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Business Monitor International
85 Queen Victoria Street
London
EC4V 4AB
UK
Tel: +44 (0) 20 7248 0468
Fax: +44 (0) 20 7248 0467
email: subs@businessmonitor.com
web: http://www.businessmonitor.com

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Executive Summary

BMI View: *The agriculture industry is very significant for the Vietnamese economy. In fact, Vietnam's agriculture industry (including forestry and aquaculture) contributes to more than 20% of the country's GDP and employs almost half of the country's population. While the country is looking forward to higher agriculture export earnings in 2011, we believe Vietnam will still face strong competition from neighbouring countries' cheap imports, especially for the livestock and dairy sectors. Thus, the government has pledged to invest more than VND20trn (US$1bn) in the agricultural sector in order to increase the 'value' of its exported products by at least 20% over the next ten years. This would imply lifting the quality of agricultural outputs such as coffee and rice, through better technologies.*

Key Trends:

- **Corn production growth to 2014/15: 39.7% to 6.9mn tonnes.** This will be due to current yield immaturity, which means significant gains are still available via this avenue, especially as robust local corn prices provide incentives to farmers. Also an important growth driver will be domestic consumption, especially from the livestock sector.

- **Coffee consumption growth to 2015: 54.2% to 1.6mn bags.** This will come as the Ministry of Agriculture and Rural Development (MARD) has said it hopes to boost domestic consumption to 10-15% of the national coffee crop.

- **Poultry production growth to 2014/15: 19.8% to 419,000 tonnes.** This is because rising incomes will stimulate domestic meat consumption growth (due to diet diversification) and production will increase to keep pace.

- **2011f Real GDP Growth: 6.3%** (down from 6.8% in 2010; predicted to average 7.0% from 2010 until 2015).

- **Consumer Price Inflation: 27% y-o-y in July 2011** (forecast to average 18.6% in 2011).

Industry Developments

With the domestic coffee supply crunch expected to persist until the 2011/12 the crop starts to come online in early October, we believe these developments should offer some support to prices in the near term. Coffee exports in June totalled 80,000 tonnes, 15.8% lower on a year-on-year basis, and July exports are forecast to reach 55,000 tonnes, representing a 38.2% dip from a year ago. A reason for the shortage is the fact that farmers had sold close to 90% of the harvested 2010/11 crop on the back of surging prices at the start of this year, leading to a year-on-year surge of exports by 21.7% for the first five months of the year. Approximately 40,000 tonnes of coffee deliveries have already been cancelled for July delivery. According to reports, there is currently about 200,000 tonnes of coffee, or only approximately three months' worth of coffee exports currently kept under storage in warehouses in Vietnam.

Consumers will be confronted with higher dairy product prices, especially milk powder prices in the medium term. Anecdotal reports in late March 2011 claimed that prices of imported milk products such as milk powder had risen by 18% on the back of an 8.5% Vietnamese Dong devaluation. According to the report, milk powder products from Abbott products have increased 12-18%, Similac IQ 400-gram box rose by 13% to VND215,000/box, and Similac IQ 900-gram box increased by 12% to VND437,000/box. Foreign milk firms such as **Nestlé**, **FrieslandCampina**, **3A** and **Mead Johnson** will also reportedly raise milk powder prices by an average 5-17% starting from March 1. Given the low incomes earned by the average worker, we think these milk price hikes will only place these products further out of reach of the masses and might lead to substitution effects in the short to medium term.

While we are largely optimistic about the growth prospects for the livestock industry - we forecast production output of poultry, pork and beef to grow by 19.8%, 15.1% and 52.5% respectively over our five-year forecast period - there are salient downside risks to this outlook. We highlight the three main challenges as high interest rates, a reliance on imports (which causes the livestock industry to be vulnerable to fluctuating input prices) and finally, the fragmented nature of the market.

SWOT Analysis

Vietnam Agricultural SWOT	
Strengths	▪ The natural fertility of Vietnam around the Red River Delta in the north and the Mekong River Delta in the south provides the country with a strong agricultural base. ▪ Vietnam is the world's second largest exporter of both rice and coffee. It also enjoys relatively high rice yields compared to its regional counterparts. ▪ Agricultural productivity has improved considerably since the opening up of the economy in 1986.
Weaknesses	▪ Much of Vietnam's agriculture is based on small-scale farms with poor yields in comparison to more developed international competitors. ▪ Transportation and production infrastructure is often poor, making getting crops to market difficult and negatively affecting quality.
Opportunities	▪ Since the opening up of the economy in 1986, allowing more private involvement in agriculture, yields have improved dramatically and look set to continue doing so over our forecast period to 2013. ▪ Vietnam's fast-growing population of over 80mn provides a large market for agro-food products. ▪ With BMI forecasting Vietnamese GDP per capita to grow rapidly over our forecast period to 2015, consumers will have more money to spend on food, spurring growth in agricultural production.
Threats	▪ Poor knowledge of good farming practices and hygiene standards leaves Vietnamese agriculture open to disease outbreaks of the kind that have plagued the livestock industry in recent years. ▪ The rising population and increasing industrialisation of the economy will increase competition for land use, curtailing the area available for expansion of agriculture.

Vietnam Political SWOT	
Strengths	▪ The Communist Party of Vietnam remains committed to market-oriented reforms and we do not expect major shifts in policy direction over the next five years. The one-party system is generally conducive to short-term political stability. ▪ Relations with the US have witnessed a marked improvement, and Washington sees Hanoi as a potential geopolitical ally in South East Asia.
Weaknesses	▪ Corruption among government officials poses a major threat to the legitimacy of the ruling Communist Party. ▪ There is increasing (albeit still limited) public dissatisfaction with the leadership's tight control over political dissent.
Opportunities	▪ The government recognises the threat that corruption poses to its legitimacy, and has acted to clamp down on graft among party officials. ▪ Vietnam has allowed legislators to become more vocal in criticising government policies. This is opening up opportunities for more checks and balances within the one-party system.
Threats	▪ Macroeconomic instabilities in 2010 and 2011 are likely to weigh on public acceptance of the one-party system, and street demonstrations to protest economic conditions could develop into a full-on challenge of undemocractic rule. ▪ Although strong domestic control will ensure little change to Vietnam's political scene in the next few years, over the longer term, the one-party-state will probably be unsustainable. ▪ Relations with China have deteriorated over recent years due to Beijing's more assertive stance over disputed islands in the South China Sea and domestic criticism of a large Chinese investment into a bauxite mining project in the central highlands, which could potentially cause widescale environmental damage.

Vietnam Economic SWOT	
Strengths	▪ Vietnam has been one of the fastest-growing economies in Asia in recent years, with GDP growth averaging 7.2% annually between 2000 and 2010. ▪ The economic boom has lifted many Vietnamese out of poverty, with the official poverty rate in the country falling from 58% in 1993 to 20% in 2004.
Weaknesses	▪ Vietnam still suffers from substantial trade, current account and fiscal deficits, leaving the economy vulnerable to global economic uncertainties in 2011. The fiscal deficit is dominated by substantial spending on social subsidies that could be difficult to withdraw. ▪ The heavily-managed and weak dong currency reduces incentives to improve quality of exports, and also serves to keep import costs high, thus contributing to inflationary pressures.
Opportunities	▪ WTO membership has given Vietnam access to both foreign markets and capital, while making Vietnamese enterprises stronger through increased competition. ▪ The government will in spite of the current macroeconomic woes, continue to move forward with market reforms, including privatisation of state-owned enterprises, and liberalising the banking sector. ▪ Urbanisation will continue to be a long-term growth driver. The UN forecasts the urban population to rise from 29% of the population to more than 50% by the early 2040s.
Threats	▪ Inflation and deficit concerns have caused some investors to re-assess their hitherto upbeat view of Vietnam. If the government focuses too much on stimulating growth and fails to root out inflationary pressure, it risks prolonging macroeconomic instability, which could lead to a potential crisis. ▪ Prolonged macroeconomic instability could prompt the authorities to put reforms on hold, as they struggle to stabilise the economy.

Vietnam Business Environment SWOT	
Strengths	▪ Vietnam has a large, skilled and low-cost workforce, that has made the country attractive to foreign investors. ▪ Vietnam's location - its proximity to China and South East Asia, and its good sea links - makes it a good base for foreign companies to export to the rest of Asia, and beyond.
Weaknesses	▪ Vietnam's infrastructure is still weak. Roads, railways and ports are inadequate to cope with the country's economic growth and links with the outside world. ▪ Vietnam remains one of the world's most corrupt countries. Its score in Transparency International's 2010 Corruption Perceptions Index was 2.7, placing it in 22nd place in the Asia-Pacific region.
Opportunities	▪ Vietnam is increasingly attracting investment from key Asian economies, such as Japan, South Korea and Taiwan. This offers the possibility of the transfer of high-tech skills and knowhow. ▪ Vietnam is pressing ahead with the privatisation of state-owned enterprises and the liberalisation of the banking sector. This should offer foreign investors new entry points.
Threats	▪ Ongoing trade disputes with the US, and the general threat of American protectionism, which will remain a concern. ▪ Labour unrest remains a lingering threat. A failure by the authorities to boost skills levels could leave Vietnam a second-rate economy for an indefinite period.

Supply Demand Analysis

Vietnam Sugar Outlook

BMI Supply View: Vietnam's sugar industry suffers from a lack of technological advancement and investment as a result of cheap imports and competition from higher quality, more efficient producers. The area harvested for sugar reached a 40-year high of 320,000 hectares in 2001/02, but has not returned to that level in subsequent seasons. To mitigate the fall in area planted, sugarcane yields have increased by 21% from 1997/98 to 2007/08. For 2010/11 we expect production to grow by a marginal 0.3% year-on-year. Over the forecast period, we expect sugar production to increase by 4.9% to 1.2mn tonnes, driven by stronger domestic demand and an increase in yields. Despite this, the country will likely remain a net sugar importer, as demand is expected to outstrip supply. The US Department of Agriculture forecasts sugar imports into Vietnam to rise again in 2011/12 to 1.5mn tonnes, after a fall to 1.4mn tonnes in 2010/11.

BMI Demand View: Increasing the country's import dependency, Vietnamese sugar consumption is forecast to continue climbing 14.3% to 2015 to reach 1.7mn tonnes. We therefore maintain our bullish Vietnamese economic growth outlook for the medium term. This positive outlook is bolstered by the robust sales figures for sugar confectionary and soft drinks of 41.3% and 53.6% growth (in local currency terms) respectively over our forecast period.

Table: Vietnam Sugar Production & Consumption, 2010-2015

	2010	2011	2012	2013	2014	2015
Sugar Production, '000 tonnes [1,2]	1,119.0	1,122.7	1,133.6	1,145.8	1,159.2	1,174.0
Sugar Consumption, '000 tonnes [2]	1,492.7	1,535.2	1,574.0	1,615.2	1,658.9	1,705.4

Notes: [f] BMI forecasts. [1] In all instances year indicates data for harvest year ending that calendar year i.e. 2011 = 2010-11; Sources: [2] USDA, BMI.

Full Potential Not Yet Realised

The industry is now in a state of transition as international agreements are forcing Vietnam to cut protection. Under the ASEAN Free Trade Area (AFTA) agreement, Vietnam has to reduce tariffs on sugar imports from ASEAN members to a maximum of 5% by 2011. This will expose the country to imports from Thailand, a major sugar exporter. Tariffs on imports from other countries will also have to be reduced by 2011 in line with the government's commitments to the WTO.

The government has been trying to increase efficiency in the sector to prepare it for greater integration with the world economy by encouraging farmers to plant high-yielding cane varieties and improving the mechanisation of cane production. In 2007, the government presented a plan for the development of the sector to 2010 and further to 2020.

The plan aimed for annual production of 1.5mn tonnes of sugar from 1.9mn tonnes of sugar cane by 2010. Obviously this was not met. The plan had envisioned 300,000 hectares (ha) planted to sugarcane and yields of 65 tonnes/ha. Average yields are still some way off this level and cane production in 2009 is estimated at around only 10mn tonnes, though it stood at 12.1mn tonnes in 2008. By 2020, the plan is aiming for production of 2.1mn tonnes to be achieved through increasing cane yields and the sugar content of cane.

To achieve these ambitious aims the government has put a moratorium on the building of new mills so that technology in existing mills can be improved. Provincial authorities will assist mills in organising the zones where their cane will come from and assist in improving farming practices. Financially, the government has committed to investing in importing and propagating new cane varieties and improving infrastructure such as reservoirs and irrigation canals.

While government support for the sector is encouraging, we believe it will struggle to produce enough sugar for domestic consumption. Once tariffs are lowered by 2011, it is likely that the government will have to support the sector by other means to keep production on course, as it is unlikely that Vietnamese-produced sugar will be able to compete with imports by then.

French shipping service company **Bourbon SA** has recently sold off its 69% stake in local sugar **company Sucrerie de Bourbon Tay Ninh** to a group of Vietnamese investors for EUR34mn (USD483mn) . **BMI** believes that as the company is now in the hands of local producers, there could be more incentive to improve efficiencies and strengthen the falling revenues of the company.

Table: Vietnam Sugar Production & Consumption, 2006-2011

	2006	2007	2008	2009	2010	2011
Sugar Production, '000 tonnes [1,2]	930.0	1,100.0	1,220.0	1,000.0	1,119.0	1,122.7
Sugar Consumption, '000 tonnes [2]	1,300.0	1,300.0	1,400.0	1,450.0	1,492.7	1,535.2

Notes: [f] BMI forecasts. [1] In all instances year indicates data for harvest year ending that calendar year i.e. 2011 = 2010-11; Sources: [2] USDA, BMI.

Risks To Outlook

Risks to consumption growth remain. We have factored in the effects of monetary tightening on spending on non-essential food and drink purchases, such as soft drinks and confectionery (both of which fell by 4% y-o-y in 2009), but were this reduction to be exacerbated by a secondary slowdown in the Vietnamese economy - perhaps due to reduced investment as a result of sluggish US and eurozone growth - our sugar consumption forecasts are unlikely to be achieved.

If government support for sugar production proves ineffective and mill owners are not able to increase profitability, the sector could struggle when import tariffs on sugar are reduced in 2012. Though it is not our core scenario, this could possibly see output fall later in our forecast period.

Vietnam Livestock Outlook

BMI Supply View: Within the Vietnamese livestock industry, pig farming is by far the most significant sector, with pork production comprising about two thirds of total meat production in 2010/11. For 2010/11, we expect poultry production to grow by a healthy 3.0% year-on-year to 360,600 tonnes. Beef and veal and pork production should also grow by 8.7% and 2.5% to reach 307,000 tonnes and 1.9mn tonnes respectively.

Despite going through hard times over recent years with disease outbreaks, soaring input costs and competition from cheap imports, we expect Vietnam's livestock production to see strong growth, led by pork production, over the medium term. This is because rising incomes will stimulate domestic meat consumption growth (due to diet diversification) and production will increase to keep pace. That said, we foresee the country to continue being a net importer of livestock over our forecast period. We further elaborate on the challenges facing the sector below.

As a result, we expect poultry production to rise by 19.8% to 419,300 tonnes over our forecast period to 2014/15 and for pork production to grow 15.1% from its 2010 level to 2.2mn tonnes over the same period. The country will still remain reliant on pork imports to satiate demand. Beef production will remain the least significant of Vietnam's livestock sectors, but will also see good growth over our forecast period, with production expected to rise by 52.6% to 430,700 tonnes.

BMI Demand View: Meat consumption in Vietnam has risen significantly over the last decade, with per-capita consumption rising by 86% from 1999 to 2009 to reach 28kg per year. Once again, buoyed by strong income as well as population growth, we see healthy demand growth for livestock over the forecast period to 2015. Poultry consumption will see the strongest growth at 54.9% to 895,000 tonnes, while pork (from a higher base) and beef consumption will increase by 15.4% and 41.5% respectively. Indeed, we foresee pork consumption to reach 2.2mn tonnes, while beef consumption will reach 766,800 tonnes. **BMI** foresees pork consumption to continue being the dominant meat consumed, comprising more than 60% of total meat consumed. Indeed, a household survey done in 2010 revealed that 40% of household meat expenditure comprised of pork, with preference given to fresh pork, as compared to chilled or processed meat.

Table: Vietnam Poultry Production & Consumption, 2010-2015

	2010	2011f	2012f	2013f	2014f	2015f
Poultry Production, '000 tonnes [1]	350.00	360.60	376.70	392.10	406.40	419.30
Poultry Consumption, '000 tonnes [1]	577.90	628.50	695.20	762.40	829.20	895.00

Notes: [f] BMI forecasts. Sources: [1] USDA, BMI.

Table: Vietnam Pork Production & Consumption, 2010-2015

	2010	2011f	2012f	2013f	2014f	2015f
Pork Production, '000 tonnes [1]	1,884.40	1,930.95	2,005.76	2,065.36	2,119.86	2,168.70
Pork Consumption, '000 tonnes [1]	1,918.83	1,958.38	2,027.46	2,093.24	2,155.34	2,213.33

Notes: [f] BMI forecasts. Sources: [1] USDA, BMI.

Table: Vietnam Beef & Veal Production & Consumption, 2010-2015

	2010	2011f	2012f	2013f	2014f	2015f
Beef & Veal Production, '000 tonnes [1]	282.30	307.00	336.00	364.60	396.10	430.70
Beef & Veal Consumption, '000 tonnes [1]	542.00	568.20	619.20	669.60	718.90	766.80

Notes: [f] BMI forecasts. Sources: [1] USDA, BMI.

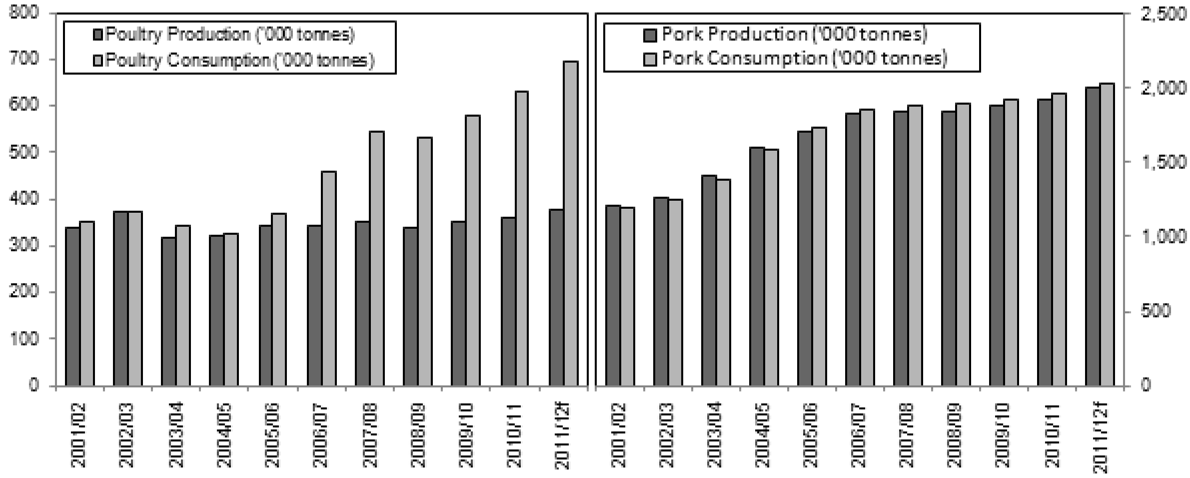
Livestock Industry Faces Crucial Challenges In Medium Term

The Vietnam's commercial animal feed sector has grown at an annual rate of about 16% between 2005 and 2009, according to the Ministry of Agriculture and Rural Development. This reflects the strong growth in livestock production in the country. We estimate that poultry and beef production grew 8.7%, 17.6% and 28.3% respectively during the same period, boosted by consolidation of the industry and increased industrial production of meat. This year alone, the livestock industry aims to raise its production value by 7.5-8%, and at the same time, increase the ratio of livestock production from the current 28% to 30% of Vietnam's total agricultural output.

While we are largely optimistic about the growth prospects for this industry - we forecast production output of poultry, pork and beef to grow by 19.8%, 15.1% and 52.5% respectively over our five-year forecast period - there are salient downside risks to this outlook. We highlight the three main challenges as high interest rates, a reliance on imports (which causes the livestock industry to be vulnerable to fluctuating input prices), and finally, the fragmented nature of the market.

Growing Poultry Deficit

Vietnam - Selected Livestock Estimates, 000 tonnes



Source: BMI

High Interest Rates Push Loans Out of Reach For Farmers

Although it is mandatory for local banks to prioritise agricultural loans as ordered by the central bank, the higher cost of loans this year led farmers to put off borrowing to expand their farms. According to reports, many pig farmers were badly in need of capital, but the banks had yet to provide them any support, while they had to cope with rising input costs.

This year alone, the State Bank of Vietnam has hiked interest rates five times, almost doubling the rate from 7.5% early this year to the level of 14% as of mid-September. Agriculture loans are between 16.0% and 21.5%, which are still considerably higher than previous years. For example, branches of the Vietnam Bank for Agriculture and Rural Development in some Mekong Delta provinces have also announced lending rates of 18-19.5% a year for agricultural households.

With farmers being squeezed by rising input costs, higher interest rates are likely to curb expansion of domestic farms and place a strain on pork production in the short-to-medium term, especially after the foot-and-mouth disease and blue ear disease epidemics, which significantly damaged the pork industry in 2009 and 2010. Nevertheless, given **BMI**'s expectations for monetary easing to come in H112 (*see 'Inflationary Pressures Remain Stubborn But Disinflation View Still In Play', August 29*), lower policy rates in 2012 could mitigate some of the production constraints faced by livestock farmers in 2011.

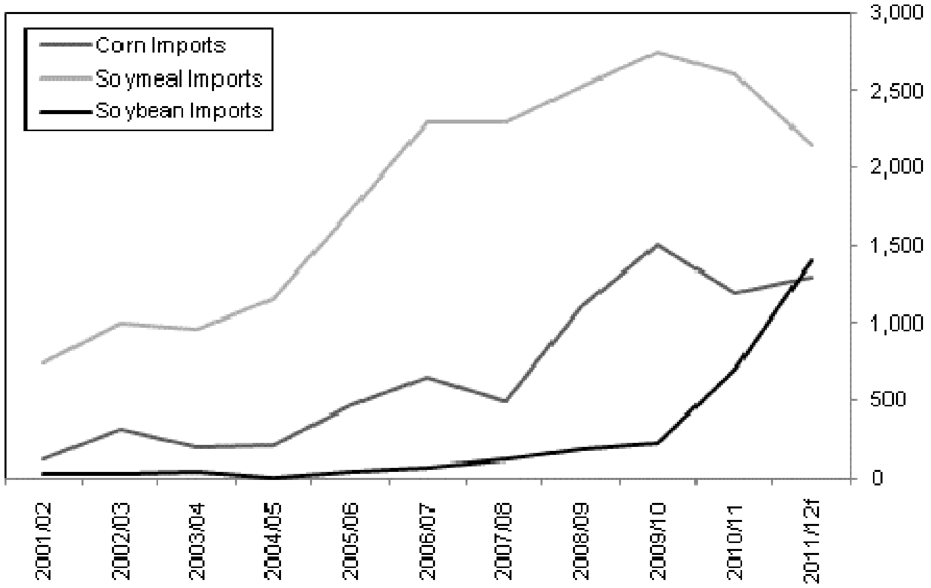
Reliance On Imports Increases Vulnerability To Price Fluctuations

Given that the dependency on imports of grains is expected to continue growing over the long term, this dynamic makes local livestock farmers highly vulnerable to fluctuations in international grain prices, which contributes 70% in producing animal feed. Import dependency for corn, for example, rose from 5.2% in 2005 to 19.0% in 2010. According to the Vietnam Animal Husbandry Department, animal feed manufacturers have increased their prices up to a dozen times since early 2011, pushing current prices 40% higher year-on-year. Higher animal feed costs, coupled with a shortage in output, have pushed the prices of live pigs up by 70% to 100% since the start of 2011, costing VND64,000-70,000/kg.

With consumption of meat growing steadily in Vietnam as incomes rise, we also expect imports of grain for animal feed to continue increasing. Unless the government boosts domestic production of these grains or improves storage conditions, the country should remain largely vulnerable to grain price fluctuations in the coming years.

Increasing Domestic Feed Production

Vietnam - Imports of Soybean, Soymeal & Corn Feed, 000 tonnes



Source: USDA, BMI

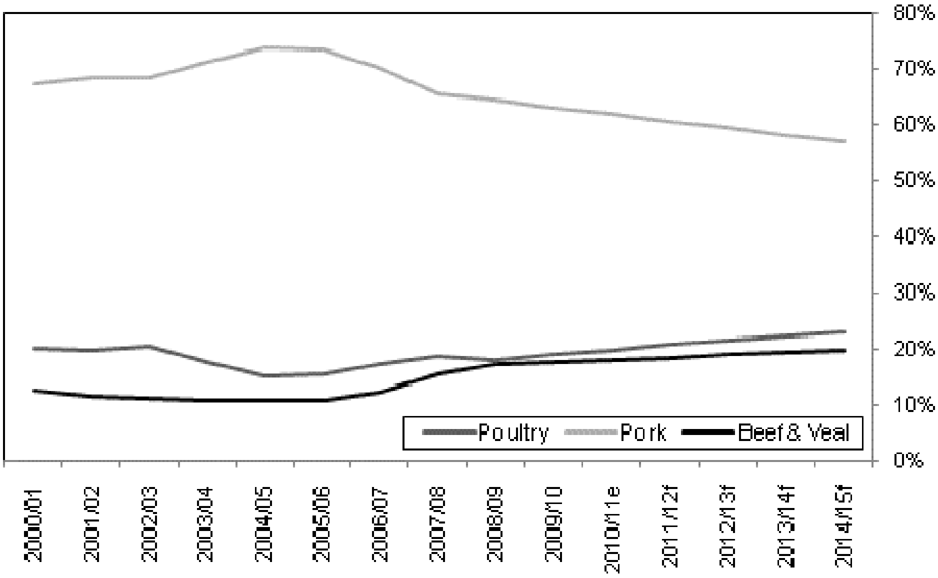
Fragmented Domestic Feed Industry Disadvantages Local Companies To Foreign Players

The domestic livestock industry is made up of mainly small-scale or backyard farm operations, which have poor hygiene standards and are susceptible to epidemics. The Vietnamese livestock sector is constantly plagued by disease outbreaks due to a lack of proper sanitation facilities in farms and meat production facilities. Since 2009, the country's livestock sector has experienced multiple rounds of avian influenza, H5N1 bird flu virus, foot-and-mouth disease and porcine reproductive respiratory syndrome, also known as blue ear disease. Disease outbreaks will constantly feature as a challenge to the industry as long as it remains fragmented and low in technology and health standards.

The fragmented nature of the industry has thus resulted in foreign companies, with their sophisticated and larger scale production facilities, dominating livestock production in Vietnam. In the poultry sector, for example, the three main companies dominating the landscape are China-based **CP Vietnam Livestock Corporation**, Indonesia-based **Japfa** and Malaysian company **Emivest**, supplying around 6mn chickens to the domestic market monthly, leaving hundreds of domestic firms to compete for the remaining market share.

Changing Meat Consumption Trends

Vietnam - Livestock Consumption By %



Source: BMI

It is estimated that approximately 20 of the foreign-owned feed companies control almost 70% of the Vietnamese animal feed industry and similar significant shares in the poultry and pork industry. According to reports, 30% of domestic firms have been forced out of the animal feed business as a result. Another advantage that foreign firms enjoy in the sector is that they are not subject to the high lending costs that local famers have to pay. Being able to rely on their parent companies also allows these foreign players to dig into deep pockets and purchase raw materials at lower costs in foreign currencies.

H5N1 Virus Mutation Renders Vaccination Ineffective

According to reports, a 'new type' of H5N1 bird flu virus has been found circulating the northern, coastal, and central regions. The Animal Health Department has, since 2010, been vaccinating animals found with the H5N1 virus but recent post-vaccination results suggest that the disease has mutated such that the vaccine has been rendered ineffective. Given the small area in which the disease has been reported, we do not think that the outbreak will spread to a national level though a prolonged outbreak should increased imports of the meat in the medium term.

Diseases Make Their Way Through Livestock Sector

Poultry

In common with many countries in the region, Vietnam battled with repeated

Outbreaks of highly pathogenic avian influenza (HPAI) in the first few months of 2009. Occurrences were reported across the country and by the end of March, three people had died of the disease. While the hot season in May should have seen a fall in outbreaks, the wide geographic spread of the disease was worrying. At the end of June, Vietnam was still not completely free of the disease, though most of the country had passed the 21-day period without infection to be declared clear. An outbreak in the northern province of Quang Ninh at the end of June saw 500 birds die and another 1,300 culled. In mid-July, this was the only province yet to be declared avian flu free.

With the start of the cool season in November, HPAI returned to Vietnam after being absent since June following the first incident in the northern province of Lai Chau which saw the culling of almost 2,000 birds. Outbreaks continued across the country through December. Unless effective measures can be put in place to stop the return of the disease every cool season, it will continue to be a major threat to the country's poultry producers. International help has been offered with the FAO pledging US$7mn to help the country improve preparedness. However, efforts are being hampered by the opaque nature of officialdom in the country with reports of government vets exaggerating the number of animals vaccinated to claim vaccination fees. The prevalence of small-scale 'backyard' poultry producers also makes implementing an effective system difficult. Indeed, the flu is continuing to hurt farmers, as six separate outbreaks were reported in August 2010, leading to the deaths of over 6,000 birds.

Cattle & Hogs

After experiencing a round of foot-mouth disease outbreak amongst the poultry population in H109, the same disease made a comeback in December 2010 and is still present at the time of this writing. In all, a total of 18,500 animals (mostly cattle) have been vaccinated to prevent the disease from spreading and reports of infected animals have emerged in 19 cities and provinces across the nation, with a total of approximately 700 buffaloes, cows and pigs reportedly affected.

Vietnam's pork sector is no stranger to disease either. Since the start of 2010 to October, as many as 105,023 pigs had been infected with the Blue Ear Disease (porcine reproductive respiratory syndrome; PRRS) with the government slaughtering almost half of them to prevent further spreading. To aid the farmers, the government gave out approximately US$1.30 per animal lost.

Despite this, the disease has spread to 21 other provinces in a month (mostly in southern areas of the country), including Dong Nai and Binh Phuoc, Nghe An, Cao Bang, Soc Trang, Quang Tri, Tien Giang, Lao Cai, Long An, Binh Duong, Bac Lieu, Quang Nam, Dong Nai, Binh Phuoc and Da Nang. Indeed, the spread of the disease has prompted local authorities to label the disease a pandemic. In an effort to stop the advance of the disease, local authorities have urged farmers to slaughter sick pigs immediately. The authorities have also called for tighter transport restrictions to keep the disease contained.

Table: Vietnam Poultry Production & Consumption,2006-2011

	2006	2007	2008	2009	2010	2011
Poultry Production, '000 tonnes [1]	344.00	344.00	350.00	340.00	350.00	360.60
Poultry Consumption, '000 tonnes [1]	370.00	460.00	545.00	530.00	577.90	628.50

Notes: [f] BMI forecasts. Sources: [1] USDA, BMI.

Table: Vietnam Pork Production & Consumption,2006-2011

	2006	2007	2008	2009	2010	2011
Pork Production, '000 tonnes [1]	1,713.00	1,832.00	1,850.00	1,850.00	1,884.40	1,930.95
Pork Consumption, '000 tonnes [1]	1,731.00	1,855.00	1,880.00	1,894.00	1,918.83	1,958.38

Notes: [f] BMI forecasts. Sources: [1] USDA, BMI.

Table: Vietnam Beef & Veal Production & Consumption,2006-2011

	2006	2007	2008	2009	2010	2011
Beef & Veal Production, '000 tonnes [1]	230.00	240.00	250.00	260.00	282.30	307.00
Beef & Veal Consumption, '000 tonnes [1]	258.00	329.00	448.00	509.00	542.00	568.20

Notes: [f] BMI forecasts. Sources: [1] USDA, BMI.

Risks To Outlook

Disease poses a major downside risk to our forecasts for livestock production in Vietnam. It is a particular risk for our poultry and pork output forecasts, although it could also affect our beef sector outlook.

A reduction in consumer spending, as a result of the return to more normal fiscal and monetary policy could adversely affect livestock consumption growth. Prolonged demand sluggishness would also weigh on production growth, removing as it would one of the key incentives currently available to domestic production.

Competition from cheap imports remains a risk to Vietnamese livestock farmers. Efficiency improvements are being made - as demonstrated by our robust production forecasts - and yet this risk might only be fully realised beyond 2012 once government intervention is reduced.

An upside production risk is continued government investment. If the sector continues to get investment from the government, the ensuing efficiency increases could pose upside risks to our forecasts.

Vietnam Coffee Outlook

BMI Supply View: Vietnam's coffee sector has grown significantly over the last 20 years, with yields doubling, while the area planted has expanded from 42,000 hectares to over 509,000. Vietnam is the world's biggest producer of robusta coffee, with more than 95% of its coffee output consisting of the cheaper bean and only around 2-3% of production devoted to the premium Arabica variety. The Vietnamese coffee market year runs from October to September, and harvesting takes place between November to February.

With the 2010/11 coffee harvest season over, we now turn our attention to the 2011/12 crop, for which **BMI** forecasts a 9.0% year-on-year (y-o-y) increase in production to 21.0mn bags. The main driver for this bullish forecast will be higher yields, as higher local prices encourage farmers to re-invest profits from the previous crop to improve the next harvest. Local coffee prices have risen by more than 100% y-o-y at the time of this writing. As a result, farmers are reportedly beginning to purchase more fertiliser and farming equipment such as water pumps. However, bringing new land into cultivation will be restricted, as according to the Vietnam Coffee and Cocoa Association (Vicofa), new seedlings and new land are limited. There is a high likelihood that yields could push past 2010/11 yields of 2.1 tonnes/hectare.

Out to 2014/15, we expect production growth of 27.5% to 24.3mn bags as the Vietnamese government endeavours to increase the replanting of coffee trees. However, in mid-2009, farmers were still investing in expanding the area under production rather than replanting existing trees. Work on replacing trees, many of which are more than 20 years old, will improve disease resistance and thus yields in the long term. Another growth driver will be export opportunities, given that Vietnam is also the world's largest exporter of robusta coffee. While the newly-approved national coffee stockpiling scheme is aimed to smooth out domestic price fluctuations in the coffee market over the long run and ensure a steady supply of coffee beans, we note that the results of the program have not shown any indication of the its success since its implementation in January.

BMI Demand View: Vietnam's population is predicted to grow by 5.0% from 2010-2015 and its GDP is forecast to rise at an average rate of 7.2% annually to the end of the forecast period. As GDP and population rise, spending on food and drink items like coffee should also increase. Increasing urbanisation and the spread of Western-style coffee shops should add to this trend. Indeed, coffee consumption grew impressively by 41.4% from 0.58kg/capita in 2006 to 0.82kg/capita in 2009, one of the highest growth rates out of all coffee-exporting countries over the period. We predict that consumption will rise 8.0% in 2011 to 1.1 bags. That said, we note that coffee consumption growth comes from a relatively low base and we foresee 54.2% growth to reach 1.6mn bags over our forecast period to 2015. The Ministry of Agriculture and Rural Development (MARD) has said it hopes to boost domestic consumption to 10-15% of the national coffee crop. We do not believe this will be achieved in our forecast period, but the existence of such a sizeable target underlines the apparent potential of domestic consumption.

Table: Vietnam Coffee Production & Consumption, 2010-2015

	2010	2011f	2012f	2013f	2014f	2015f
Coffee Production, '000 60kg bags [1,2]	19,083.70	19,282.87	21,019.26	22,050.02	23,151.20	24,327.87
Coffee Consumption, '000 60kg bags [3]	1,017.19	1,102.57	1,207.85	1,320.30	1,440.42	1,568.78

Notes: [f] BMI forecasts. [1] In all instances year indicates data for harvest year ending that calendar year i.e. 2011 = 2008-09; Sources: [2] USDA, Vietnam Coffee and Cocoa Association, BMI. [3] USDA, BMI.

Vietnamese Coffee Export Contract Cancellations Keep Market Tight

With the domestic coffee supply crunch expected to persist until the 2011/12 crop starts to come online in early October, we believe these developments should offer some support to prices in the near term. Coffee exports in June totalled 80,000 tonnes, 15.8% lower on a year-on-year basis, and July exports are estimated to have reached 55,000 tonnes, representing a 38.2% dip from a year ago. A reason for the shortage is the fact that farmers had sold close to 90% of the harvested 2010/11 crop on the back of surging prices at the start of 2011, leading to a year-on-year surge of exports by 21.7% for the first five months of the year. Approximately 40,000 tonnes of coffee deliveries have already been cancelled for July delivery. According to reports, there is about 200,000 tonnes of coffee, or only approximately three months' worth of coffee exports currently kept under storage in warehouses in Vietnam. Vietnam contributes to about 15% of all global (mainly robusta) coffee production.

While Vietnamese coffee exports are seasonally lower in Q2 and Q3, we note that exports of the commodity in June and July have fallen below the five-year average, underscoring the severe scarcity of the bean in the local market. This development, coupled with our recent downgrade of the Indonesian coffee crop (*see 'Lower Indonesian Coffee Output To Tighten Robusta Export Markets', July 21*), should keep the robusta coffee market tight and could serve to restrain recent moderation in global coffee prices.

Looking ahead, we maintain our forecast for the 2011/12 coffee crop to post strong growth of 9.0% to reach 21.1mn tonnes. Despite expectations of a bumper crop, we do not rule out the possibility of a replay of this export crunch next year. This is so as domestic prices are still prone to fluctuations, and as farmers are heavily leveraged, sharp swings in prices (as was the case this year) could lead to another situation where farmers sell off more of their crops than they should before the next harvest.

Coffee Hoarding Causing Delay In Shipments, Likely to Support Prices

Thinning Vietnamese coffee stocks could keep global coffee prices supported in the short term after having sold off considerably in recent trading. According to reports, about 100,000 tonnes of coffee shipments due for May delivery have been delayed due to shortages of domestic supply. This represents approximately 10% of the country's total coffee exports, based on last year's overall export volume.

A reason for the shortage is because farmers reportedly sold close to 90% of the harvested 2010/11 crop on the back of surging prices at the start of 2011, leading to a year-on-year surge of exports 21.7% for the first five months of this year. Domestic hoarding of remaining coffee stocks is a major reason for the lack of supplies for exports. F.O. Licht reports that an alleged 2.5-4.1mn 60kg bags (150,000-246,000 tonnes) are being withheld by 'rich farmers' in anticipation of higher prices.

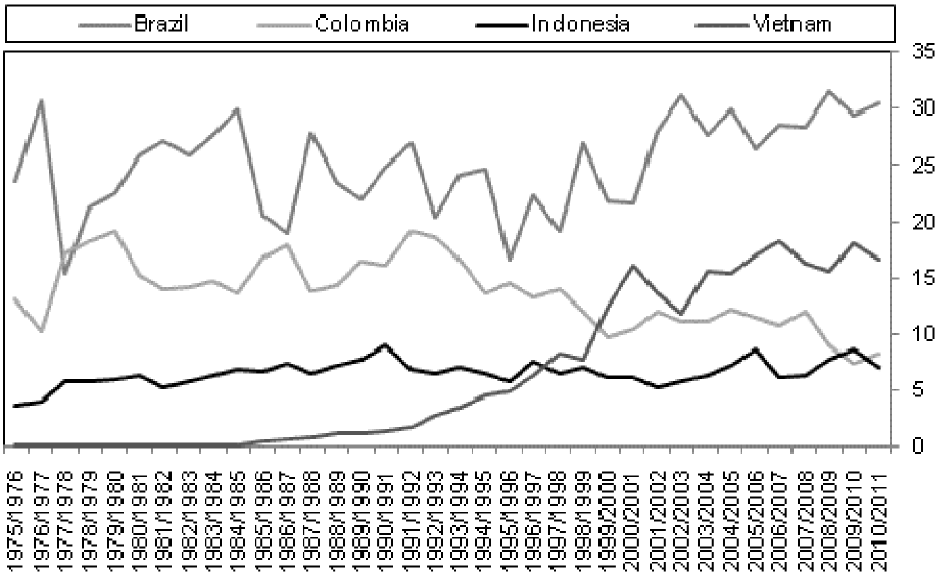
As a result of these, local exporters have turned to purchasing beans from foreign trading houses at a premium. There are also fears that these developments could have lead to a dearth in coffee exports in June and July to between 65,000 tonnes and 80,000 tonnes per month. Coffee exports for those two months came in at 100,000 tonnes and 95,000 tonnes respectively in 2010. Given that Vietnam contributes to about 15% of all global coffee production, a significant fall in robusta shipments out of Vietnam should be supportive of international coffee prices in the near term. We note that the correlation between Vietnamese domestic coffee prices in Dak Lak, a major coffee-growing region, and LIFEE Robusta coffee prices broke down considerably, with the Dak Lak/LIFFE Robusta ratio recently reaching a peak. We believe that these dynamics should provide upside risk to our currently bearish view on global coffee prices.

Increasing Foreign Competition

According to Vicofa, local exporters are facing increasing competition from foreign players in securing coffee bean stocks to be shipped out of the country. Larger foreign players are currently allowed to invest only in cultivating, processing and preserving coffee for export, as well as 'the transfer of advanced technology'. However, anecdotal evidence suggests that these companies have also been setting up unofficial networks to buy coffee stocks for export, thus depriving local exporters of coffee bean supply. **BMI** believes that any measure to curb such activity will only be a temporary solution. The fragmented structure of the industry results in local companies being less competitive than larger foreign companies in terms of economies of scale and the ability to take out business loans. We believe a greater consolidation of the local industry and better development of networks between exporters and farmers is needed, especially once the coffee market eventually opens up to foreign wholesalers in accordance with World Trade Organisation commitments.

Vietnam Catching Up

Brazil, Colombia, Indonesia, And Vietnam % Of Global Coffee Exports



Note: f = forecast, Source: USDA

Domestic Demand Could Soar But Poor Business Landscape Undermines Potential

While the vast majority of Vietnam's coffee will be destined for the export market for a long time to come, we expect domestic consumption to rise rapidly in the coming years. A 2009 survey by the Policy and Strategy Institute on Agriculture and Rural Development on coffee drinking habits in Hanoi and Ho Chi Minh City clearly reinforces this trend. Results showed that coffee consumption was highest among the young and the well-educated living in urban areas and lowest among the elderly and in rural areas. Consumption was also far higher in the south than in the north. The US Department of Agriculture has also noted that 'domestic consumption has been increasing due to the effective marketing strategies of domestic coffee companies.' Having said that, **BMI** notes that other factors undermine this otherwise positive picture.

Table: Vietnam Coffee Production & Consumption, 2006-2011

	2006	2007	2008	2009	2010	2011f
Coffee Production, '000 60kg bags [1,2]	16,335.00	19,500.00	18,000.00	16,980.00	19,083.70	19,282.87
Coffee Consumption, '000 60kg bags [3]	665.00	750.00	850.00	950.00	1,017.19	1,102.57

Notes: [f] BMI forecasts. [1] In all instances year indicates data for harvest year ending that calendar year i.e. 2011 = 2008-09; Sources: [2] USDA, Vietnam Coffee and Cocoa Association, BMI. [3] USDA, BMI.

Risks To Outlook

Higher lending rates could be a downside risk to crop yield improvements. According to a report by the State Bank of Vietnam, the financing rates for agriculture and rural areas increased by 14.5%-17.0% per year in 2010. However, we do not think that this is a significant downside risk because the agriculture sector traditionally receives a significant amount of government support, and lending to the agriculture sector is considered relatively low risk compared with other sectors. Indeed, credit tightening should only limit farmer investment to a small extent.

With Vietnam's coffee industry so dependent on exports, our forecasts for production will be heavily dependent on world demand and prices for robusta coffee. **BMI** is expecting prices to remain relatively high over the medium term, but should further demand weakness - or indeed global oversupply - cause prices to come in lower than expected, production could undershoot our growth forecast.

While Vietnam's coffee consumption forecast indicates significant growth, it is coming from a low base. This highlights the fact that despite government efforts to lift local consumption, coffee remains a luxury, discretionary item. Its status leaves it exposed to any period of reduced consumer confidence resulting from government monetary normalisation or a secondary economic slowdown. Such a scenario would likely see our consumption growth forecast missed.

Vietnam Dairy Outlook

BMI Supply View: Vietnamese dairy consumption has expanded significantly in the last 15 years, driven by relatively large increases in domestic consumption, as well as rising incomes which have fostered increased milk consumption. In fact, per-capita milk consumption in Vietnam has virtually doubled between 2000 and 2009 to 12kg per person per year. Despite this increase, the country remains below the regional average of 65kg. Though there has been an increase in milk production over the years, the country produces neither cheese nor butter. Condensed milk and yoghurt are also highly popular dairy products in the country. We expect the country to be increasingly reliant on dairy imports to meet its domestic needs.

In 2010/11 we foresee milk production growth of 7.2% to reach 315,500 tonnes. Out to 2014/15, we are forecasting Vietnamese fluid milk production growth of 39.5% to 410,700 tonnes. Dramatic increases in cattle numbers and increased public and private sector investment, in an effort to reduce the country's growing import dependency, will be the main boost to strong growth. Commercialisation will also play a key role, as larger, more efficient farms come to play a greater part in total milk production. A sustained period of high global milk prices - thanks to rising global demand and supply sluggishness - will also prove production-supportive and encourage producers to be more long-term in their approach to cattle farming. Finally, the sector should benefit from the continued increase in yields, which have been rising over the last decade by almost 130% and should continue to do so given the new private investments in the sector.

BMI Demand View: Vietnamese dairy consumption growth will remain strong over our forecast period to 2015. Strong economic growth will filter through into rising disposable incomes, pushing up demand for non-essential foodstuffs. Through to 2015, we expect fluid milk consumption growth of 31.4% to 238,600 tonnes, while demand for butter, cheese and whole milk powder will soar 73.1%, 192.9% and 3.1% respectively, albeit from a far lower base. Increased urbanisation, increased home ownership of Western goods and the ongoing spread of modern, organised retail will all prove supportive of strong dairy consumption growth, even if the forecast higher global dairy prices limits the growth outlook to some extent. Indeed, **BMI**'s forecasts for GDP per capita growth of 114% from US$1,160 in 2010 to US$2,484 in 2015 serves to reinforce our bullish outlook.

Table: Vietnam Milk Production & Consumption, 2010-2015

	2010	2011f	2012f	2013f	2014f	2015f
Milk Production, '000 tonnes [1,2]	294.4	315.5	339.6	363.4	387.2	410.7
Liquid Milk Consumption, '000 tonnes [3]	181.6	190.7	198.3	209.7	223.8	238.6

Notes: [f] BMI forecasts. [1] In all instances year indicates data for harvest year ending that calendar year i.e. 2011 = 2008-09; Sources: [2] General Statistics Office of Vietnam, BMI. [3] FAPRI, BMI.

Table: Vietnam Butter Production & Consumption, 2010-2015

	2010	2011f	2012f	2013f	2014f	2015f
Butter Production, '000 tonnes [1]	0.0	0.0	0.0	0.0	0.0	0.0
Butter Consumption, '000 tonnes [1]	11.7	12.8	14.4	16.2	18.1	20.3

Notes: [f] BMI forecasts. Sources: [1] FAPRI, BMI.

Table: Vietnam Cheese Production & Consumption, 2010-2015

	2010	2011f	2012f	2013f	2014f	2015f
Cheese Production, '000 tonnes [1]	0.0	0.0	0.0	0.0	0.0	0.0
Cheese Consumption, '000 tonnes [1]	4.4	5.3	6.7	8.3	10.3	12.8

Notes: [f] BMI forecasts. Sources: [1] FAPRI, BMI.

Table: Vietnam Whole Milk Powder Production & Consumption, 2010-2015

	2010	2011f	2012f	2013f	2014f	2015f
Whole Milk Powder Production, '000 tonnes [1]	0.0	0.0	0.0	0.0	0.0	0.0
Whole Milk Powder Consumption, '000 tonnes [1]	33.2	34.8	34.6	34.4	34.3	34.2

Notes: [f] BMI forecasts. Sources: [1] FAPRI, BMI.

Consumers Struggling With High Milk Prices

Consumers will be confronted with higher dairy product prices, especially milk powder prices in the medium term. Anecdotal reports in late March 2011 claimed that prices of imported milk products such as milk powder had risen by 18% on the back of an 8.5% Vietnamese Dong devaluation. According to the report, milk powder products from **Abbott** products have increased 12-18%, **Similac** IQ 400-gram box rose by 13% to VND215,000/box, and Similac IQ 900-gram box increased by 12% to VND437,000/box. Some foreign milk firms with the likes of **Nestlé**, **Frisland Campina**, **3A** and **Mead Johnson** will also reportedly raise milk powder prices by an average 5-17% starting from March 1. Given the low incomes earned by the average worker, we think these milk price hikes will only place these products further out of reach of the masses and might lead to substitution effects in the short to medium term.

Production To Benefit From Private Sector Investment

Since the opening up of the economy in 1986, there has been considerable change in the structure of the Vietnamese dairy industry. The contribution of state farms, which were previously responsible for almost all milk production, has fallen to around just 5%, with the other 95% of milk production coming mainly from small- and medium-sized private farms. Doi Moi, as the restructuring of the economy is known, has also led to the emergence of a highly consolidated private milk collection and processing sector, within which **TH Milk** plays a dominant role.

To exploit the rewards on offer in the country's dairy sector, **Vinamilk** has reported in August 2010 that it had started construction on a US$120mn milk factory in the southern Binh Duong province . We believe Vinamilk's expansion on its production capacity will allow Vietnam to reduce its import dependency gradually over the long term. The new factory will have a capacity of 400mn litres of milk per year when it becomes operational in 2012, and is expected to double its capacity by 2017. The company is also planning to increase its stock of milk cows to 80,000, which will allow it to boost its milk supply by 1.3mn litres a day.

This was followed by a September announcement by Vinamilk that it has invested in acquiring a 19.3% stake in New Zealand's **Miraka Limited** , in order to ease domestic milk supply shortages. Vinamilk's initial investment will be of NZD121mn (US$88.2mn) in a new Miraka dairy processing plant, which has commenced operations in August 2011, and has a production capacity of up to 32,000 tonnes of milk powder annually. While this is the company's first international investment, it is not expected to be the last, with Vinamilk stating that it is on the lookout for further international investment opportunities. On the back of this statement, in October it was reported by Food Production Daily that German food processor GEA won a EUR30mn (US$41.6mn) contract with Vinamilk. The deal will see **GEA** use dairy processing equipment to produce baby milk formula. When production starts in 2012, Vinamilk will use the output to serve both the export market and the Vietnamese domestic market.

Vinamilk is not the only dairy major ramping up local production. In May 2010, it was announced that Dutch dairy cooperative Royal Friesland Campina is to invest US$12mn in the expansion of production capacity at a factory in Vietnam. The company hopes to meet the growing demand for dairy products with its Dutch Lady, YoMost and Friso brands. The factory in Binh Duong is scheduled to be fully operational by the end of 2012. Meanwhile, New Zealand-based Fonterra has also been ramping up its domestic production and exploring new regional export markets, including Vietnam.

Table: Vietnam Milk Production & Consumption, 2006-2011

	2006	2007	2008	2009	2010	2011f
Milk Production, '000 tonnes [1,2]	216.0	234.4	262.2	283.4	294.4	315.5
Liquid Milk Consumption, '000 tonnes [3]	158.8	127.6	158.4	175.1	181.6	190.7

Notes: [f] BMI forecasts. [1] In all instances year indicates data for harvest year ending that calendar year i.e. 2011 = 2008-09; Sources: [2] General Statistics Office of Vietnam, BMI. [3] FAPRI, BMI.

Table: Vietnam Butter Production & Consumption, 2006-2011

	2006	2007	2008	2009	2010	2011f
Butter Production, '000 tonnes [1]	0.0	0.0	0.0	0.0	0.0	0.0
Butter Consumption, '000 tonnes [1]	11.1	10.8	10.8	10.8	11.7	12.8

Notes: [f] BMI forecasts. Sources: [1] FAPRI, BMI.

Table: Vietnam Cheese Production & Consumption, 2006-2011

	2006	2007	2008	2009	2010	2011f
Cheese Production, '000 tonnes [1]	0.0	0.0	0.0	0.0	0.0	0.0
Cheese Consumption, '000 tonnes [1]	2.8	2.9	3.1	3.8	4.4	5.3

Notes: [f] BMI forecasts. Sources: [1] FAPRI, BMI.

Table: Vietnam Whole Milk Powder Production & Consumption, 2006-2011

	2006	2007	2008	2009	2010	2011f
Whole Milk Powder Production, '000 tonnes [1]	0.0	0.0	0.0	0.0	0.0	0.0
Whole Milk Powder Consumption, '000 tonnes [1]	34.4	33.1	33.1	33.1	33.2	34.8

Notes: [f] BMI forecasts. Sources: [1] FAPRI, BMI.

Risks To Outlook

Higher than currently forecast dairy prices in 2010 and 2011 (either owing to supply shortages or the quicker than expected return of global demand) would negatively impact Vietnamese consumption growth in the short term, putting dairy goods beyond the reach of the average consumer.

Another downside production risk is that another economic slowdown on the back of fiscal and monetary tightening would weigh on our consumption growth forecasts, as it would force consumers to cut back on their discretionary spending.

Finally, the lack of a national quality control body for dairy products will continue to place downside risks on our production and consumption forecasts, as it places the dairy industry at risk of a similar scandal at home, which would further tar the image of dairy products in Vietnam.

Vietnam Grains Outlook

BMI Supply View: Vietnamese corn production is forecast to reach 5.3mn tonnes in 2010/11, a 6.9% year-on-year (y-o-y) improvement due to a slight increase in area planted, as well as higher yields. This output maintains a decade-long trend of higher yields for the corn sector, which have increased by 52.7% to 4.2MT/Ha from 2000/01 to 2010/11. This is higher than the South East Asian average yield of 3.2MT/HA in 2010/11. Corn's harvested area has also increased from 730,000 hectares in 2000/01 to 1.3mn in 2010/11. These increases have come as domestic consumption rose significantly on the back of improving incomes, encouraging consumers to buy more meat, of which corn is the main feedstock.

To 2014/15, we expect corn production to increase by 39.7% to 6.9mn tonnes. Acreage is likely to remain stagnant or diminish; current yield immaturity means significant gains are still available via this avenue, especially as robust local corn prices provide incentives to farmers. The important growth driver will be domestic consumption, especially from the livestock sector. Corn consumption doubled from 2005 to 2010 and we expect this trend to continue, although not at such a rate, to 2015. The demand gains will partly come from livestock growth, as beef, veal and poultry production should all see strong growth. As a result, Vietnam should become increasingly reliant on corn imports to meet domestic demand.

BMI Demand View: To 2015, corn consumption growth will continue to exceed that of production, at 31.9%. This will increase the country's import dependency of the grain. However, strong economic growth over the period should ensure that the impact of a rising import bill on consumption is deemed manageable. Animal feed will remain the primary use for corn to 2015 and beyond (according to the US Department of Agriculture, 80% of total corn consumption goes to animal feed use). Indeed, we have a positive view on livestock production to 2015, thanks to income growth and the fact that the sector has been identified as a recipient of government modernisation efforts.

Table: Vietnam Corn Production & Consumption, 2010-2015

	2010	2011f	2012f	2013f	2014f	2015f
Corn Production, '000 tonnes [1,2]	4,946.4	5,289.3	5,688.1	6,092.0	6,499.6	6,909.8
Corn Consumption, '000 tonnes [2]	5,996.0	6,232.7	6,886.2	7,582.2	8,324.8	9,116.8

Notes: [f] BMI forecasts. [1] In all instances year indicates data for harvest year ending that calendar year i.e. 2011 = 2010-11; Sources: [2] USDA, BMI.

Table: Vietnam Corn Production & Consumption, 2006-2011						
	2006	**2007**	**2008**	**2009**	**2010**	**2011f**
Corn Production, '000 tonnes [1,2]	3,818.0	4,251.0	4,600.0	4,432.0	4,946.4	5,289.3
Corn Consumption, '000 tonnes [2]	4,250.0	4,900.0	5,200.0	5,400.0	5,996.0	6,232.7

Notes: [f] BMI forecasts. [1] In all instances year indicates data for harvest year ending that calendar year i.e. 2011 = 2010-11; Sources: [2] USDA, BMI.

Risks To Outlook

We see downside risks to our corn production and consumption forecasts through to 2014/15. Corn, like many Vietnamese agricultural industries, is suffering from reducing acreage, both as a result of under-investment and the country's rapid pace of urbanisation. We see yield growth, coming from a fairly low base as it is, being sufficient to support output growth in spite of stagnant or reduced acreage. However, the ongoing introduction of hardier and higher yielding crops will ultimately necessitate greater investment - corn prices will have to remain in favourable territory in the medium term to ensure that this investment is forthcoming.

An important long-term downside consumption risk is that the country's dependence on imports could impede Vietnamese demand growth should a sustained period of inflated global corn prices occur. Fiscal and monetary tightening also poses a risk to consumption growth. Corn is not a luxury good and thus demand will not retrench in line with tighter spending conditions. However, if the 2008 financial crisis is anything to go by, corn production in the country did dip by 3.7% y-o-y in 2008/09 on the back of tighter credit regulations throughout Vietnam then.

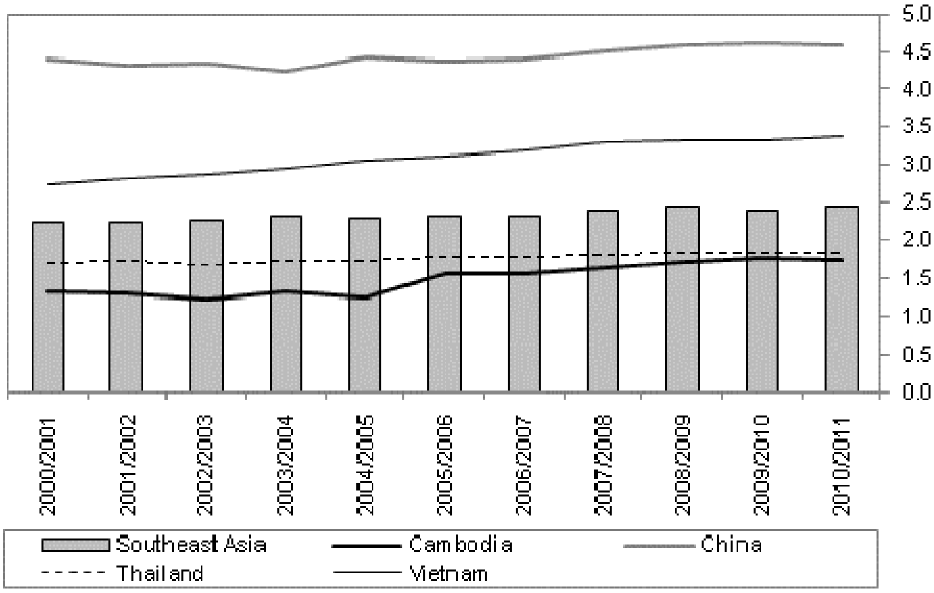
Vietnam Rice Outlook

BMI Supply View: Compared with many of its agricultural sub-sectors, Vietnamese rice is actually very competitive relative to many of its regional peers and is well positioned to benefit from both regional and global demand growth. Another advantage of Vietnamese rice is in its relatively higher yields. With the government's added backing to increase yields through the use of hybrid rice varieties for a 50% increase in area currently planted with the seeds, this bolsters our bullish outlook for the country's rice production capabilities over the long term.

For 2010/11, we forecast rice production to expand by 3.2% year-on-year to 25.8mn tonnes. Favourable weather has supported the crop prospects of Vietnam's two main rice crops, namely the spring crop and the autumn crop. In 2009/10, the spring crop contributed to 46.5% of total rice production, while the autumn crop output made up 33.6%. 2010/11 rice yields are expected to increase from 5.43 tonnes/hectare to 5.47 tonnes/hectare on the back of the government's efforts to encourage the use of new rice varieties including hybrid seedlings among rice farmers. Area harvested is also estimated to increase 1.4% y-o-y to 7.5mn hectares. Over our five-year forecast period, we expect rice output to grow by 14.5% to 28.6mn tonnes.

Surprisingly High

Rice Yields of Selected Asian Countries (MT/HA)



Source: USDA

BMI Demand View: We foresee a modest increase of 2.4% for consumption to reach 19.7mn tonnes in 2010/11. We expect consumption to climb by 14.9% to 22.0mn tonnes in 2015. Rice remains the major food staple in Vietnam and we do not see this changing over our forecast period. However, rising interest in other foods such as wheat-based goods - supported by growing affluence - will restrict demand for rice, and over the forecast period we expect production growth to significantly outpace that of consumption. Ultimately, demand growth will be influenced by population growth, as per-capita consumption is expected to remain roughly the same as the population continues to diversify its diet on the back of rising incomes. As such, the country will remain one of the world's top rice exporters.

Table: Vietnam Rice Production & Consumption, 2010-2015

	2010	2011f	2012f	2013f	2014f	2015f
Rice Production, '000 tonnes [1,2]	24,993.4	25,801.9	26,272.7	26,644.9	27,603.7	28,628.0
Rice Consumption, '000 tonnes [2]	19,179.7	19,695.1	20,330.1	20,883.8	21,453.1	22,036.9

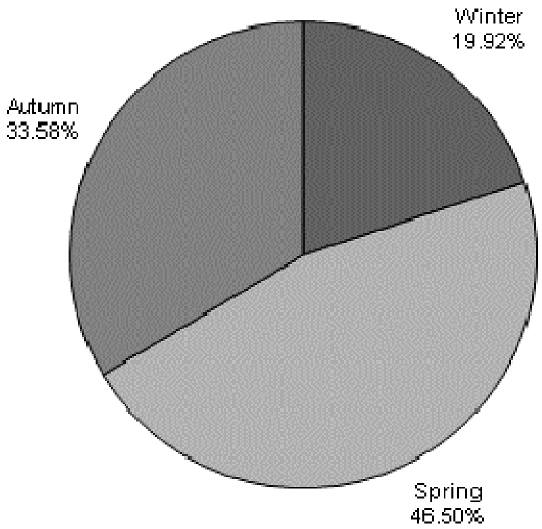
Notes: [f] BMI forecasts. [1] In all instances year indicates data for harvest year ending that calendar year i.e. 2011 = 2010-11; Sources: [2] USDA, BMI.

Strong Exports In 2011

Rice exports out of Vietnam will reach record levels in 2011, especially if export momentum continues apace for the rest of the year. Indeed, exports of the grain totalled 5.3mn tonnes between January and August, approximately 7.8% higher year-on-year (y-o-y). The Vietnam Food Association forecasts total exports to grow 9.8% on the year to reach 7.5mn tonnes for the 2010/11 season, which runs from January to December. This ties in with our forecast for rice production to grow by 3.2% y-o-y to come in at 25.8mn tonnes in 2010/11.

Counting On Spring & Autumn

Vietnam - Rice Seasons (% Of Production in 2010)



Source: USDA, BMI

Flooding Poses Increased Upside Risks to 2010/11 & 2011/12 Production Outlook

Excess flooding in the Mekong region poses downside risks to our production outlook for 2010/11 and 2011/12 rice output. According to official news sources, seasonal floods are expected to rise to the highest level in nine years. The delta's waters are likely to rise to higher than four metres above sea level and could break the dykes, causing havoc to residential villages as well as rice farms in the area. The freshly planted main crop remains particularly threatened. An estimated 600,000 hectares of rice have reportedly been planted so far, about 100,000 hectares more than the same period in 2010.

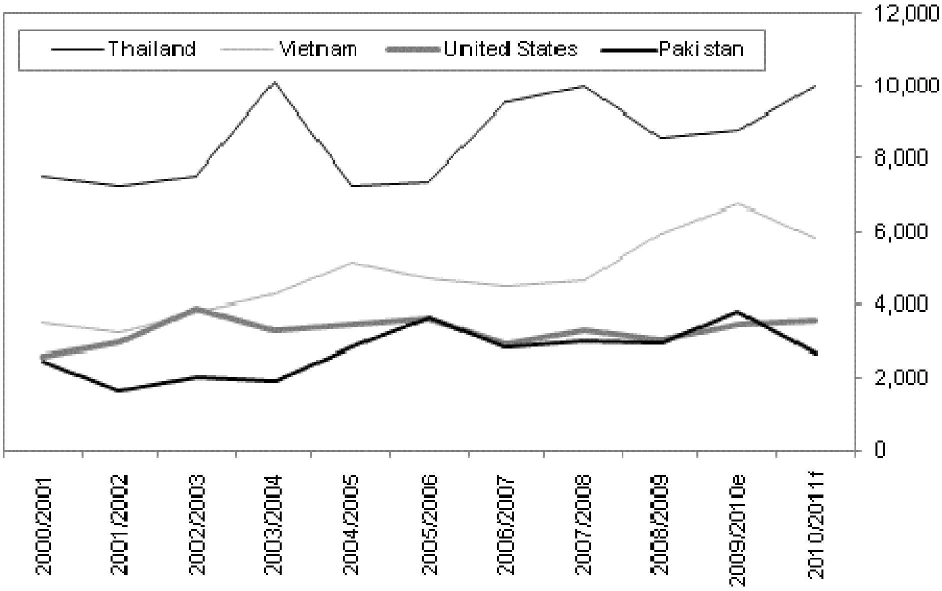
Vietnam's Central Steering Committee for Flood Prevention and Control has already ordered localities to reinforce the dykes and pump water from paddy fields to protect the crops. Nonetheless, these developments pose downside risks to our production forecast of 26.3mn tonnes in 2011/12 and could also place upside pressure on prices.

Opening Up The Market

BMI believes that the impact of the Vietnamese rice market opening up to foreign traders from 2011 onwards poses a likely upside risk to production over the longer term. From this year onwards under World Trade Organisation commitments, foreign traders will now be allowed to directly undertake rice trading in the country, instead of the previous requirements for foreign companies to enter in joint ventures with local players. In efforts to improve the capabilities of local rice exporters, and prepare for the impending increase of competition with bigger more experienced foreign players, the government has stepped up efforts to improve the local rice industry. The government has mandated that all rice exporters are required to have at least one rice storage warehouse with a minimum capacity of 5,000 tonnes of paddy and a rice processing facility with a minimum processing capacity of 10 tonnes/hour. All rice exporters will have until September 2012 to take the necessary actions and adapt to these changes. While this is likely to lead to a reduction in the 264 rice export companies in the country as of 2010, these developments should increase the industry's economies of scale and increase the competitiveness of the industry. We believe that this development is a step in the right direction to restructure the local rice industry and encourage consolidation, so as to better prepare local players for eventual foreign competition in the sector.

Weighing Up Against The Rest

Rice - Top Exporters ('000 tonnes)



Source: USDA

Improving Infrastructure

The vast majority of Vietnam's exportable rice is grown in the Mekong Delta. The region produces around half the country's rice output, but is home to only around a fifth of the county's population. The country's other major rice cultivating centre, the Red River Delta, produces just under a fifth of the nation's rice, but owing to the high population density is still unable to supply all its rice needs.

Considering its importance both to national food security and export revenues, rice infrastructure is poor. Warehouse storage capacity is a mere 1.2mn tonnes compared with the country's paddies' annual production of over 20mn tonnes. Of this capacity, less than a third is regularly used as warehouses are often decrepit and inconveniently located. The Ministry of Agriculture and Rural Development (MARD) is now aiming to change this. In 2009, the ministry said it would spend US$400mn on upgrading existing storage capacity and adding extra capacity to store another 2.8mn tonnes of rice. The new capacity will be built around the Mekong Delta's ports and the southern capital Ho Chi Minh City.

The extra capacity and upgraded storage facilities, set to be finished in 2011, will ease the flow of exports and allow exporters more flexibility. The modern facilities should also reduce loss to spoilage and improve the quality of stored rice. Both these factors should help Vietnam go some way to reducing the discount at which the country's rice exports are currently sold compared with rice from other exporters in the region such as Thailand.

The government has also approved a plan by the state-run **Southern Food Corporation** to build a US$34mn rice trading centre in the delta city of Can Tho. The centre aims to help the sale of rice by farmers to millers without the need for middle men. The facility, to be spread over 23 ha, will also have facilities for auctions and telephone and online sales. The 200,000 tonne storage centre, if it goes ahead as planned, should serve to improve efficiency in the rice trade in the Mekong Delta and help farmers get their produce to market.

Tale: Vietnam Rice Production & Consumption, 2006-2011

	2006	2007	2008	2009	2010	2011f
Rice Production, '000 tonnes [1,2]	22,772.0	22,922.0	24,375.0	24,393.0	24,993.4	25,801.9
Rice Consumption, '000 tonnes [2]	18,392.0	18,775.0	19,400.0	19,000.0	19,179.7	19,695.1

Notes: [f] BMI forecasts. [1] In all instances year indicates data for harvest year ending that calendar year i.e. 2011 = 2010-11; Sources: [2] USDA, BMI.

Risks To Outlook

We place upside risks on our Vietnamese rice consumption forecasts. It remains a substantial part of the local diet and any period of prolonged food price inflation or economic weakness would likely see more consumers revert to traditional diets lifting overall demand.

On the production side, we see downside risks to our existing forecasts. We do not expect any significant increase in rice acreage in Vietnam over our forecast period, or indeed beyond as a result of increasing urbanisation. We see production gains being possible as a result of continued yield, infrastructural and harvesting improvements. However, such advancements require ongoing investment. While rice remains so economically important, this investment is likely to continue to be forthcoming and yet any reduction would put our production forecasts in jeopardy.

Commodity Price Analysis

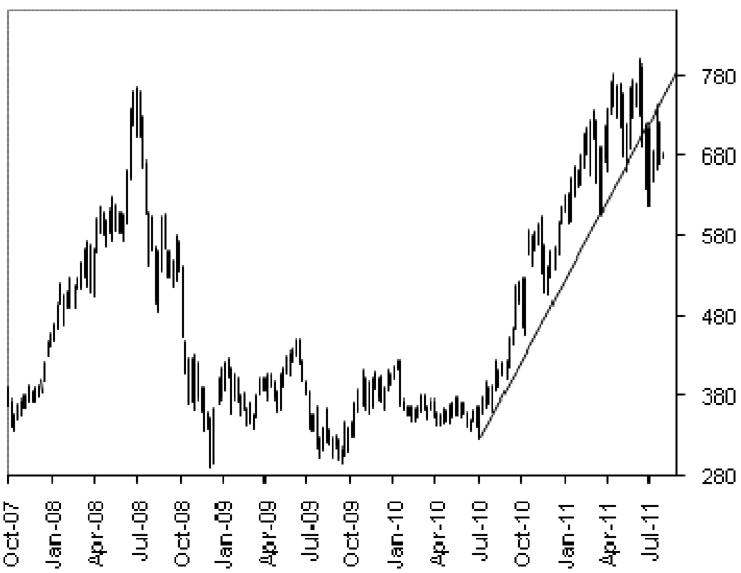
Monthly Grains Update

Corn

Front-month corn saw a strong increase in the first half of July, but moderated in the second half of the month. After a significant global market deficit in 2010/11, the corn market is forecast to return to a small surplus in 2011/12, backed by a strong rebound in US output. With livestock output in the US forecast to remain subdued in the coming months and a potential elimination of ethanol subsidies, US corn demand should remain weak in both 2011 and 2012. Consequently, even with strong Chinese demand growth and occasional imports, we forecast prices to average USc680/bushel in 2011 before moderating to USc600/bushel in 2012.

Front-Month Corn

USc/bushel



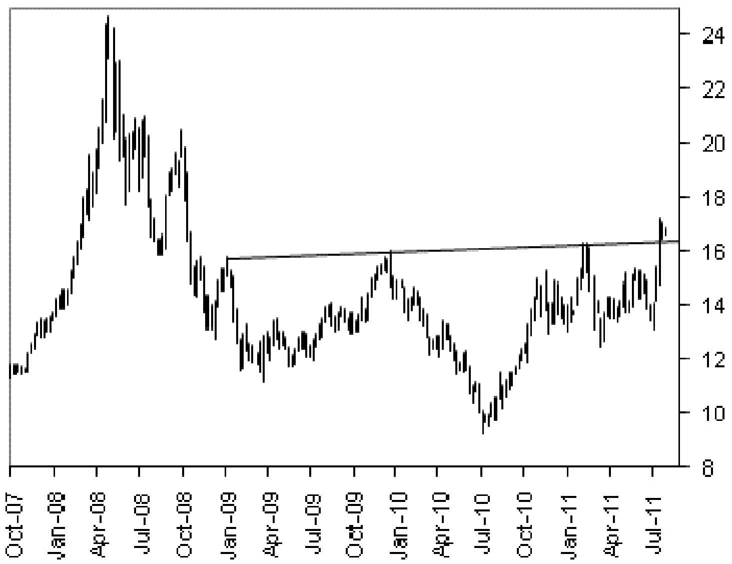
Source: BMI

Rice

Front-month rice broke through multi-year resistance of US$16.00/cwt in July, prompting us to reassess our views. Prices should likely remain elevated until full details of the Thai government's new rice policy have been finalised. However, we do not foresee a replay of 2008 when rice prices hovered close to US$25/cwt; instead, we see room for recent gains to be unwound over the medium term as the global market should remain well supplied. As an increase in demand for rice seems unlikely to add further upward pressure to prices in the medium term, we maintain our view for rice prices to average US$14.00/cwt in 2011.

Front-Month Rough Rice

US$/cwt



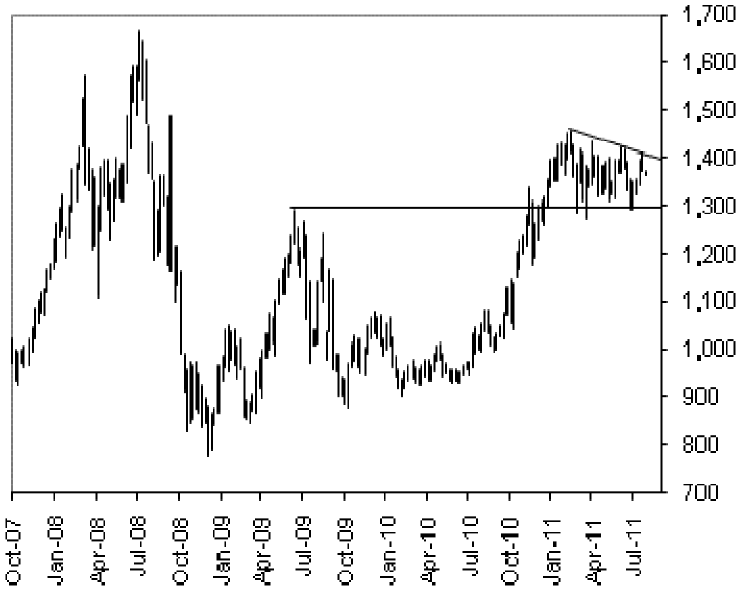
Source: BMI

Soybean

We now expect front-month soybean to be an outperformer among the grains complex over the short term - a view that has played out so far in July. Technical factors and a declining surplus should increase marginal tightness in the market, leading to our view that soybean prices should hold up better than wheat and corn. Demand for soybean has shown a strong increase in 2011, although supply should continue to increase in 2011/12 as prices remain elevated by historical standards. As a result, we expect another global production surplus in 2011/12, but are forecasting prices to only moderate slightly to average USc1,350/bushel in 2011 and USc1,300/bushel in 2012.

Front-Month Soybean

USc/bushel



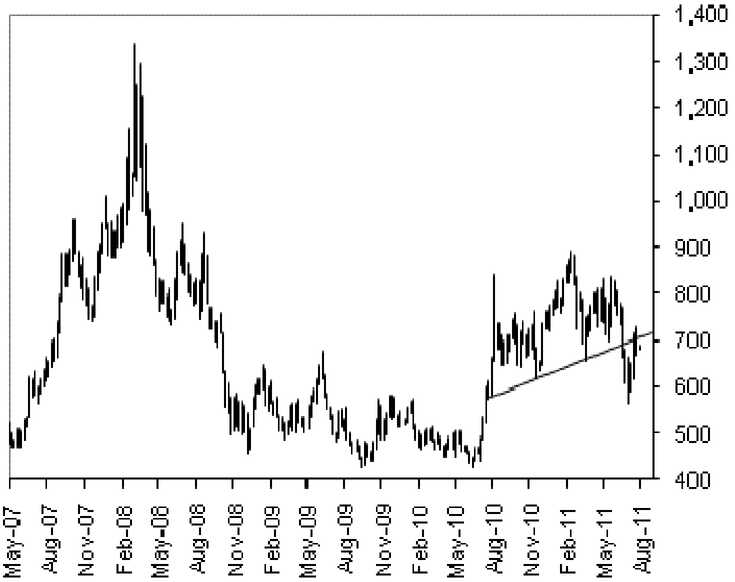
Source: BMI

Wheat

Front-month wheat has rebounded in recent weeks after a significant sell-off at the end of Q211. Much of the support concerns lingering production risks in North America and Australia. The EU-27 crop is also at risk owing to poor weather. However, this should be at least partly mitigated by strong export projections from Russia and the return of India to the wheat export market. The increased supply from the Black Sea and around the world informs our view of a global production surplus in 2011/12. This, combined with greater exports, underpins our view of prices to average USc750/bushel in 2011 and USc650/bushel in 2012.

Front-Month Wheat

USc/bushel



Source: BMI

Monthly Softs Update

Cocoa

Front-month cocoa continued to rebound in July, mainly as a result of a modest tightening of the market as the Ivoirien and Ghanaian harvests neared completion. Production (and thus export) figures from West Africa have exceeded virtually all expectations in 2010/11, leading to a large global surplus of 130,000 tonnes in the season despite concerns over bad weather affecting Indonesian production. In 2011/12, we are forecasting only a slight surplus owing to changes in how Indonesian output is counted and as weather in West Africa returns to normal. Nevertheless, we forecast cocoa prices to average lower at GBP2,000/tonne in 2011 and GBP1,900/tonne in 2012, as the market remains in surplus.

Front-month Cocoa

GBP/tonne

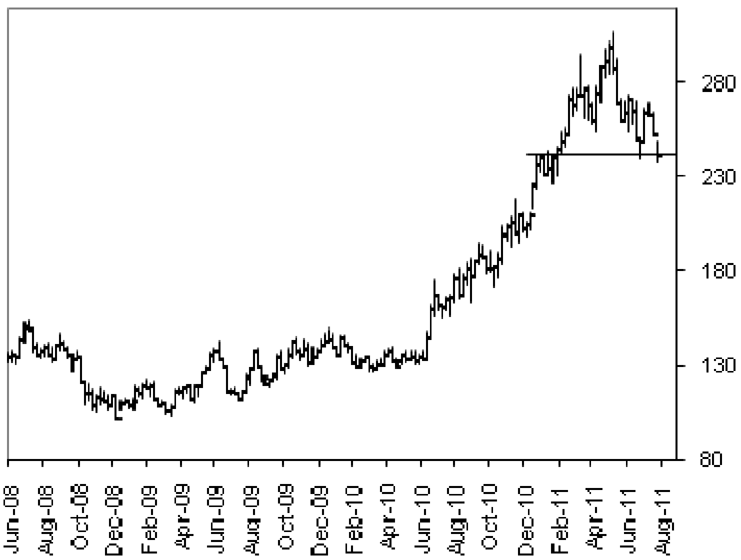
Source: BMI

Coffee

Front-month coffee continued to head lower in July and we see potential for further weakness in H211. Market fundamentals suggest additional declines, as 2011/12 exports from Brazil have registered a strong start and should benefit from speedier delivery owing to less port congestion than last year. With output in Colombia also forecast to be relatively strong for the balance of 2010/11, we see the possibility of a fresh move down in prices. However, we expect prices to remain elevated by historical standards, as a down-year in Brazilian production should keep the global market in deficit over the 2011/12 season. As a result, we maintain our forecast for an average of USc225/lb in 2011 and USc200/lb in 2012.

Front-Month Coffee

USc/lb



Source: BMI

Palm Oil

Front-month palm oil largely traded sideways in July owing to subdued import demand. Higher domestic stocks also contributed to a well-supplied market, which kept prices in check. We maintain that increased demand for palm oil in the run-up to Ramadan in August should tighten the market in the coming weeks, leading to a seasonal uptick in prices. Looking ahead, we foresee strong demand and limited prospects for supply growth, which should keep prices on a long-term uptrend. For this reason, we maintain our view for prices to average MYR3,500/tonne in 2011.

Front-Month Palm Oil

MYR/tonne

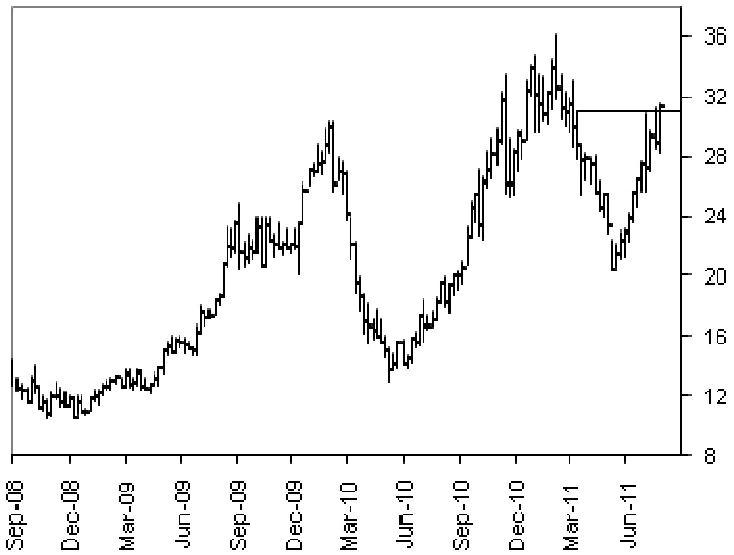
Source: BMI

Sugar

Front-month sugar continued its surge in July, touching a high of USc31.00/lb - a level unseen since March. We expect prices to continue trading in its wedge pattern, barring a significant downgrade to Brazilian 2011/12 supply. Sugar prices have been in a strong upward trend in recent months in spite of news that India will return to being a relatively large sugar exporter in the 2010/11 season. As we still do not see a need to revise our Brazilian sugar forecasts at this point, we maintain our view for prices to average below current spot levels, at USc25.00/lb in 2011 and USc20.00/lb in 2012.

Front-Month Sugar

USc/lb



Source: BMI

Industry Forecast Scenario

Vietnam's Consumer Outlook

Food

Monetary Tightening Leads To Softer Domestic Demand Conditions In H211

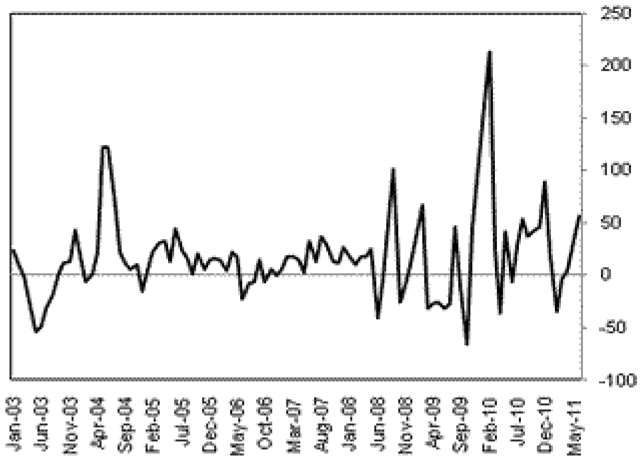
The State Bank of Vietnam's aggressive monetary tightening measures in H111 are expected to take the steam out of domestic demand over the coming quarters. While there are encouraging signs that inflationary pressures are beginning to cool, we remain concerned about the lagged impact of monetary tightening on consumer spending. However, given the positive dynamics of low unemployment, strong tourism growth and increasing remittance inflows, there is still considerable scope for optimism in the country's domestic demand picture in the near term. Over the longer term, the domestic demand picture for Vietnam looks brighter. A massive youthful population, sector immaturity and a plethora of macroeconomic driving factors make the Vietnamese consumer goods sector a high-growth prospect.

Strong Tourism Growth Boosts Demand Growth

A strong showing in the Vietnamese tourism sector is also expected to have positive spillover effects for the consumer-facing sectors. Vietnamese tourist arrivals increased by 55.9% y-o-y in June. While base effects (due to a year-on-year decline in tourist arrivals in the previous year) have a part to play behind this impressive growth figure, we observe that tourist arrival growth has been particularly strong over the past few months, which should provide a strong fillip for consumer goods sales, particularly for more expensive premium products (*see chart*).

On The Up

Tourist Arrival Growth, % chg y-o-y



Source: General Statistics Office, Bloomberg

Rising Remittances, Low Unemployment

Vietnam's buoyant labour market conditions and rising remittance inflows are expected to give firm impetus to consumerism over the coming quarters. According to a recent report by CNN, Vietnam recorded one of the lowest unemployment rates of 2.6% in June among the Asia Pacific countries. On another positive note, remittance inflows are steadily increasing, which should translate into stronger purchasing power and a greater willingness to spend among local consumers. While actual data on remittances in Vietnam is not available, anecdotal evidence from local banks and financial institutions points to growing momentum in remittance inflows. Local bank Sacombank, for instance, noted a 30% y-o-y increase in overseas remittances for H111, while Western Union, a subsidiary of Asia Commercial Bank, reported an increase of 8% y-o-y in remittance revenue over the same period.

Aggressive Monetary Tightening Dampens Domestic Demand

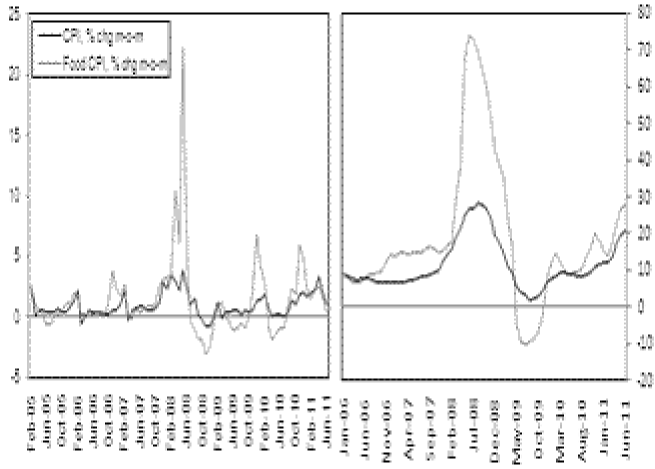
Despite these positives, the impact of aggressive rate hikes since the beginning of the year provides some reason for caution in Vietnam's near-term domestic demand picture, and we believe consumer spending growth will continue to moderate over the coming quarters. Prompted by the sustained intensity of inflationary pressures and overheating concerns, the State Bank of Vietnam engaged in an aggressive round of monetary tightening in the earlier months of 2011. Between February and April, the central bank hiked its benchmark policy rate by 800 basis points (bps).

While our Country Risk team does not envisage further rate hikes in the Vietnamese economy in 2011, we believe the lagged impact of monetary tightening in the earlier months of 2011 would prevent domestic demand from reaching its full potential this year. As the accompanying chart shows, we are beginning to see signs of a moderation in consumer price inflation in month-on-month terms. This, coupled with the central bank's decision to keep rates on hold at 14% since May, underpins our view that we have come to an end of a monetary tightening cycle for Vietnam.

The impact of monetary tightening on consumer spending is borne out by recent retail sales figures. Retail sales have moderated since February when the central bank initiated its monetary tightening cycle, recording growth of 22.6% in June. While this is an impressive growth figure which underlines the robustness of the domestic demand conditions, we observe that retail sales growth has trended along a distinct deceleratory path in recent months (*see chart*), bearing out the impact of monetary tightening on consumer spending.

Moderating Inflationary Pressures

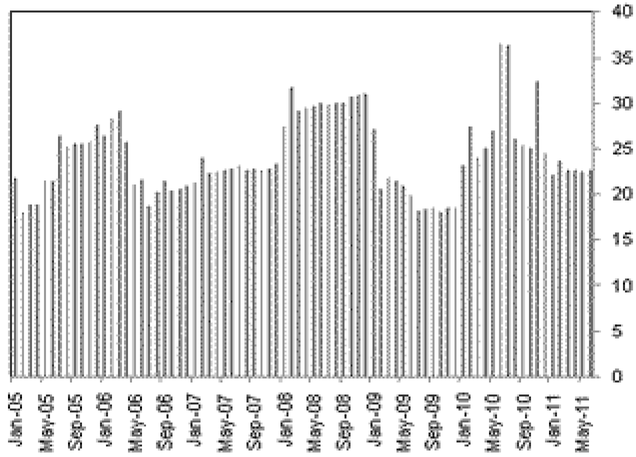
CPI and Food CPI, % chg m-o-m (LHS) & CPI & Food CPI, % chg y-o-y (RHS)



Source: Bloomberg, General Statistics Office

Retail Sales Taking A Hit

Retail Sales Growth, % chg y-o-y



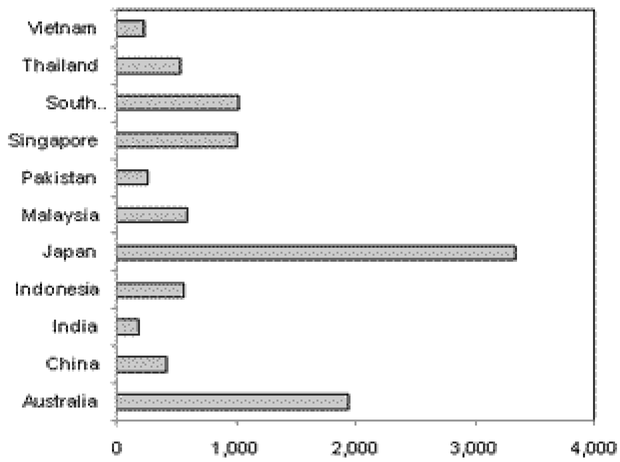
Source: General Statistics Office, Bloomberg

Cannot Deny Vietnam's Long-Term Potential

If a tighter credit environment poses a threat to near-term domestic demand conditions, the long-term potential of the consumer-facing sectors in Vietnam is undeniable. Rapid economic growth in Vietnam over the coming years should translate into higher income, in turn benefiting consumerism. GDP per capita in Vietnam is forecast to more than triple to reach US$4,444 by 2020.

Low Consumption But Massive Room For Growth

Selected Countries' Per Capita Food Consumption (2011)



Source: BMI forecast

Most exciting though is the country's favourable demographic profile; 51.9% of the population is estimated to be younger than 30, implying potentially dynamic opportunities for consumer goods players targeting the mass-market segment in particular as this demographic group matures over time.

The immaturity of food, drink and retail sectors in Vietnam ensures that the country will retain its appeal as one of the most exciting markets in the region for some time to come. Low existing per capita food and drink consumption levels in Vietnam imply that considerable room for growth remains (*see chart*). Moreover, organised grocery retail makes up only 15% of overall grocery retail sales, compared with levels of between 40%-70% elsewhere in South East Asia. Given just how far organised retail has to run before its proportional contribution is comparable with developed economies and countries such as China, Thailand and Malaysia, there are going to be huge opportunities for mass grocery retail (MGR) growth in Vietnam.

Food

Food Consumption

- Food consumption is forecast to expand at a compound annual average growth rate of 9.6% to 2015.
- Per capita food consumption is also forecast to increase robustly at a compound annual average rate of 8.6% to 2015.

Looking ahead, food consumption in Vietnam is forecast to experience strong growth of 9.6% on compound annual average terms between 2011 and 2015 at which point consumption is expected to reach VND594.1trn (US$32.6bn). Meanwhile, per capita food consumption is forecast to grow by an impressive 8.6% on a compound annual average basis over the same time period, reaching a fairly modest VND6.4mn (US$350.7) by 2015, reflecting the low starting base.

This impressive level of growth in food consumption could be attributed to two key factors: the rising affluence among Vietnamese consumers and an ongoing expansion of the MGR industry in the country.

At present, income levels in Vietnam are a long way behind developed economies, and consumer purchases remain largely centred on food staples and daily necessities. However, as incomes start to accelerate off a low base on the back of sturdy economic growth, consumer tastes and preferences are expected to calibrate towards the higher value food and beverage segments, which should guarantee a receptive and growing audience for branded food and beverage products in the medium term.

In particular, we expect functional food products to garner stronger appeal among Vietnamese consumers over the coming years. Given the nutritional health benefits of functional foods, these products have witnessed strong demand in Vietnam over the past few years in line with a growing shift towards health awareness. In 2000, the functional food market comprised only a dozen imported functional food products. By 2005-2006, domestically produced functional foods accounted for 33% of the entire food market, and in 2008, this figure doubled, underlining the burgeoning demand for functional food products.

The ongoing expansion of the MGR industry will also drive up per capita food consumption levels, provided goods sold through such outlets remain competitively priced. Ultimately, food consumption growth will be driven by the government's ability to harness rural spending power and by modern retailers' ability to find a model that stirs consumer interest, without forgetting that price will remain the major purchasing determinant.

Table: Food Consumption Indicators -- Historical Data & Forecasts, 2010-2015

	2010	2011f	2012f	2013f	2014f	2015f
Food consumption (US$bn)	19.29	20.82	22.90	25.79	29.00	32.55
Food consumption (VNDbn)	369,870	411,258	452,325	496,471	543,754	594,089
Per capita food consumption (US$)	218.3	233.3	254.0	283.2	315.4	350.7
Per capita food consumption (VND)	4,185,848	4,606,834	5,016,201	5,451,740	5,913,444	6,399,755
Total food consumption growth (y-o-y)	14.54	11.19	9.99	9.76	9.52	9.26

NB Excludes beverage consumption. e/f = BMI estimate/forecast. Source: General Statistics Office of Vietnam, BMI

Canned Food

- Canned food value sales growth is expected to outpace canned food volume sales growth; value sales is forecast to increase at a compound annual average rate of 8.3%, outperforming volume sales growth of 5.3% to 2015.

Buoyed by ongoing urbanisation and increasing affluence among Vietnamese consumers, **BMI** is currently forecasting a strong compound annual average growth of 8.3% in canned food sales, in value terms, over the next five years, significantly overshadowing a 5.3% compound annual average growth in canned food volume sales. This stronger value growth in the canned food sub-sector reflects an acceleration of a premiumisation momentum, as demand for higher value products such as canned food picks up strongly on the back of rising disposable incomes.

Vietnamese consumers are experiencing a growing awareness of hygiene concerns and food origin as their living standards improve and numerous health scares beg their greater caution. This will further encourage consumers to purchase processed foods over fresh produce, and strong investment in this sector from both domestic and international operators should also help to fuel sales growth. Meanwhile, city workers are increasingly cutting back on restaurant meals and opting for canned and processed foods in order to save money, with major retailers such as **Saigon Co-op** reporting a recent spike in sales.

Table: Value/Volume Sales of Selected Food Sub-Sectors -- Historical Data & Forecasts, 2010-2015

	2010	2011f	2012f	2013f	2014f	2015f
Canned food sales ('000 tonnes)	9.24	9.88	10.40	10.95	11.54	12.16
Canned food sales (VNDmn)	386,334	433,095	467,062	506,680	549,339	594,955
Canned food sales (US$mn)	20.15	21.93	23.65	26.32	29.30	32.60

e/f = BMI estimate/forecast. Source: General Statistics Office, Company information, Trade press, BMI

Confectionery

- Confectionery value sales growth is forecast at 8.2% on compound annual average terms to 2015.

- The chocolate sub-sector will continue to outperform over the next five years, with value sales in the sector forecast to grow at a compound annual average rate of 10.0% to 2015.

Vietnamese confectioners are facing mixed headwinds over the coming quarters. On the one hand, the gradual appreciation of the Vietnamese dong in recent months is fanning depreciatory pressures on the prices of imported raw materials and manufactured confectionery products, in turn placing pressure on the margins of domestic confectioners. On the other hand, prices across the global agricultural complex are moderating, which should provide some relief to the profitability of domestic confectionery players. Over the longer term, dynamics such as rising purchasing power, a massive youthful population, growing health awareness and continued investments in the sector underpin a strong growth outlook for the Vietnamese confectionery sector.

Although the Vietnamese dong experienced only mild appreciation against the US dollar, domestic confectioners are already feeling a greater squeeze from the lower prices of imported goods. A survey conducted by local media Sai Gon Tiep Thi revealed that average prices of imported confectionery products fell by VND5,000 (US$0.2) per kilogram. Moreover, according to Phan Van Thien, the deputy general director of Vietnamese confectioner **Bibica**, imported products are currently priced around 10% more than domestic goods, compared with an average price differential of 20% previously. Against the backdrop of lower prices in imported confectionery products, domestic confectioners typically have to resort to lowering their product prices in order to protect sales, in turn dampening their margins.

Since February, the Vietnamese central bank has implemented 800bps worth of interest rate hikes. While we are not expecting significant appreciation in the Vietnamese dong on the back of this aggressive monetary tightening in recent months, this policy is likely to help prevent significant depreciation of the dong, implying sustained pressures on domestic confectioners. Our Country Risk team is expecting the

VND/US$ exchange rate to average VND/US$20,375 in 2012, representing a mild appreciation from the current spot rate of VND/US$20,408.

On the other hand, moderating prices of key raw materials such as sugar and cocoa should lend some upward support to the profitability of domestic confectionery players. Given our expectations of further moderation in raw material prices, this should help mitigate the impact of deflationary pressures in imported goods on the bottom line of domestic confectioners.

The longer-term outlook for the Vietnamese confectionery market is more certain. With factors such as rising purchasing power, favourable demographics, growing health awareness and continued investments in the sector supporting confectionery demand, we are forecasting a compound annual average growth of 8.2% in confectionery value sales in local currency terms to 2015.

- **Rising Disposable Incomes:** Rapid wealth accrual (GDP per capita is forecast to more than triple to reach US$4,444 by 2020) translates into a greater discretionary appetite for premium confectionery products. As an increasing number of domestic confectioners expand their upmarket product ranges, this would bolster value sales growth over the coming years.

- A Massive Youthful Population: 51.9% of the Vietnamese population is estimated to be younger than 30, and the maturation of this demographic group means that there are dynamic opportunities in the mass market. Moreover, this demographic group is generally more receptive to Western cultures, which should give an impetus to confectionery demand.

- Growing Health Awareness: Health awareness is prompting shifts of consumption habits towards functional and healthy confectionery products. Capitalising on the growing trend, domestic confectioners such as **Tan Tan Food & Foodstuff** and **Vina Mit** are expanding their functional product offerings. These products typically carry higher price tags, and their rising demand should translate into higher value sales in the sector.

- Continued Sector Investments: Sustained competition levels in the Vietnamese confectionery sector ensure that dynamism in the market is unlikely to cool off anytime soon. **Nabati Indonesia**, a leading Indonesian biscuit producer, recently announced plans to start distributing its biscuit products in Vietnam -- a testament to the attractiveness of the sector. Meanwhile, domestic confectioners such as **Kinh Do** will continue to invest in broadening its product ranges and expanding its distribution channels.

Table: Value/Volume Sales of Selected Food Sub-Sectors -- Historical Data & Forecasts, 2010-2015

	2010	2011f	2012f	2013f	2014f	2015f
Confectionery sales ('000 tonnes)	103.8	108.1	111.9	116.0	120.3	124.9
Confectionery sales growth, tonne, (y-o-y)	4.70	4.10	3.56	3.65	3.74	3.82
Chocolate sales (VNDmn)	2,883,376	3,207,756	3,527,200	3,887,029	4,274,321	4,688,321
Sugar confectionery sales (VNDmn)	2,465,632	2,690,144	2,878,914	3,083,532	3,303,833	3,539,386
Gum sales (VNDmn)	440,228	455,163	462,954	471,006	479,608	488,744
Confectionery sales (VNDmn)	5,789,237	6,353,063	6,869,068	7,441,567	8,057,763	8,716,451
Confectionery sales growth, VND, (y-o-y)	11.76	9.74	8.12	8.33	8.28	8.17
Chocolate sales (US$mn)	150.4	162.4	178.6	201.9	228.0	256.9
Sugar confectionery sales (US$mn)	128.6	136.2	145.8	160.2	176.2	193.9
Gum sales (US$mn)	22.96	23.05	23.44	24.47	25.58	26.78
Confectionery sales (US$mn)	301.9	321.7	347.8	386.6	429.7	477.6

e/f = BMI estimate/forecast. Source: General Statistics Office, Company information, Trade press, BMI

Table: Sugar Confectionery, 2008-2015

	2008	2009	2010	2011f	2012f	2013f	2014f	2015f
Sugar confectionery production, tonnes	121,385.41	134,692.90	152,553.18	170,193.58	191,577.42	214,561.54	239,269.67	265,835.29
Sugar confectionery production, tonnes, % change y-o-y	13.93	10.96	13.26	11.56	12.56	12.00	11.52	11.10
Sugar confectionery sales, tonnes	110,745.92	124,650.34	141,697.61	159,028.74	179,943.03	202,408.71	226,544.84	252,479.85
Sugar confectionery sales, tonnes, % change y-o-y	11.18	12.56	13.68	12.23	13.15	12.48	11.92	11.45
Sugar confectionery exports, tonnes	22,026.69	20,014.22	22,409.06	23,926.94	25,152.28	26,475.64	27,904.88	29,448.45
Sugar confectionery exports, tonnes, % change y-o-y	28.02	-9.14	11.97	6.77	5.12	5.26	5.40	5.53
Sugar confectionery imports, tonnes	11,387.20	9,971.65	11,553.50	12,762.10	13,517.89	14,322.81	15,180.05	16,093.00
Sugar confectionery imports, tonnes, % change y-o-y	10.91	-12.43	15.86	10.46	5.92	5.95	5.99	6.01
Sugar confectionery balance, tonnes	10,639.49	10,042.57	10,855.56	11,164.84	11,634.38	12,152.83	12,724.83	13,355.44
Sugar confectionery balance, tonnes, % change y-o-y	53.33	-5.61	8.10	2.85	4.21	4.46	4.71	4.96

Source: e/f = BMI estimate/forecast. Source: United Nations, BMI

Trade

- Export growth is forecast at a compound annual average rate of 10.2%, stronger than import growth of 9.6% to 2015.

The 8.5% devaluation in the Vietnamese dong in February is expected to provide strong support to the country's food and beverage export growth over the coming months. Although we are optimistic that trade exports are beginning to show signs of strength, we caution that global economic headwinds in the US and eurozone remains a downside risk to external demand. On the other hand, we are forecasting slower growth in food and drink imports over the coming months on the back of moderating domestic demand and a slowdown in the broader economy. For 2011, we are currently pencilling in a 7.5% growth in exports, outperforming a 6.5% growth rate pencilled in for import.

Over the next five years, however, the outlook for Vietnam's food and drink trade balance is relatively stronger, as the country is forecast to maintain a healthy and growing trade balance. While exports are forecast to experience growth of 10.2% on a compound annual average growth basis between 2011 and 2015, imports are forecast to experience compound annual average growth of 9.6% over the same period.

A major driver behind the growth in exports is sustained government effort to improve local food production and agricultural industries. This will boost output and make more produce available for export, as well as improve the quality competitiveness of local exports.

Over the long term, increasing urbanisation and continued exposure to Western influences are expected to generate growing import demand, and increasingly busy lifestyles and rising interest in branded produce will lead to growth in the processed-food industry. In order to meet this demand, local manufacturers will be forced to import the necessary raw ingredients.

Beyond 2015, we believe the government will be hopeful that its investments and efforts to attract foreign investors will pay off, and that much of this new and specific type of demand will be able to be accommodated domestically.

Table: Food & Drink Trade Indicators -- Historical Data & Forecasts, 2010-2015

	2010	2011f	2012f	2013f	2014f	2015f
Exports (US$mn)	10,988	11,812	12,910	14,239	15,728	17,396
Imports (US$mn)	3,549	3,779	4,136	4,532	4,972	5,460
Balance (US$mn)	7,439	8,033	8,774	9,707	10,757	11,936

e/f = BMI estimate/forecast. Source: UNCTAD, BMI

Mass Grocery Retail

- Overall MGR sales are forecast to increase at a compound annual average growth rate of 11.6% to 2015.
- The hypermarket sector is expected to witness strongest growth among the MGR sub-sectors; recording a compound annual average growth rate of 13.0% to 2015.

Vietnam continues to be one of the most promising markets for MGR in the Asia Pacific region, and we are continuing to forecast very strong growth rates in what is considered one of the region's brightest new prospects. Over our forecast period of 2011 to 2015, **BMI** is forecasting that value sales through modern retail outlets in Vietnam will increase by 11.6% on a compound annual average growth basis, with all modern formats present in the country -- supermarkets, hypermarkets and convenience stores -- contributing to this growth.

There are two primary drivers of this growth forecast. One is Vietnam's economic development. The country has proved successful at attracting multinational investment in spite of its often-restrictive foreign investment policies and underdeveloped infrastructure. This investment has led to job creation, which in turn has led to the emergence of a new consumer class in the country -- in major urban centres at least -- which has an interest and can afford to participate in modern consumption methods such as mass grocery retailing.

With Vietnam increasingly becoming one of South East Asia's top attractions, the country's increasing tourism levels will also assist the emergence of modern retail, particularly in the convenience sector. Recent government data show that tourism levels increased by 55.9% y-o-y in June 2011, and this continued strength in the tourism sector is expected to provide a strong fillip to domestic retail sales.

Rapid inflows of sector investment should bolster growth in domestic retail sales as well. Japanese retailer AEON has plans to enter the Vietnamese market by 2013, while E-Mart recently inked an agreement with **U&I Investment Corporation** to establish a joint venture in Vietnam with an aim of setting up retail stores in the country. These investments clearly underline the massive potential on offer in the Vietnamese retail sector.

It should also be noted that while multinationals pose a serious threat to local enterprises operating in the attractive urban centres of Hanoi and Ho Chi Minh City, secondary and tertiary towns and cities in outlying provinces could actually reap considerable benefits from multinational investment. In our view, multinational sector involvement will eventually lead to rapid crowding in Vietnam's major urban centres, forcing retailers to turn to unexplored regions in search of growth.

Sales through the convenience store format are forecast to experience the slowest growth rate, at 9.3% on compound annual average growth terms to 2015. The main reason behind this relatively modest growth is the format's low starting point, with the concept still very much in its infancy. Accordingly, the demand for convenience, with the pay-off of higher prices, is not yet on the agenda for most consumers; they are still familiarising themselves with the modern format in general. Nevertheless, this subsector can be expected to attract growing interest from retailers, with Japanese convenience retailer **FamilyMart** having recently opened its first outlet in Ho Chi Minh City. The retailers plans to have 300 stores in five years as it looks to capitalise on the city's young and increasingly busy population.

Vietnamese consumers are most familiar with the standard supermarket format, as well as with hypermarkets, owing to its popular combination of both food and non-food items. Therefore, these two formats are set to witness the strongest levels of growth at 11.7% and 13.0%, on compound annual average growth terms, respectively over our forecast period. In addition, the supermarket and hypermarket formats are set to receive the most attention from new retail investors, owing to their greater per-store profitability levels, which will be of vital importance in a market where foreign investment in store openings is still limited.

Singapore MGR operator **NTUC Fairprice** and Vietnam's **Saigon Union of Trading Co-operatives** are two recent examples of companies looking to exploit the high per-store profitability levels in the hypermarket sector. The two companies have recently inked a joint venture agreement to establish a chain of hypermarkets in Vietnam. Given Saigon's local expertise and NTUC's experience in operating hypermarket stores, this is clearly a formidable-looking partnership, and their expansionary activities are likely to place considerable upward pressure on our hypermarket growth forecast for Vietnam.

If there can be a downside in the case of such an impressive retail growth forecast, it comes in the form of Vietnam's majority rural population, which drags down food consumption levels in the market to unattractive levels. The risk for retailers is that as soon as the country's major cities start to become saturated with business opportunities, few other communities exist that can currently support modern retail development. Even the low prices offered by discounters would be unlikely to attract buyers in rural communities, for whom self-sufficiency and wet markets remain the sole methods of consumption. This point is, however, still a long way off. Retailers will invest in Vietnam in line with their own need to expand, confident of the country's economic development and growing consumer base.

Table: MGR Indicators -- Value Sales by Format -- Historical Data & Forecasts, 2010-2015

	2010	2011f	2012f	2013f	2014f	2015f
Supermarkets (VNDbn)	53,451	62,308	69,800	78,188	87,289	97,107
Hypermarkets (VNDbn)	22,294	25,683	29,221	33,097	37,316	41,879
Convenience Stores (VNDbn)	16,635	18,363	20,086	21,968	24,012	26,219
Total mass grocery retail sector (VNDbn)	92,381	106,355	119,107	133,253	148,617	165,205
Total mass grocery retail sector growth, VND, (y-o-y)	17.47	15.13	11.99	11.88	11.53	11.16
Supermarkets (US$bn)	2.79	3.16	3.53	4.06	4.66	5.32
Hypermarkets (US$bn)	1.16	1.30	1.48	1.72	1.99	2.29
Convenience Stores (US$bn)	0.87	0.93	1.02	1.14	1.28	1.44
Total mass grocery retail sector (US$bn)	4.82	5.39	6.03	6.92	7.93	9.05

e/f = BMI estimate/forecast. Source: Company information, Trade press, BMI

Macroeconomic Forecast

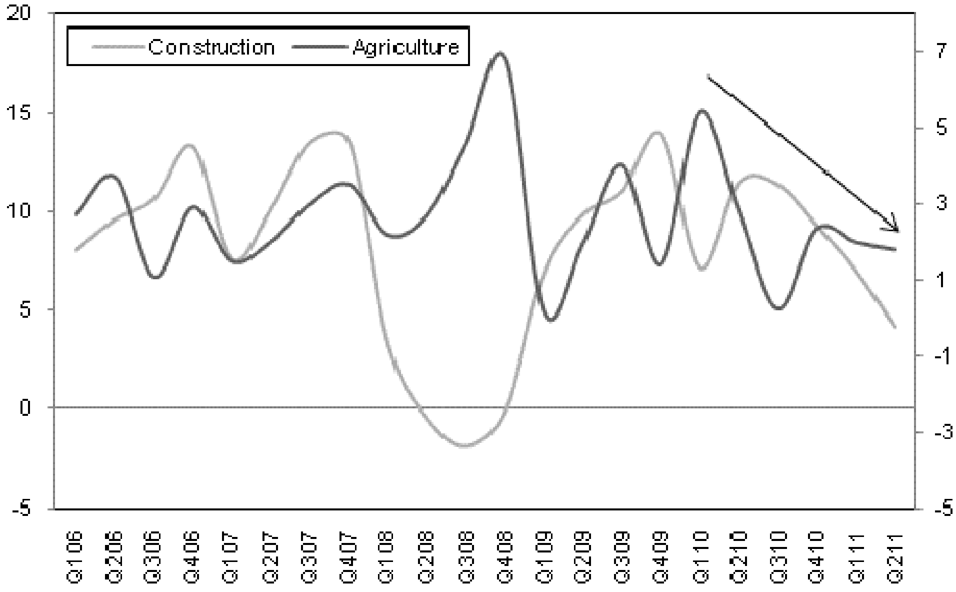
Growth To Moderate Despite Improvement In Net Exports

BMI View: *Vietnam's real GDP growth figure came in slightly better than expected at 5.7% y-o-y in Q211. However, we expect economic activity to continue to moderate in H211, and we see this as a positive sign that government efforts to iron out macroeconomic imbalances in the economy remain on track. Despite incipient evidence of a narrowing trade deficit, we warn that global economic headwinds remain a downside risk to external demand. Accordingly, we are projecting real GDP growth to remain subdued at 6.3% for 2011 (below the government's target of 6.5%), but we remain optimistic that we could see a pickup in growth towards 7.2% in 2012.*

Vietnam's real GDP growth figure came in slightly better than expected at 5.7% y-o-y in Q211. However, leading indicators suggest that economic activity should continue to moderate, and we see this as a positive sign that government efforts to iron out the country's macroeconomic imbalances remain on track. Going forward, prevailing economic headwinds in the US and Eurozone should continue to act as a dampener on external demand. This in turn suggests that production activity in the manufacturing sector and other export-based industries should remain depressed in H211. Furthermore, lending rates, which have surged to around 25.0-27.0% as a result of the State Bank of Vietnam's (SBV) aggressive monetary tightening in recent months, suggests that gross fixed capital formation (GFCF) growth would remain subdued in H211. Although the SBV has cut its reverse repurchase rate by 100bps from 15.00% to 14.00% on July 4, we see the move as an attempt to ease liquidity in the banking system rather than a signal for further rate cuts. We note that the SBV's benchmark policy rate (refinance rate) remains unchanged at 14.00% and we expect the rate to remain on hold through 2011.

Starting To Cool

Vietnam - Output For Selected Sectors, % chg y-o-y



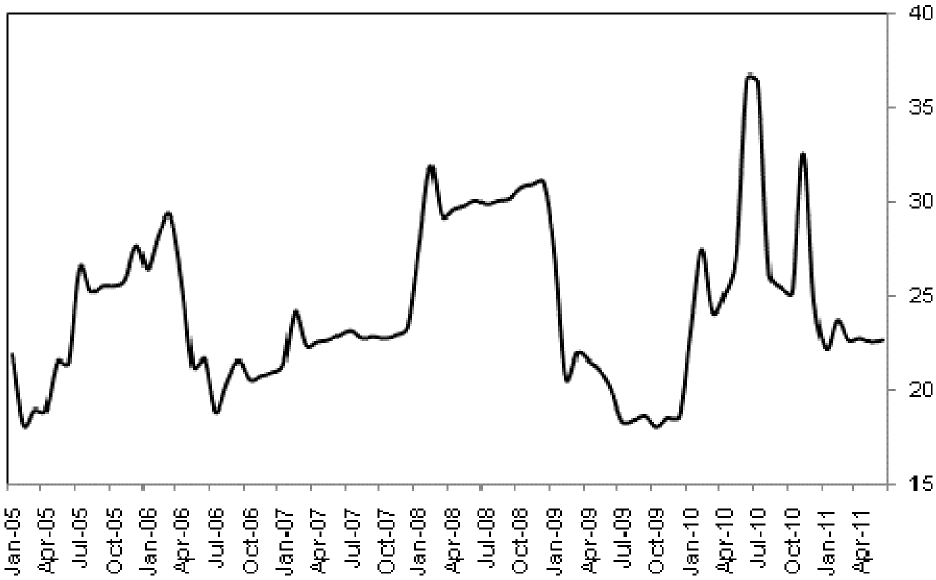
Source: General Statistics Office, BMI

Growth Slows In Construction And Agricultural Sectors

According to figures published by the General Statistics Office, output in the agricultural sector has slowed to around multi-year lows of just 1.8% y-o-y in Q211 compared to 2.0% in Q111. Meanwhile, growth in the construction sector also witnessed a significant slowdown from 7.0% y-o-y in Q111 to 4.2% y-o-y in Q211. We believe that exorbitant lending rates due to aggressive monetary tightening by the central bank were mainly responsible for stemming growth in the construction sector. Indeed, construction and infrastructure companies have complained about having to cope with higher debt servicing costs due to their capital-intensive structure. Meanwhile, tight credit conditions may have prompted commercial banks to adjust their loan portfolios towards higher return industries over the agricultural sector (which traditionally provide lower returns and are given preferential interest rates by state-owned banks). Given that the agricultural sector accounts for a significant 18.4% of nominal GDP, we note that high lending rates should continue to depress agricultural production and in turn broader economic growth this year.

Subdued But Resilient

Vietnam - Retail Sales, % chg y-o-y



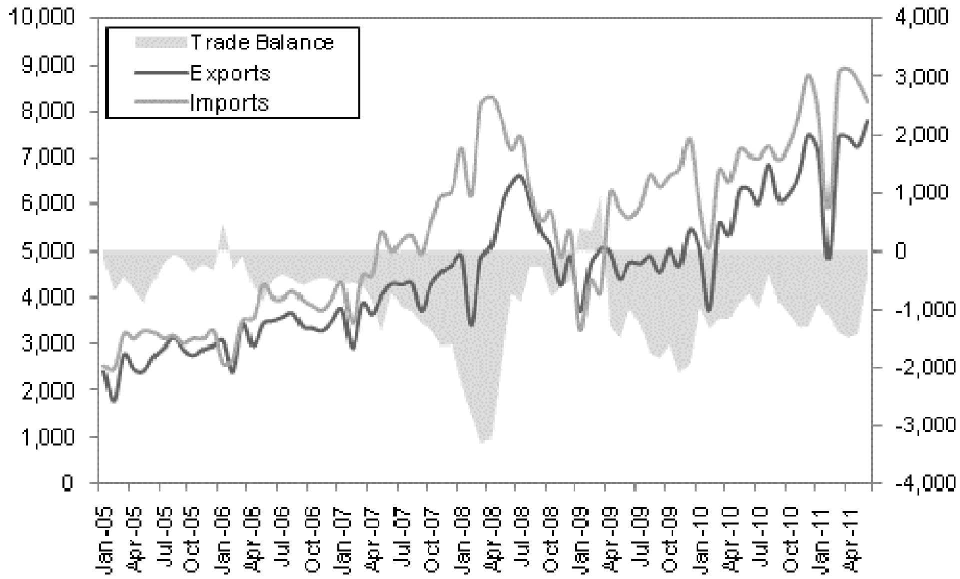
Source: General Statistics Office, BMI

Private Consumption To Remain Resilient In 2011

Retail sales have moderated considerably since November 2010 when the SBV initiated its monetary tightening cycle. As the accompanying chart shows, retail sales growth slowed from 32.5% in November 2010 to 22.6% in June, indicating that monetary tightening has dampened private consumption growth. Nonetheless, retail sales remain at double-digit growth rates, indicating that private consumption growth remains resilient. This supports our view that private consumption would remain resilient on the back of robust labour market conditions and rising wages in Vietnam. However, public spending cuts and a subdued outlook on GFCF growth due to high lending rates, mean that domestic demand would continue to moderate throughout the year.

Still A Drag On The Economy

Vietnam - Goods Exports & Imports, US$mn (LHS) & Trade Balance, US$mn (RHS)



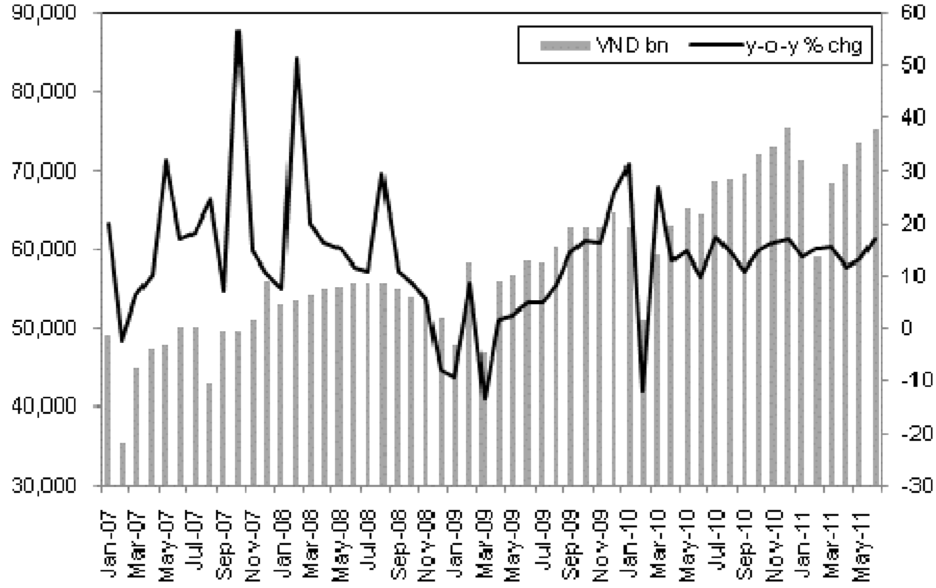
General Statistics Office, BMI

Narrowing Trade Deficit To Help Cushion Against Slowdown In Domestic Demand

Following a significant 8.5% devaluation in the Vietnamese dong in February, we are finally beginning to see incipient signs of a narrowing trade deficit (*see chart*). Trade export growth accelerated to 23.5% y-o-y in June from 14.6% in May, while imports growth slowed to 16.2% y-o-y from 20.5% in May. The latest trade figures showed a smaller trade deficit of US$0.4bn in June (the smallest deficit since August 2010) compared to US$1.4mn in May, providing relief to concerns that further deterioration in the trade balance would suggest another devaluation in the coming months. Industrial production, which provides a reliable gauge for export orders, also indicate that demand for exports remained resilient. As the accompanying chart shows, industrial production growth has begun to pick up in recent months, rising from 11.8% y-o-y in April to 17.0% in June.

Nice And Steady

Vietnam - Industrial Production, VNDbn (LHS) & % chg y-o-y (RHS)



Source: General Statistics Office, BMI

Although we are optimistic that trade exports are beginning to show signs of strength, we caution that global economic headwinds in the US and Eurozone remains a downside risk to external demand. Nonetheless, trade imports, which are beginning to slow on the back of moderating domestic demand and a slowdown in the broader economy, should help reduce the trade deficit over the coming months. Although, we remain optimistic that an improvement in net exports would help cushion against the impact of a slowdown in domestic demand, headline economic growth should continue to moderate throughout the year. Looking ahead into 2012, we expect the SBV to ease monetary policy in light of moderating inflation and this should support a pickup in economic growth. Accordingly, we are maintaining our real GDP growth forecast of 6.3% for 2011, followed by a pickup towards 7.2% in 2012.

Table: Vietnam - Economic Activity, 2008-2015

	2008	2009	2010	2011f	2012f	2013f	2014f	2015f
Nominal GDP, VNDbn [2]	1,485,038.0	1,658,389.0	1,953,223.3	2,379,025.2	2,783,319.1	3,152,968.4	3,547,056.7	3,972,115.8
Nominal GDP, US$bn [2]	89.8	92.8	101.9	115.5	136.6	159.2	184.3	211.8
Real GDP growth, % change y-o-y [2]	6.3	5.3	6.8	6.3	7.2	7.2	7.2	7.2
GDP per capita, US$ [2]	1,041	1,063	1,153	1,294	1,515	1,749	2,004	2,282
Population, mn [3]	86.2	87.3	88.4	89.3	90.2	91.1	92.0	92.8
Industrial production index, % y-o-y, ave [1,2]	13.6	6.7	14.1	10.0	15.0	16.0	17.0	16.0
Unemployment, % of labour force, eop [2]	4.7	6.0	5.0	6.0	5.0	5.0	5.0	5.0

Notes: [e] BMI estimates. [f] BMI forecasts. [1] at 1994 prices; Sources: [2] General Statistics Office. [3] World Bank/BMI calculation/BMI.

Company News Alert

Opportunities Abound In China, Vietnam And India For Starbucks

US coffee giant **Starbucks** recently launched its instant coffee brand in Singapore as it looks to build a stronger footprint in the Asia Pacific region. As incomes grow quickly across the region, bolstering consumers' appetite for higher-value beverage products, the market is, unsurprisingly, coming into greater focus for Starbucks. In the near-to-medium term, Starbucks is likely to focus its expansion efforts on the high-growth coffee markets of India, China and Vietnam, and the exciting demand prospects in these markets should supply dynamic momentum to the coffee giant's international sales.

Starbucks Tapping Into Singapore's Growing Demand For Convenience

Starbucks' launch of its 'Starbucks Via Ready Brew' single-serve instant coffee sachets in Singapore underlines a growing consumer demand for convenience in the country. While the instant coffee sachets are available only at Starbucks stores currently, Starbucks plans to eventually introduce its products to retail stores as well. With Singaporeans already leading hectic and urbanised lifestyles, convenience is a key purchasing determinant for most locals. Moreover, the relatively higher incomes of Singaporeans mean that they have generally been willing to pay a premium for convenience, which should translate into a strong appetite for Starbucks' instant coffee products.

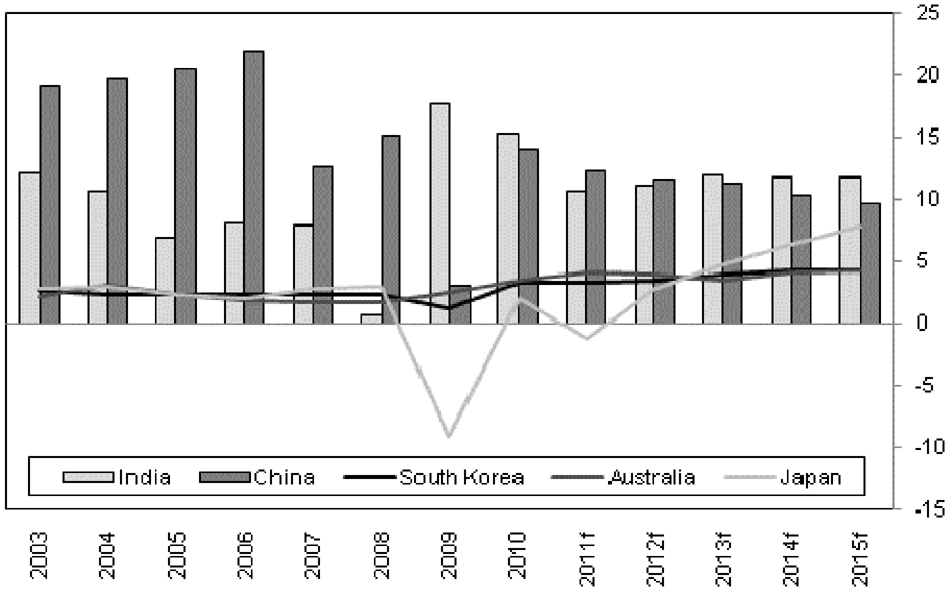
Starbucks Has Big Asian Ambitions

From a broader perspective, Starbucks' launch of its new instant coffee product in Singapore, which is already available in Taiwan, Japan and China, is illustrative of its ambitions in the Asia Pacific region. The emerging Asian consumer story offers very exciting prospects and Starbucks clearly wants to consolidate a stronger market presence in this high-growth region. According to Wang Jinlong, the Asia Pacific president of Starbucks, growth in countries such as South Korea and China has been 'tremendous' and the proportional contribution of the region to the company's overall sales was increasing 'dramatically and substantially'. Faced with such exciting growth prospects, Starbucks plans to open 600 stores in its international markets in 2012, with a strong focus on the Asia Pacific region in particular.

China And India To Remain Key Growth Assets

India and China Outperforming

Selected Asian Countries Coffee Sales Growth, % chg y-o-y



f= BMI forecast. Source: Trade Press, Statistical Agencies

China and India will feature very strongly on Starbucks' investment radar over the coming years given our hugely attractive outlook for the coffee sectors in these countries (*see chart*). A young and increasingly affluent population is one of the major positives underpinning our outlook for the coffee markets in these markets. Younger consumers are proving more receptive to Western influences and are quickly developing a greater penchant for higher value beverages as they climb up the income ranks. Starbucks' positioning as a 'third place' outside of work and home is garnering increasing popularity among Chinese consumers.

The relative immaturity of the coffee sectors in India and China also translates into a stronger scope for growth. In India, for instance, the tea market is comparatively more mature than the coffee sector, and this relative immaturity of the coffee sector means that multinational coffee producers would face lesser competition from established market players in setting up shop in the market.

Attracted by the aforementioned dynamics, Starbucks clearly has big ambitions for the coffee markets in China and India. Starbucks' first store in India is scheduled to be opened in 2012 and the firm is currently in talks to source coffee beans from Indian coffee producer **Tata Coffee** . Starbucks is also primed to expand in China, with plans to triple its number of stores in the country from 470 to 1,500 by 2015.

Vietnam On The Cards

Another high growth coffee market that is also likely to emerge on Starbucks' radar is Vietnam. As in China and India, drinking coffee is a growing lifestyle choice in Vietnam and the rise in incomes of the local youth population will serve to further buoy the demand for premium coffee products. To 2015, we are forecasting a 11.6% compound annual average growth in Vietnamese coffee sales, in volume terms, attracting the sights of Starbucks as it plans to open its first outlet in Vietnam in 2013.

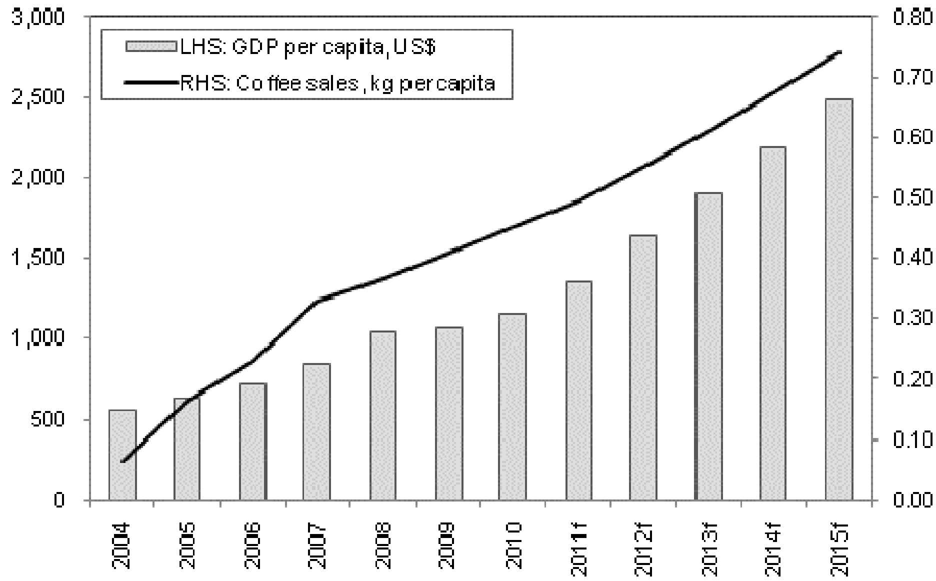
Vinacafe Offers A Strong Platform For Masan To Pursue Coffee Sector Growth

Masan Consumer , which is the largest producer of condiments like fish, soy and chili sauce and the second biggest producer of instant noodles in Vietnam, has launched a bid for a 50.1% stake, valued at around VND1.07trn (US$51mn), in the Vietnamese coffee producer **Vinacafe Bien Hoa Joint-Stock Company** . Masan plans to acquire 13.32mn Vinacafe shares for VND80,000 (US$3.84) per share. In our opinion, the very dynamic rewards on offer in the Vietnamese coffee sector and an exciting consumer growth story are likely to have emerged as strong motivations behind Masan's acquisition.

A very dynamic consumer story continues to take shape in Vietnam, and Masan's investment clearly underlines its confidence in the country's consumer outlook. A massive youth population (51.9% of Vietnam's population is estimated to be under 30 years old) underpins a hugely dynamic outlook for consumer-facing players in Vietnam, particularly for consumer goods players targeting the mass-market segment as this demographic group matures over time. This, coupled with low existing per capita food and drink consumption levels, implies that considerable room for growth in the food and drink sectors remains.

A Coffee Consumption Boom

LHS: Vietnam GDP per capita (US$) and RHS: Coffee Sales (kg per capita)



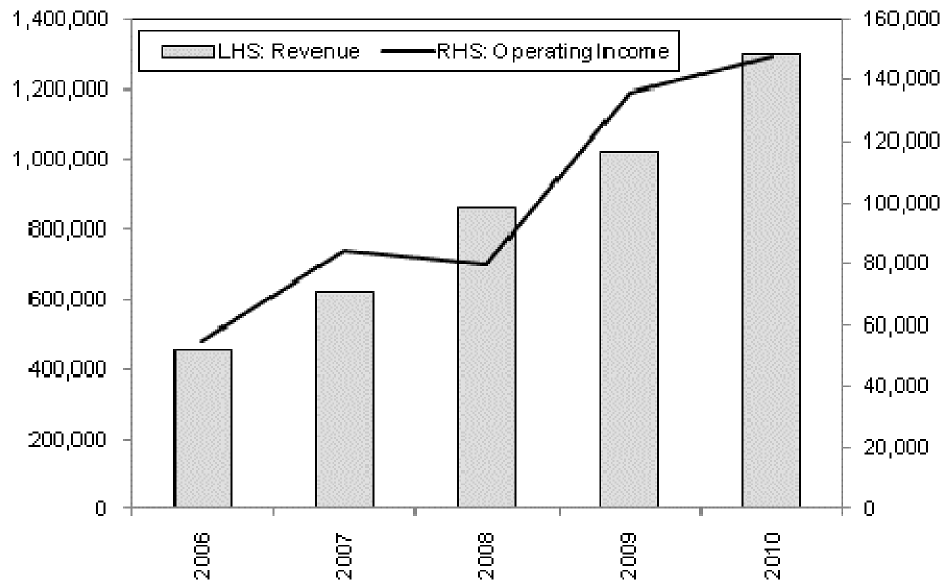
f= BMI forecast. Source: General Statistics Office, Trade Press, UNCTAD

As income rise in Vietnam, coffee consumption is expected to grow impressively over the coming decade. As people get richer, opportunities at the premium end of the coffee market should strengthen. The younger, more educated generation, in particular, are witnessing a stronger uptake of higher-quality coffee. As a case in point, a 2009 survey conducted by the Policy and Strategy Institute on Agriculture and Rural Development on coffee drinking habits showed that coffee consumption was highest among the young and the well-educated living in urban areas and lowest among the elderly and in rural areas. Although Vietnam's per capita coffee consumption level of 0.5kg per capita is small in comparison to coffee consumption in other coffee-exporting countries like Brazil, which has a per capita coffee consumption level of 5.7kg per capita, we believe this low base translates into significant growth potential in the domestic coffee market (see chart).

By acquiring a controlling stake in Vinacafe, Masan clearly wants to put itself in a strong position to leverage on the exciting demand dynamics in the Vietnamese coffee sector. According to Vietnam Coffee and Cocoa Association, Vinacafe is the country's second-largest coffee exporter, and Masan could tap on Vinacafe's expertise and brand name to grow its presence in the domestic coffee sector. Reflecting Vinacafe's strength in the Vietnamese coffee sector, the coffee producer consistently grew its revenues over the past five years and recorded an impressive 30% compound annual average growth in its headline sales between 2006 and 2010.

Coffee Dynamism Boosting Sales

LHS: Vinacafe Revenue and RHS: Operating Income (VND mn)



Source: Bloomberg

Looking ahead, the backing of an expansion-oriented private equity player **Kohlberg Kravis Roberts & Co** (KKR) should continue to prove very supportive of Masan's expansion plans beyond the processed food sectors into other consumer goods products. Earlier in April, KKR acquired a 10% stake in Masan for US$159mn as it looks to leverage off Vietnam's private consumption boom. Given KKR's growing appetite for emerging market-based assets, we believe it will continue to commit significant sums of investment in expanding Masan's domestic scale. Closely following KKR's injection of equity capital into Masan, the latter announced that it has a war chest of as much as US$500mn to pursue acquisitional growth, which should leave Masan increasingly well-placed to reap the attractive rewards on offer in Vietnam.

Industry Trend Analysis

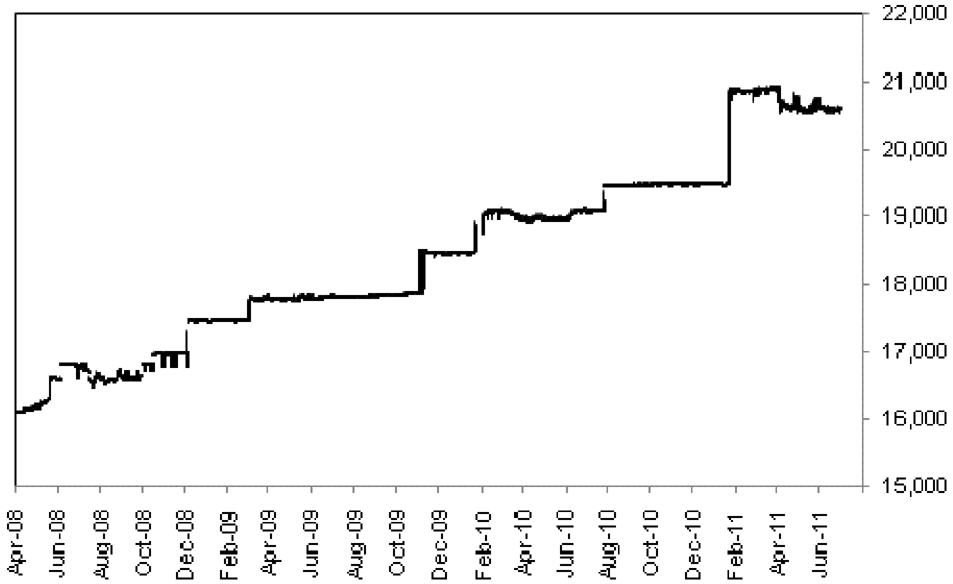
Vietnamese Craving For More Sweets

Vietnamese confectioners are facing mixed headwinds over the coming quarters. On the one hand, the gradual appreciation of the Vietnamese dong in recent months is fanning depreciatory pressures on price of imported raw materials and manufactured confectionery products, in turn placing pressure on the margins of domestic confectioners. On the other hand, prices across the global agricultural complex are moderating, which should provide some relief to the profitability of domestic confectionery players. Over the longer term, dynamics such as rising purchasing power, a massive youthful population, growing health awareness and continued investments in the sector underpin a strong growth outlook for the Vietnamese confectionery sector.

The gradual appreciation of the Vietnamese dong in recent months is fuelling depreciatory pressures on prices of imported confectionery products, consequently threatening the margins of domestic confectionery producers. Although the Vietnamese dong experienced only mild appreciation against the US dollar, domestic confectioners are already feeling a greater squeeze from the lower prices of imported goods. A survey conducted by local media Sai Gon Tiep Thi revealed that average prices of imported confectionery products fell by VND5,000 (US$0.2) per kilogram. Moreover, according to Phan Van Thien, the deputy general director of Vietnamese confectioner **Bibica** , imported products are currently priced at around 10% more than domestic goods, compared with an average price differential of 20% previously. Against the backdrop of lower prices in imported confectionery products, domestic confectioners typically have to resort to lowering their product prices in order to protect sales, in turn dampening their margins.

A Mild Appreciation

Vietnamese Dong/US Dollar Spot Rate



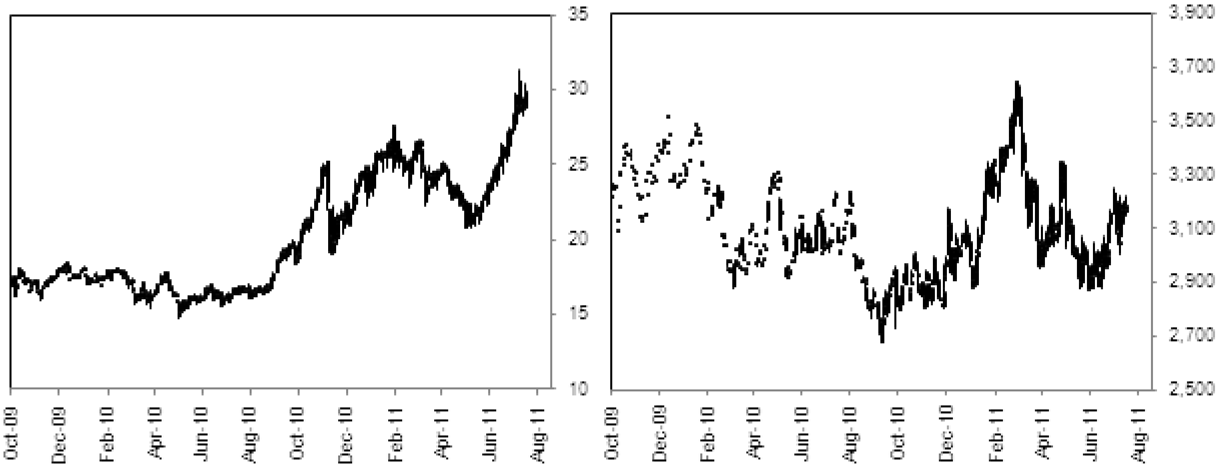
Source: BMI, Bloomberg

Since February, the Vietnamese central bank has implemented 800 basis points worth of interest rate hikes. While we are not expecting significant appreciation in the Vietnamese dong on the back of this aggressive monetary tightening in recent months, this policy is likely to help prevent significant depreciation of the dong, implying sustained pressures on domestic confectioners. Our Country Risk team is expecting the VND/US$ exchange rate to average VND/US$20,375 in 2012, representing a mild appreciation from the current spot rate of VND/US$20,610 (*see chart*).

On the other hand, moderating prices of key raw materials such as sugar and cocoa should lend some upward support to the profitability of domestic confectionery players (*see chart*). Given our expectations of further moderation in raw material prices, this should help mitigate the impact of deflationary pressures in imported goods on the bottom line of domestic confectioners.

Moderating Prices

LHS: Front-Month Sugar (October 11), Usc/lb and RHS: Front-Month Cocoa (September 11), GBP/tonne



Source: Bloomberg

The longer-term outlook for the Vietnamese confectionery market is more certain. With factors such as rising purchasing power, favourable demographics, growing health awareness and continued investments in the sector supporting confectionery demand, we are forecasting a compound annual average growth of 8.2% in confectionery value sales in local currency terms to 2015.

- Rising Disposable Incomes: Rapid wealth accrual (GDP per capita is forecast to more than triple to reach US$4,444 by 2020) translates into a greater discretionary appetite for premium confectionery products. As an increasing number of domestic confectioners expand their upmarket product ranges, this would bolster value sales growth over the coming years.

- A Massive Youthful Population: 51.9% of the Vietnamese population is estimated to be under 30 years old, and the maturation of this demographic group mean that there are dynamic opportunities in the mass market. Moreover, this demographic group is generally more receptive to western cultures, which should give an impetus to confectionery demand.

- Growing Health Awareness: Rising health awareness are prompting shifts of consumption habits towards functional and healthy confectionery products. Capitalising on the growing health awareness trend, domestic confectioners such as **Tan Tan Food & Foodstuff** and **Vina Mit** are also expanding their functional product offerings. These products typically carry higher price tags, and their rising demand should translate into higher value sales in the sector.

- Continued Sector Investments: Sustained competition levels in the Vietnamese confectionery sector ensure that dynamism in the market is unlikely to cool off anytime soon. **Nabati**

Indonesia , a leading Indonesian biscuit producer, recently announced plans to start distributing its biscuit products in Vietnam - a testament to the attractiveness of the sector. Meanwhile, domestic confectioners such as **Kinh Do** will continue to invest in broadening its product ranges and expanding its distribution channels.

Rural Market Potential Firmly In The Sights Of Consumer-Facing Players

More consumer goods producers are setting their sights on the massive, rapidly expanding rural consumer market in Vietnam. Fast-moving consumer goods giants **Unilever** and **Procter & Gamble** (P&G) are providing smaller variants of their household products at relatively lower prices as they look to target the lower-income rural consumer base, while the fast-growing rural exposure of domestic consumer goods players such as **Masan Consumer** and **Hanoi Liquor Joint Stock Company** (Halico) has caught the eye of multinationals. Vietnamese consumers getting richer, improving infrastructure and the spread of organised retail are all supportive of the growing spending power of the rural consumer. We expect more multinationals to get in on the act over the coming years.

Reaching out to the Vietnamese rural consumer base has not been particularly easy for consumer goods manufacturers, both local and multinational. With lower income, rural consumers have a smaller discretionary appetite for higher-value consumer goods, which has made it tougher for the likes of Unilever and P&G to sell some of their products. In the rural areas, weak distribution infrastructure frustrates the expansion efforts of consumer goods producers, while the dominance of traditional retail makes it even harder to reach would-be consumers efficiently.

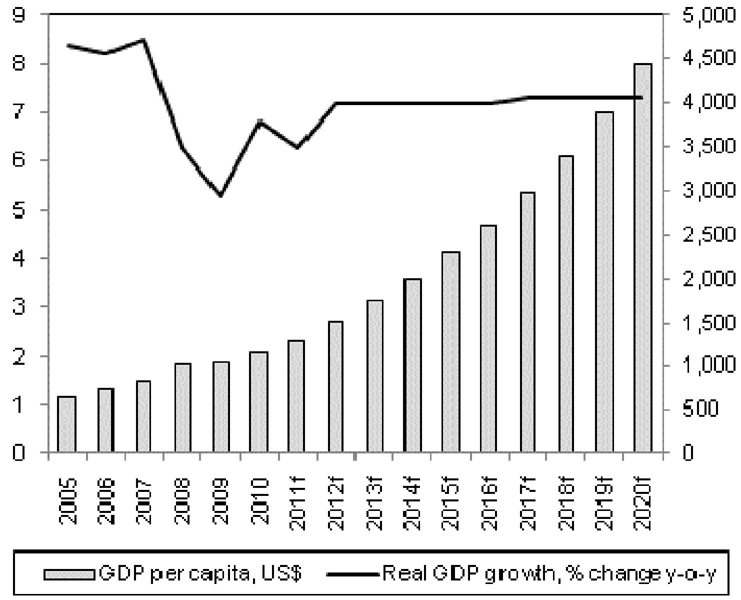
However, these challenges have not deterred consumer goods manufacturers from setting up shop in the Vietnamese rural consumer market, clearly underlining the immense potential in this market. Fast-growing rural sales at Masan Consumer, the largest producer of condiments, such as fish, soy and chilli sauce, and the second biggest producer of instant noodles in Vietnam, has attracted the sights of global private equity firm **Kohlberg Kravis Roberts & Co** (KKR). KKR agreed to acquire a 10% stake in Masan Consumer in April 2011 for US$159mn (*see 'Vietnam Catching The Attention Of The Private Equity World', April 21*). As another example, Vietnamese spirits major Halico's expansions in the rural market caught the attention of UK spirits producer **Diageo** as it agreed to acquire a stake of around 24% in Halico for GBP33.0mn in March 2011 (US$53.9mn).

Exciting Dynamics In The Rural Market

These investments underline the fantastic fundamental long-term growth prospects in the Vietnamese rural market, which ties in nicely with our wider outlook on the country's domestic demand story. Rising income, sector immaturity, the spread of organised retail, and a plethora of macroeconomic-driving factors make the Vietnamese consumer goods sector a high-growth prospect, and the rural consumer market will benefit strongly from these dynamics, which we will elaborate on below. According to Tran Vu Hoai, the head of corporate relations for **Unilever Vietnam** , Unilever's Vietnam sales have been growing at an annual average of 18.5% over the past decade to reach US$700mn in 2010, of which rural sales make up about 50%, bearing out strong growth prospects in the rural consumer market.

Upwardly Mobile

Vietnam: LHS: Real GDP growth (% chg y-o-y) and RHS: GDP per capita (US$)



Source: General Statistics Office

- Rising Incomes: Vietnam's GDP per capita is forecast to more than triple to reach US$4,444 by 2020. As rural consumers move up the income ranks, there are potentially dynamic opportunities in the mass market as higher-value, higher-quality products become more affordable to more people.

- Improving Infrastructure: Recent surveys indicate that approximately 40% of the national road network in Vietnam is in poor condition and will require substantial investment to reach a maintainable condition. However, with measures in place to upgrade the country's distribution infrastructure, the improving infrastructure standards, particularly in the rural areas, should make it easier to target more consumers at a lower cost than before.

- Development of Organised Retail Channels: Pockets of wealth in the rural areas are capturing the attention of foreign retailers such as **Groupe Casino** and **Metro Cash and Carry** , encouraging the spread of organised grocery retail across the rural market. The opening of more modern retail stores such as supermarkets and hypermarkets should ease the distribution of consumer goods and improve the visibility of products to rural consumers.

These dynamics mean that multinationals and local consumer goods players have unsurprisingly been keen to position themselves early and will continue expanding in the rural markets in order to reap the exciting rewards on offer. Unilever and P&G are offering some of their products such as shampoos and fabric softeners in cheaper small sachets, which cost around VND500 (US$0.02), while local confectioner

Pham Nguyen Foods is providing smaller variants of its chocolate cakes as they look to familiarise consumers with their products. Lowering production costs is another initiative employed by consumer goods manufacturers when tapping into rural consumer demand. Halico, for instance, used plastic instead of glass for its vodka bottles to cut costs so as to offer its products at more affordable prices to its rural consumers.

Consumer Outlook - Monetary Tightening Leads To Softer Domestic Demand Conditions In H211

The State Bank of Vietnam's aggressive monetary tightening measures in H111 are expected to take the steam out of domestic demand over the coming quarters. While there are encouraging signs that inflationary pressures are beginning to cool, we remain concerned about the lagged impact of monetary tightening on consumer spending. However, given the positive dynamics of low unemployment, strong tourism growth and increasing remittance inflows, there is still considerable scope for optimism in the country's domestic demand picture in the near term. Over the longer term, the domestic demand picture for Vietnam looks brighter. A massive youthful population, sector immaturity and a plethora of macroeconomic driving factors make the Vietnamese consumer goods sector a high-growth prospect.

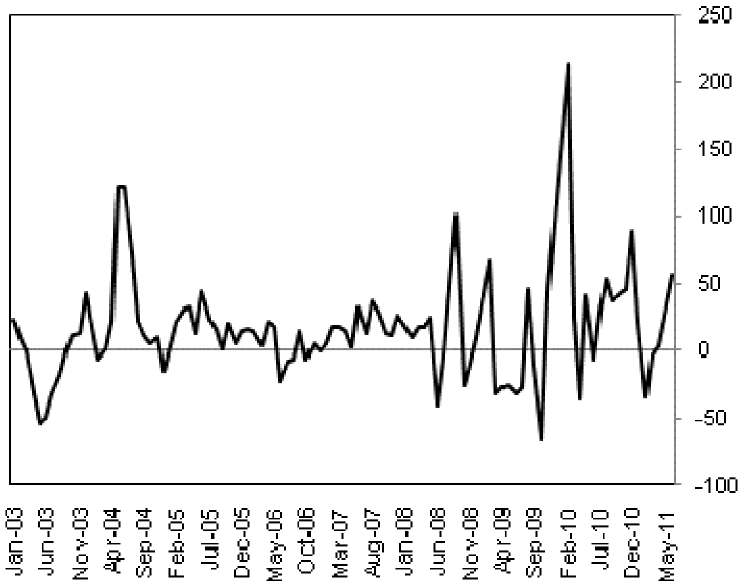
Rising Remittances, Low Unemployment

Vietnam's buoyant labour market conditions and rising remittance inflows are expected to give firm impetus to consumerism over the coming quarters. According to a recent report by CNN, Vietnam recorded one of the lowest unemployment rates of 2.6% in June among the Asia Pacific countries. On another positive note, remittance inflows are steadily increasing, which should translate into stronger purchasing power and a greater willingness to spend among local consumers. While actual data on remittances in Vietnam is not available, anecdotal evidence from local banks and financial institutions points to growing momentum in remittance inflows. Local bank Sacombank, for instance, noted a 30% year-on-year (y-o-y) increase in overseas remittances for H111, while Western Union, a subsidiary of Asia Commercial Bank reported an increase of 8% y-o-y in remittance revenue over the same period.

Strong Tourism Growth Boosts Demand Growth

On The Up

Vietnam Tourist Arrival Growth, % chg y-o-y



Source: General Statistics Office, Bloomberg

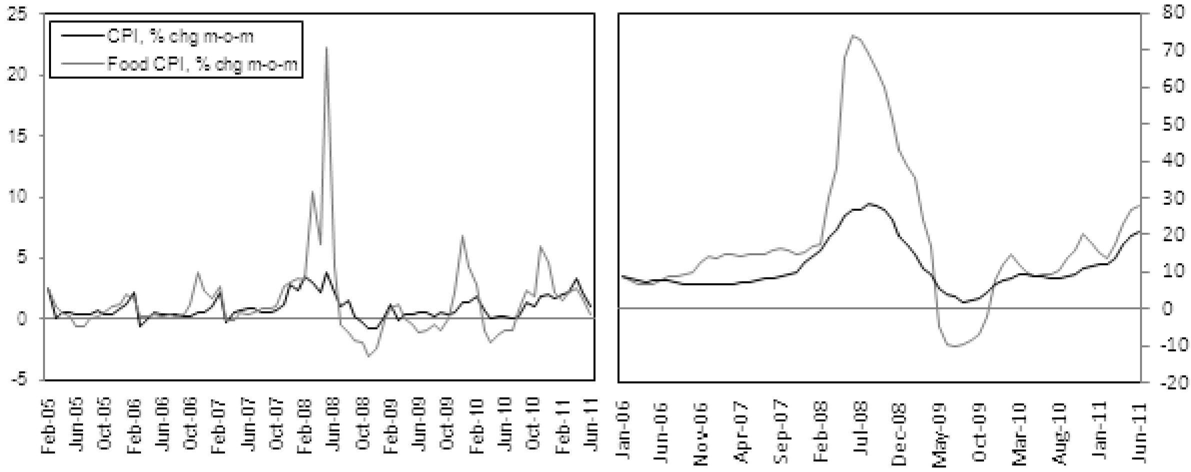
A strong showing in the Vietnamese tourism sector is also expected to have positive spillover effects for the consumer-facing sectors. Vietnamese tourist arrivals increased by 55.9% y-o-y in June. While base effects (due to a y-o-y decline in tourist arrivals in the previous year) has a part to play behind this impressive growth figure, we observe that tourist arrival growth has been particularly strong over the past few months, which should provide a strong fillip for consumer goods sales, particularly for more expensive premium products (*see chart*).

Aggressive Monetary Tightening Dampens Domestic Demand

Despite these positives, the impact of aggressive rate hikes since the beginning of the year provides some reason for caution in Vietnam's near-term domestic demand picture, and we believe consumer spending growth will continue to moderate over the coming quarters. Prompted by the sustained intensity of inflationary pressures and overheating concerns, the State Bank of Vietnam engaged in an aggressive round of monetary tightening in the earlier months of 2011. Between February and April, the central bank hiked its benchmark policy rate by 800 basis points.

Moderating Inflationary Pressures

Vietnam: LHS: CPI and Food CPI (% chg m-o-m) and RHS: CPI and Food CPI (% chg y-o-y)

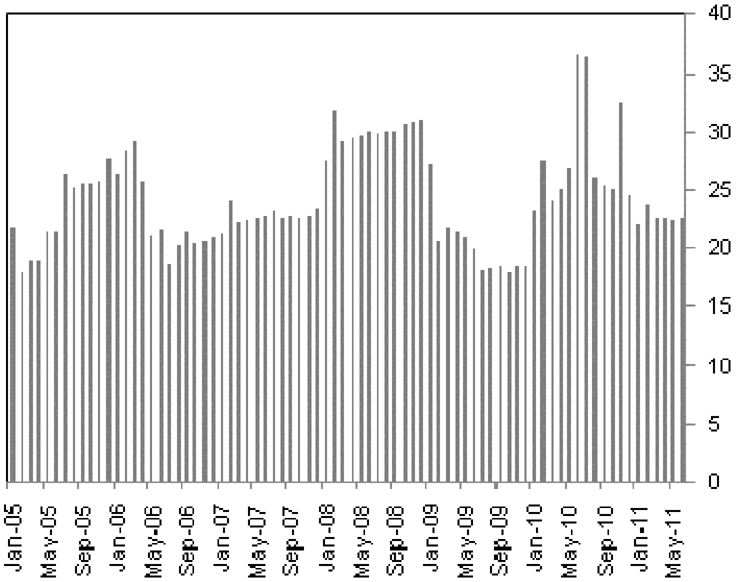


Source: Bloomberg, General Statistics Office

While our Country Risk team does not envisage further rate hikes in the Vietnamese economy in 2011, we believe the lagged impact of monetary tightening in the earlier months of 2011 would prevent domestic demand from reaching its full potential this year. As the accompanying chart shows, we are beginning to see signs of a moderation in consumer price inflation in month-on-month terms. This, coupled with the central bank's decision to keep rates on hold at 14% since May, underpins our view that we have come to an end of a monetary tightening cycle for Vietnam.

Retail Sales Taking A Hit

Vietnam Retail Sales Growth, % chg y-o-y



Source: General Statistics Office, Bloomberg

The impact of monetary tightening on consumer spending is borne out by recent retail sales figures. Retail sales have moderated since February when the central bank initiated its monetary tightening cycle, recording growth of 22.6% in June. While this is an impressive growth figure, which underlines the robustness of the domestic demand conditions, we observe that retail sales growth has trended along a distinct deceleratory path in recent months (*see chart*), bearing out the impact of monetary tightening on consumer spending.

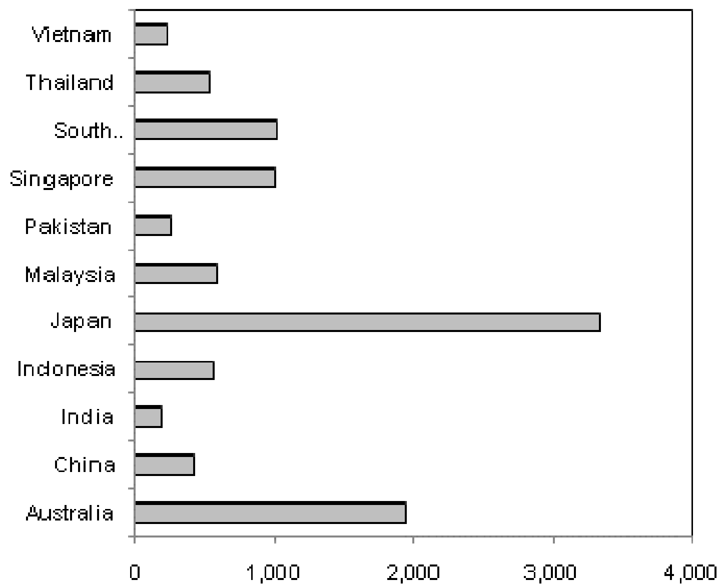
Cannot Deny Vietnam's Long-Term Potential

If a tighter credit environment poses a threat to near-term domestic demand conditions, the long-term potential of the consumer-facing sectors in Vietnam is undeniable. Rapid economic growth in Vietnam over the coming years should translate into higher income, in turn benefiting consumerism. GDP per capita in Vietnam is forecast to more than triple to reach US$4,444 by 2020.

Most exciting though is the country's favourable demographic profile; 51.9% of the population is estimated to be under 30 years old, implying potentially dynamic opportunities for consumer goods players targeting the mass-market segment in particular as this demographic group matures over time.

Low Consumption But Massive Room For Growth

Selected Countries Per Capita Food Consumption (2011)



Source: BMI forecast

The immaturity of food, drink and retail sectors in Vietnam ensures that the country will retain its appeal as one of the most exciting markets in the region for some time to come. Low existing per capita food and drink consumption levels in Vietnam imply that considerable room for growth remains (*see chart*). Moreover, organised grocery retail makes up only 15% of overall grocery retail sales, compared with levels of between 40-70% elsewhere in South East Asia. Given just how far organised retail has to run before its proportional contribution is comparable with developed economies and countries such as China, Thailand and Malaysia, there are going to be huge opportunities for mass grocery retail growth in Vietnam.

BMI Forecast Modelling

How We Generate Our Industry Forecasts

BMI's industry forecasts are generated using the best-practice techniques of time-series modelling and causal/econometric modelling. The precise form of model we use varies from industry to industry, in each case being determined, as per standard practice, by the prevailing features of the industry data being examined. **BMI** mainly uses OLS estimators and in order to avoid relying on subjective views and encourage the use of objective views, **BMI** uses a 'general-to-specific' method. **BMI** mainly uses a linear model, but simple non-linear models, such as the log-linear model, are used when necessary. During periods of 'industry shock', for example poor weather conditions impeding agricultural output, dummy variables are used to determine the level of impact.

Effective forecasting depends on appropriately-selected regression models. **BMI** selects the best model according to various different criteria and tests, including, but not exclusive to:

- R^2 tests explanatory power; Adjusted R^2 takes degree of freedom into account
- Testing the directional movement and magnitude of coefficients
- Hypothesis testing to ensure coefficients are significant (normally t-test and/or P-value)
- All results are assessed to alleviate issues related to auto-correlation and multi-collinearity

BMI uses the selected best model to perform forecasting.

It must be remembered that human intervention plays a necessary and desirable role in all of **BMI**'s industry forecasting. Experience, expertise and knowledge of industry data and trends ensures that analysts spot structural breaks, anomalous data, turning points and seasonal features where a purely mechanical forecasting process would not.

Within the Agribusiness industry, this intervention might include, but is not exclusive to, technology development that might influence future output levels (for example greater use of biotechnology), dramatic changes in local production levels due to public or private sector investment, the regulatory environment and specific areas of legislation, such as import and export tariffs and farm subsidies, changes in lifestyles and general societal trends, the formation of bilateral and multilateral trading agreements and political factors.

The following two examples show the demand (consumption) and the supply (production) of rice. Note: the explanatory variables for both of them are quite similar, but the underlying economic theory is different.

Example of Rice Consumption Model:

$(\text{Rice Consumption})_t = \beta_0 + \beta_1*(\text{Real Private Consumption per capita})_t + \beta_2*(\text{Inflation})_t + \beta_3*(\text{Real Lending Rate})_t + \beta_4*(\text{Population})_t + \beta_5*(\text{Government Expenditure})_t + \beta_6*(\text{Food Consumption})_{t-1} + \varepsilon_t$

Where:

- β are parameters for this function.
- Real Private Consumption per capita has a positive relationship with Rice Consumption, if rice is a normal good in a particular country. If rice is an inferior good in a country, the relationship is negative. So the sign of β_1 is determined by a specific product within a specific country.
- When Inflation is high, people with rational expectations will consume 'today' rather than wait for 'tomorrow's high price to come. Higher rice demand in Year t due to higher inflation in that year leads to an assumed positive sign of β_2.
- The relationship between Real Lending Rate and Rice Consumption is expected to be negative. When real lending rates increase, disposable incomes, especially for those with mortgage burdens etc, will decrease. So the sign of β_3 is expected to be negative.
- Of course, other things being equal, growth in rice consumption can also be caused by growth in population. Consequently, positive sign of β_4 is expected.
- Government Expenditure typically causes total disposable incomes to rise. So the sign of β_5 is expected to be positive.
- Human behaviour has a trend: A high level of food consumption in previous years means there is very likely to be a high level of food consumption the next year. So the positive sign of β_6 is expected.
- ε is the error/residual term.

Example of Rice Production Model:

$(\text{Rice Production})_t = \beta_0 + \beta_1*(\text{Real GDP per capita})_t + \beta_2*(\text{Inflation})_t + \beta_3*(\text{Real Lending Rate})_t + \beta_4*(\text{Rural Population})_t + \beta_5*(\text{Government Expenditure})_t + \beta_6*(\text{Food Production})_{t-1} + \varepsilon_t$

Where:

- The same as above, the relationship between Real GDP per capita and rice production depends on whether rice is normal or inferior good in that country.
- If high inflation is caused by food prices increasing, farmers will be more profitable. Then they will supply more agricultural product (e.g. rice) to increase their marginal (extra) profit, although this is tempered by the rising cost of other inputs in line with inflation.
- There is a global move towards corporate farming, away from small holdings, in order to achieve greater agricultural productivity. Corporate farming means more investment in the modes of

production i.e. agricultural machinery. Higher real lending rates discourage investment, which in turn reduce production.

- BMI assumes only the rural population has a positive effect on agricultural product supply.
- With supportive government policy, other things being equal, rice production is expected to go up. Government Expenditure is likely to play some role in supporting agribusiness.
- Again, previous food production positively affects this year's prediction.