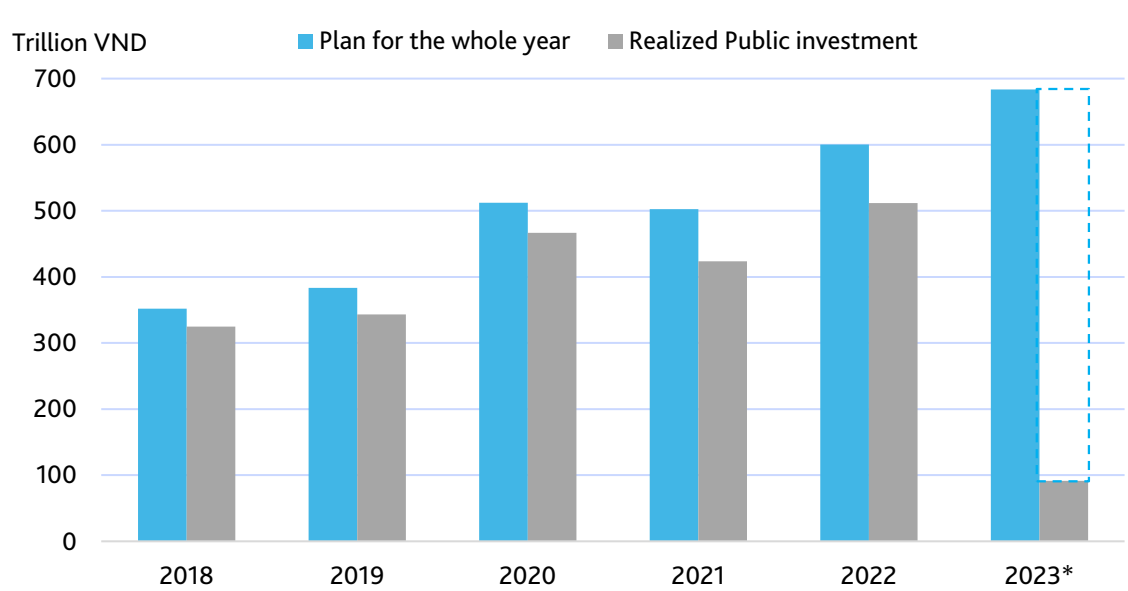
The percentages in parentheses indicates the proportion of a market in the total exports of Vietnam

Source: GDVC, Vietnam Investors Service

Government policy action will be key to support the economy

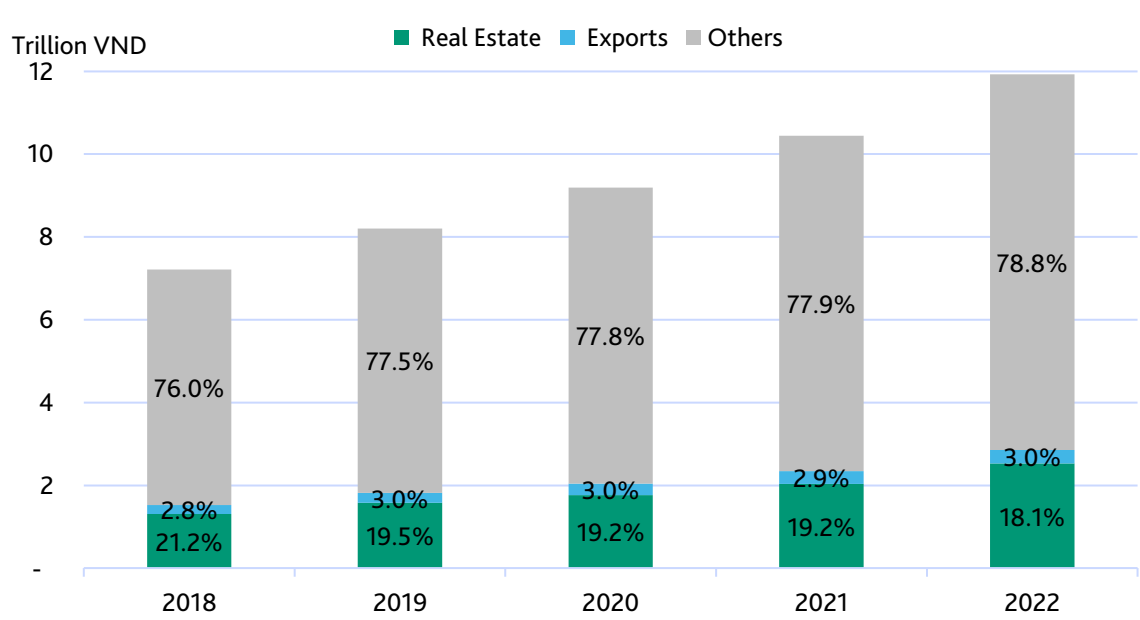
- » The National Assembly has approved the public investment plan for 2023 with a total capital of nearly VND700 trillion, increasing by VND140 trillion compared to the plan for 2022. Public investment disbursement has not met the annual target for the last consecutive 5 years, and it continued to be slow in the first quarter of 2023. Recently, the Ministry of Finance has started to support the firms by extending tax payment date and stimulate domestic demand by proposing a 2% cut in the VAT rate which we estimate would result in a USD1.5 billion in tax cuts to directly support consumers and businesses this year.
- » Although the export sector has been on priority loan package from the government since the last couple of years, the banks' loan value to local export-oriented firms is about USD14 billion – small relative to other sectors like real estate sector. Based on the target of 14-15% total credit growth rate this year, we estimate that the banking system has available credit room to increase lending to export firms by USD60 billion more in the next 3 quarters of 2023.
 - In April 2023, the State Bank of Vietnam called for the four state-owned banks to speed up the disbursement of credit package of VND120 trillion (USD5 billion) for the development of social housing projects with preferential interest rates. This credit package is part of the preferential loan packages totaling VND382 trillion (USD15.98 billion) launched by the government in March 2023 to lower financing costs and support business enterprises.

There is a budget of VND600 trillion on public investment for remaining three quarters of this year



* Realized public investment for the first quarter of 2023
 Source: GSO, Vietnam Investors Service

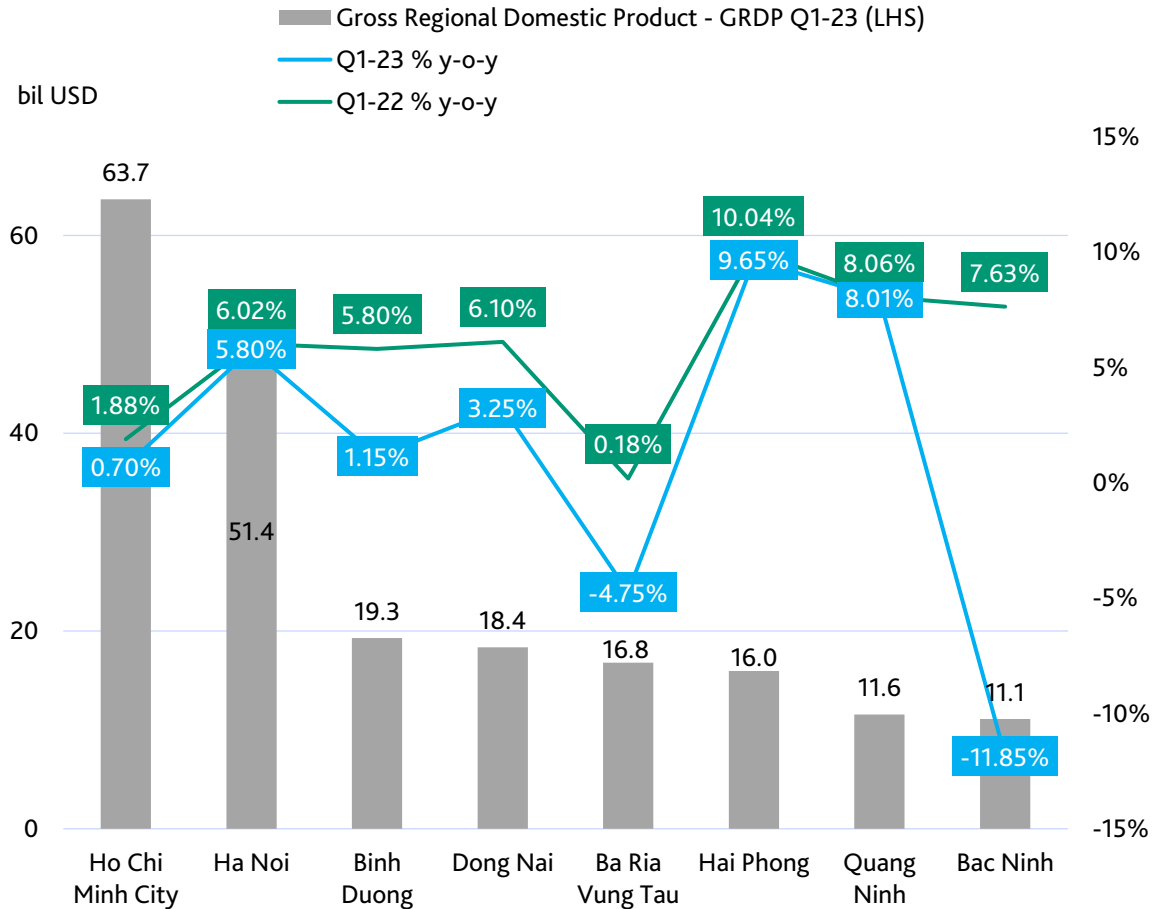
Bank loans to local export-oriented firms is about 3% of total credit



Source: State Bank of Vietnam (SBV), Vietnam Investors Service

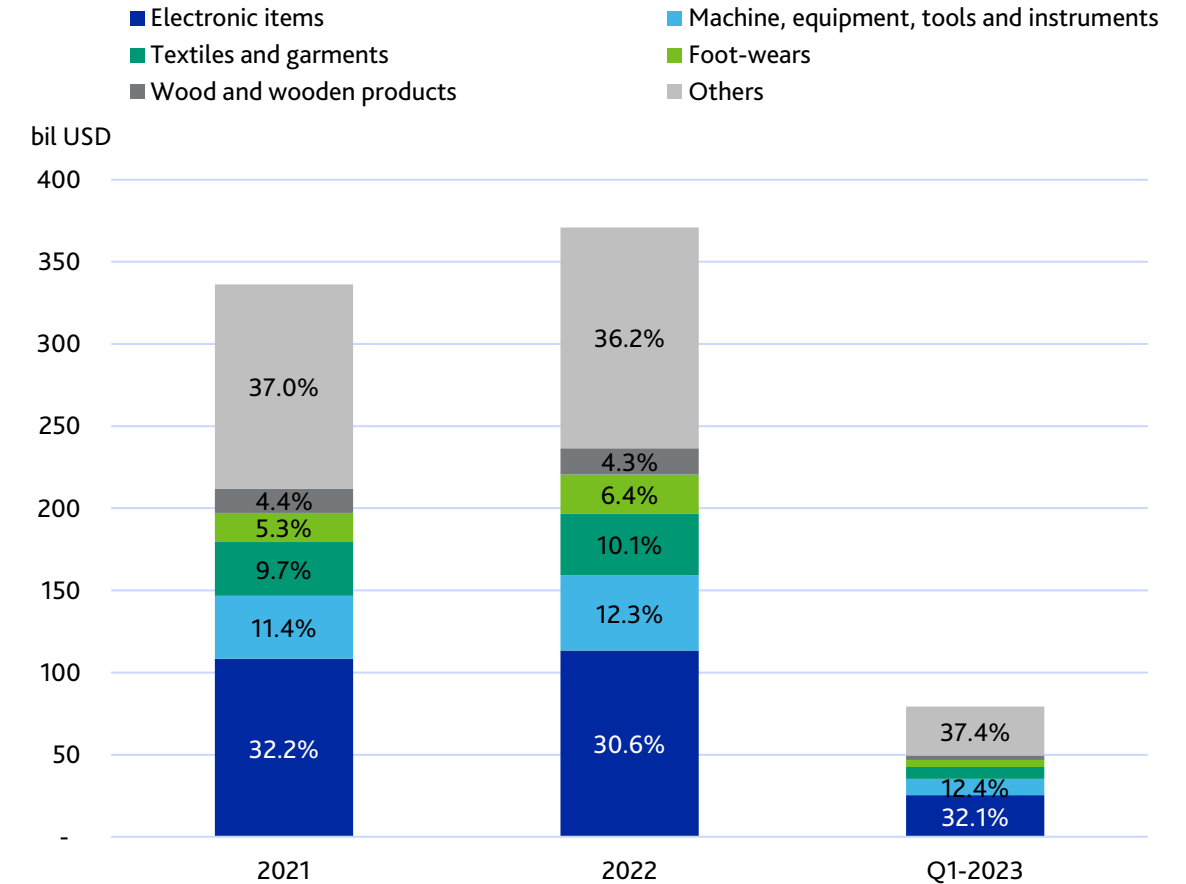
Appendix 1: The export sector in Vietnam is concentrated in a few products and industrial zones

All largest export-oriented industrial zones, such as Bac Ninh, Binh Duong, Dong Nai, Ba Ria – Vung Tau, Ho Chi Minh City, experienced low growth rate in Q1-2023



Source: GSO, Vietnam Investors Service

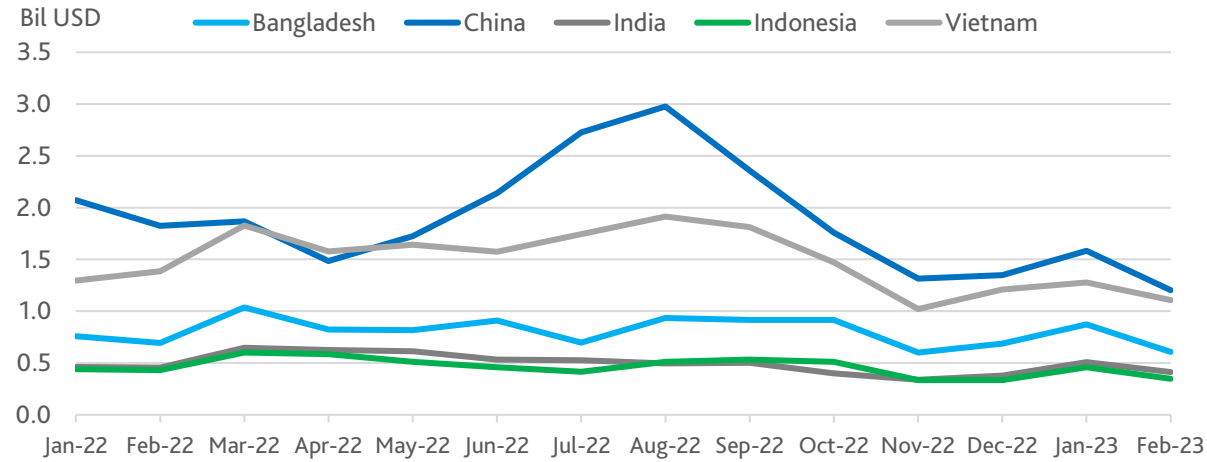
Top 5 main export products of Vietnam contribute more than 60% of exports



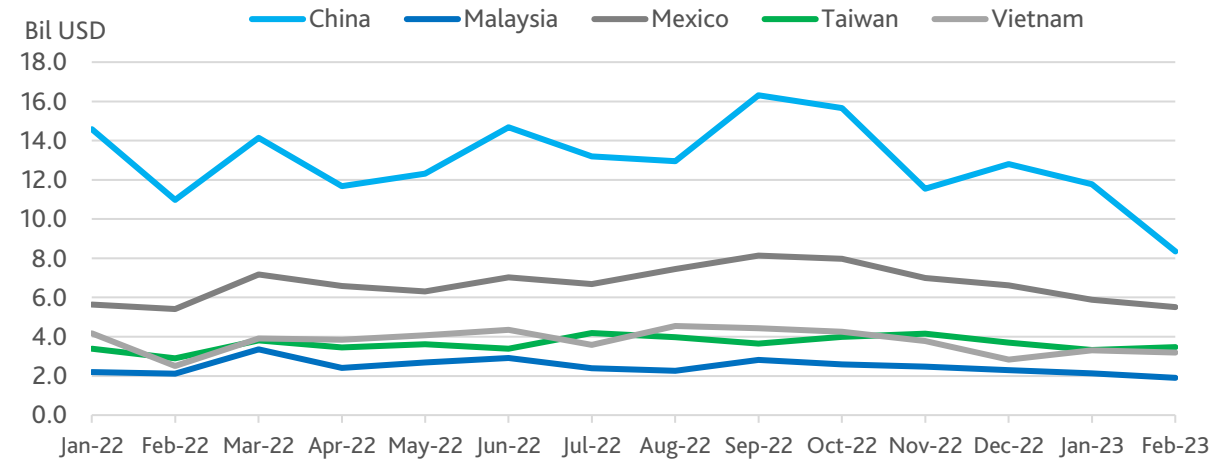
Source: GDVC, Vietnam Investors Service

Appendix 2: Data of exports (Electronics, Textiles, Leather & Footwear, and Furniture) to the United States

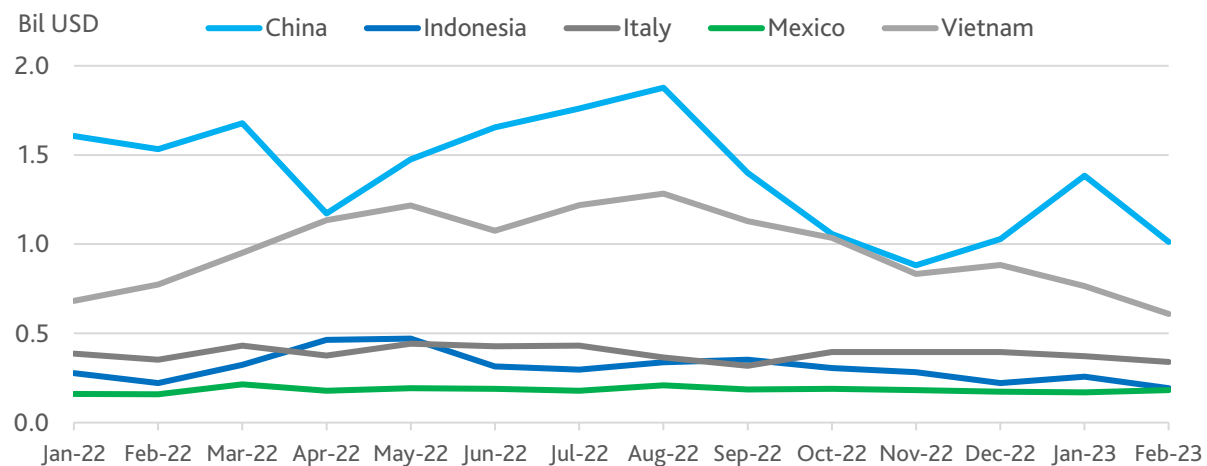
Top 5 countries export Textile products to US



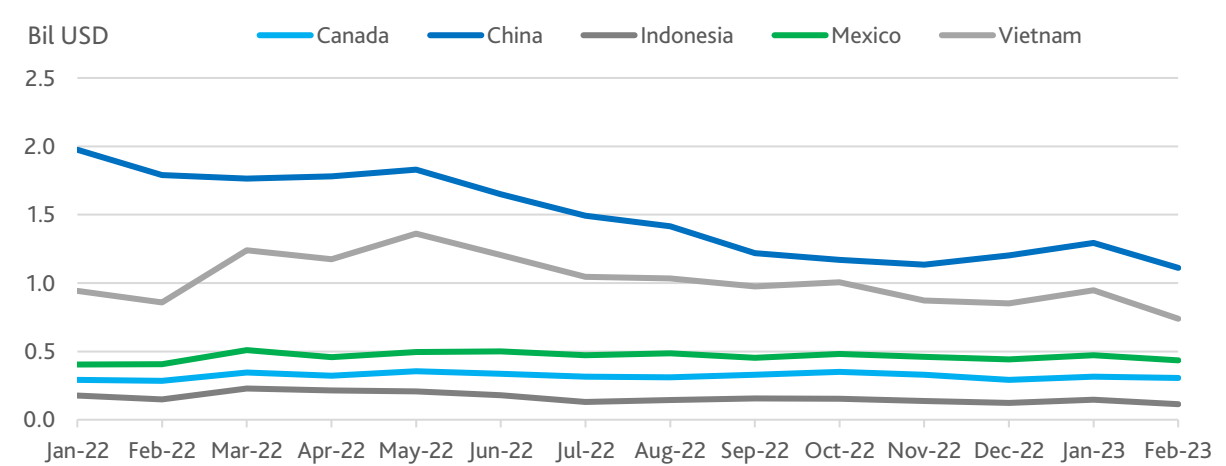
Top 5 countries export Electronic products to US



Top 5 countries export Leather & footwear products to US



Top 5 countries export Furniture products to US



Source: United States International Trade Commission (USITC), Vietnam Investors Service



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