BUSINESS MONITOR international

Q2 2011

www.businessmonitor.com

VIETNAM

BUSINESS FORECAST REPORT

INCLUDES 10-YEAR FORECAST TO 2020

Growth At The Expense Of Price Stability

ISSN 1745-0764

Published by Business Monitor International Ltd.

Copy Deadline: 17 February 2011

TABLE: VIETNAM – MACROECONOMIC DATA AND FORECASTS

	2006	2007	2008	2009	2010e	2011f	2012f	2013f	2014f	2015f
Population, mn [4]	84.1	85.2	86.2	87.3	88.4	89.3	90.2	91.1	92.0	92.8
Nominal GDP, US$bn [5]	60.9	71.1	89.8	92.8	101.9	117.8	133.8	155.1	179.1	206.1
Nominal GDP, VNDbn [5]	974,265.8	1,143,715.1	1,485,038.0	1,658,389.0	1,953,223.3	2,326,853.6	2,641,667.1	2,985,462.7	3,358,614.4	3,761,091.7
GDP per capita, US$ [5]	724	835	1,041	1,063	1,153	1,320	1,483	1,703	1,948	2,220
Real GDP growth, % change y-o-y [5]	8.2	8.5	6.3	5.3	6.8	6.3	7.2	7.2	7.2	7.2
Industrial production index, % y-o-y, ave [1,5]	18.0	16.8	13.6	6.7	14.0	10.0	15.0	16.0	17.0	16.0
Unemployment, % of labour force, eop [5]	4.8	4.6	4.7	6.0	5.0	6.0	5.0	5.0	5.0	5.0
Budget balance, VNDbn [6]	13,000.0	-11,194.0	9,897.0	-108,722.0	-91,365.0	-50,745.9	-50,113.7	-47,725.3	-42,949.8	-34,975.5
Budget balance, % of GDP [6]	1.3	-1.0	0.7	-6.6	-4.7	-2.2	-1.9	-1.6	-1.3	-0.9
Consumer prices, % y-o-y, eop [2,5]	6.6	12.6	19.9	6.5	11.8	7.2	6.0	6.0	5.0	5.0
Consumer prices, % y-o-y, ave [2,5]	7.5	8.3	23.0	7.0	9.2	11.5	6.5	6.0	5.5	5.0
Central bank policy rate, % [7]	8.20	8.20	8.50	9.00	9.00	10.00	9.00	8.00	7.00	7.00
Exchange rate VND/US$, eop [8]	16,056.00	16,017.00	17,483.00	18,469.00	19,498.00	20,000.00	20,000.00	19,500.00	19,000.00	18,500.00
Exchange rate VND/US$, ave [8]	15,993.58	16,077.42	16,543.00	17,868.67	19,174.42	19,749.00	19,750.00	19,250.00	18,750.00	18,250.00
Exchange rate VND/EUR, eop [8]	21,187.50	23,367.20	24,476.20	23,455.63	26,082.48	26,600.00	25,000.00	24,375.00	23,750.00	23,125.00
Goods exports, US$bn [9]	39.8	48.6	62.7	57.1	64.0	69.7	77.4	86.7	97.0	108.7
Goods imports, US$bn [9]	42.6	58.9	75.5	65.4	71.3	78.4	87.0	96.6	107.2	119.0
Balance of trade in goods, US$bn [9]	-2.8	-10.4	-12.8	-8.3	-7.3	-8.7	-9.7	-10.0	-10.2	-10.3
Balance of trade in goods and services, US$bn [3,10]	-4.2	-13.4	-18.1	-14.0	-13.1	-15.3	-17.1	-18.4	-19.8	-21.2
Current account, US$bn [9]	-0.2	-7.1	-10.8	-7.4	-5.6	-7.0	-8.1	-8.4	-8.8	-9.2
Current account, % of GDP [9]	-0.3	-10.0	-12.0	-8.0	-5.5	-6.0	-6.0	-5.4	-4.9	-4.4
Foreign reserves ex gold, US$bn [9]	13.4	23.5	23.9	16.4	17.5	20.1	22.9	25.9	29.3	33.1
Import cover, months g&s [9]	3.8	4.8	3.8	3.1	3.0	3.1	3.2	3.2	3.3	3.3
Total external debt stock, % of GDP [11]	30.6	32.0	27.8	30.9	30.8	29.1	27.8	25.9	24.3	22.9
Total external debt stock % of XGS [11]	40.8	40.8	35.1	45.1	44.0	43.8	42.7	41.2	39.8	38.5

Notes: e/f = BMI estimates/forecasts. 1 At 1994 prices; 2 Base year 2000; 3 Includes investment income flows up until 2004; Sources: 4 World Bank/BMI calculation/BMI; 5 General Statistics Office; 6 Asian Development Bank, Ministry of Finance; 7 State Bank of Vietnam; 8 BMI; 9 Asian Development Bank; 10 Asian Development Bank, General Statistics Office; 11 World Bank.

Contents

Executive Summary

Strained Relations With China Set To Continue

- Vietnam's real GDP growth came in at a better-than-expected 6.8% in 2010, led by a strong performance in the construction sector. Going forward, we expect domestic demand to remain robust on the back of rising wages and improving consumer sentiment. In light of a good Q410 result and our Global team's recent upgrade on the US economy, we are revising our real GDP growth forecast upwards from 5.5% to 6.3% for 2011. However, we warn that mounting inflationary pressures, a persistent trade deficit and fiscal imbalances remain outstanding risks that could undermine macroeconomic stability over the coming months.

- Strained relations with China are set to continue as we anticipate further efforts by Hanoi to deepen ties with Washington and the Association of Southeast Asian Nations (ASEAN) to counter Beijing's growing political clout and military presence in the region. The revelation of a Chinese stealth fighter jet in the final stages of development in January 2011 is expected to reignite Vietnam's concerns over China's ambitions to modernise its military. We also expect Vietnam to continue to show support for ASEAN's efforts to promote intra-regional trade and investment in a bid to reduce the country's dependence on Chinese imports.

- Vietnam's fiscal deficit narrowed from 6.6% of GDP in 2009 to 4.7% of GDP in 2010, largely in line with our previous forecast of 4.6%. Despite an improvement in the country's fiscal position, we warn that social expenditures as a percentage of total fiscal expenditure have continued to rise since 2007. Withdrawing these subsidies will prove a challenging task and we remain sceptical that the government will be successful in bringing the fiscal budget back into balance in the short-to-medium term. Moreover, rising food and fuel prices remain a significant threat that could translate into heavier government subsidies in 2011.

- Despite the State Bank of Vietnam's decision to impose a 14.0% ceiling on local currency deposit rates, we believe the central bank's failure to anchor inflation expectations will continue to put upward pressure on interest rates. We expect business conditions to remain difficult as lending rates remain elevated in the short-to-medium term. Businesses with tight profit margins in particular could struggle to stay profitable if they fail to pass on higher production and financing costs to the consumer. We warn that businesses may begin to face financing difficulties should lending rates continue to climb over the coming months.

Chapter 1:
Political Outlook

SWOT Analysis

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 likely 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 substantial Chinese investment into a bauxite mining project in the central highlands, which could potentially cause wide-scale environmental damage.

BMI Political Risk Ratings

Vietnam's short-term political risk rating of 78.1 reflects a largely stable political system, kept in place largely by the ruling Communist Party of Vietnam's monopoly on power. While public expressions of discontent have so far been limited, slower growth and high inflation pose a threat to stability in the near term. However, we see one-party rule as inherently unsustainable in the longer term and thus accord Vietnam a rating of 53.8 in our long-term political risk ratings, due mainly to a score of 27.6 in the 'characteristics of polity' rating.

	S-T Political	Rank	Trend
Singapore	96.7	1	=
Brunei Darussalam	90.6	2	=
Hong Kong	86.7	3	=
Taiwan	82.7	4	=
Japan	81.9	5	=
China	80.4	6	=
Laos	80.4	6	=
Malaysia	80.2	8	=
Vietnam	**78.1**	**9**	**=**
South Korea	77.1	10	=
North Korea	73.5	11	=
Indonesia	73.5	12	=
Sri Lanka	72.3	13	=
Philippines	67.9	14	=
India	66.5	15	=
Thailand	65.4	16	=
Bangladesh	65.0	17	=
Cambodia	62.7	18	=
Bhutan	61.0	19	=
Myanmar	54.8	20	=
Papua New Guinea	51.9	21	=
Pakistan	33.5	22	=

Regional ave 72.1 / Global ave 67.1 / Emerging Markets ave 64.9

	L-T Political	Rank	Trend
Japan	89.1	1	=
South Korea	82.2	2	=
Singapore	81.6	3	=
Taiwan	75.4	4	=
Hong Kong	72.9	5	=
China	69.4	6	=
Malaysia	69.2	7	=
India	66.7	8	=
Brunei Darussalam	65.6	9	=
Philippines	62.8	10	=
Sri Lanka	61.7	11	=
Indonesia	59.0	12	=
Bangladesh	58.8	13	=
Papua New Guinea	58.7	14	=
Cambodia	57.9	15	=
North Korea	57.1	16	=
Thailand	56.8	17	=
Vietnam	**53.8**	**18**	**=**
Bhutan	51.0	19	=
Pakistan	44.9	20	=
Laos	44.5	21	=
Myanmar	33.3	22	=

Regional ave 61.6 / Global ave 63.6 / Emerging Markets ave 60.1

Domestic Politics

National Congress Unlikely To See Shift In Expansionary Focus

BMI VIEW

We reiterate our view that Vietnam's 11th National Congress is unlikely to result in a major shift in policy direction over the next five years. Prime Minister Nguyen Tan Dung retained his post for another term, which suggests that the Communist Party of Vietnam's stance on economic reforms will continue over the coming years. Vietnam's socio-economic targets for 2011 indicate an increased focus on achieving macroeconomic stability and controlling inflation. Nonetheless, the National Assembly's real GDP growth target of 7.5% in 2011 remains overly ambitious in light of overheating pressures in the economy.

Vietnam's 11th National Congress, which was held in January, witnessed the rise of Nguyen Phu Trong to the post of General Secretary of the CPV. Key political figures including former party general secretary Nong Duc Manh will retire due to the age ceiling of 65 for members seeking re-election. Having survived a no-confidence vote in November – due to criticism of the handling of the near-bankrupt state-owned shipbuilding company **Vinashin** – we see this as an indication that Prime Minister Dung's popularity and his influence within the National Assembly remain strong. As such, Dung's stance on economic reforms is expected to continue over the coming years. The National Congress will also approve draft documents on national development and Vietnam's political framework, which are expected to reaffirm the socialist orientation of the country.

No Change To Policy Direction

Back in October, we highlighted our view that the direction of Vietnam's economic policies would remain largely unchanged in spite of a reshuffle of key political figures within the politburo (*see our online service, October 18 2010, 'Policy Direction Set To Continue In 2011'*). We argued that the CPV's economic policies would continue to centre on opening the economy to foreign competition, addressing corruption, promoting trade and upgrading the country's infrastructure and technology. The theme of the National Congress also remains dedicated towards continuing the 'Doi Moi' (meaning 'renovation') process of market-oriented reforms, as the congress reiterates its commitment to become a fully industrialised economy by 2020. Despite the socialist rhetoric that we expect to come out of this congress, Vietnam will continue to move in the direction of a market-based economy. From our perspective, we regard this as a positive development that will provide support for our bullish long-term economic outlook for Vietnam.

Calling For A Balance To Growth

The National Assembly is targeting real GDP growth of 7.5% for 2011 which, in our opinion, remains overly ambitious in light

TABLE: VIETNAM POLITICAL OVERVIEW

System of Government	Single-party socialist republic
Head of State	President Nguyen Minh Triet
Head of Government	Prime Minister Nguyen Tan Dung
Last Election	Parliamentary – May 2007
Communist Party Congress – April 2006	
Composition Of Current Government	Communist Party of Vietnam
Key Figures	The 14-person Communist Party politburo, elected by the 160-person party central committee at the national party congress, acts as the de facto highest decision-making body and comprises the top leadership of the Communist Party of Vietnam. Its most important members are Party General Secretary Nguyen Phu Trong, State President Nguyen Minh Triet, Prime Minister Nguyen Tan Dung and General Minister of Public Security Le Hong Anh.
Other Key Posts	Deputy Prime Minister – Nguyen Sinh Hung; Foreign Minister – Pham Gia Khiem; Minister of Planning and Investment – Vo Hong Phuc; Vice President – Truong My Hoa; Central Bank Governor – Nguyen Van Giau
Main Political Parties	Communist Party of Vietnam (CPV): Founded in Hong Kong in 1930, the CPV has been in power in North Vietnam since independence in 1954 and in the South since the end of the American War in 1975. Divisions exist within the party between a younger, more reform-minded faction originating from South Vietnam and an older generation, originating from the North, more aligned to traditionally communist ideology.
Next Election	Presidential and parliamentary – May 2012
Ongoing Disputes	Ongoing dispute with China, Malaysia, the Philippines and Taiwan over Spratly Islands in South China Sea
Key Relations/ Treaties	ASEAN and WTO member, temporary seat (2008-2009) on the UN Security Council
BMI Short-Term Political Risk Rating	78.1
BMI Structural Political Risk Rating	53.8

Source: BMI

of overheating pressures in the economy. Vietnam continues to struggle with mounting inflationary pressures, persistent trade deficits and deteriorating confidence in the domestic currency. We see these short-term macroeconomic problems as key challenges for the government in 2011. Given that the government is set to pursue economic growth at the expense of higher inflation and larger trade and fiscal deficits, we believe that this would eventually backfire on the economy's growth. As such, we are maintaining a relatively subdued real GDP growth forecast of 6.3% in 2011. Highlighting our concerns that the government remains too narrowly focused on economic growth, Minister of Planning and Investment Vo Hong Phuc warned during the congress that the government needs to pay more attention to the sustainability of development and reassess Vietnam's model of growth. He added that it is necessary to seek a balance between speed and quality of the country's development.

Vietnam's socio-economic targets for 2011 indicate an increased focus on achieving macroeconomic stability and controlling inflation. We believe this could be due to growing concerns among members of the National Assembly towards mounting inflationary pressures in recent months. The CPV's new leadership will be assessed by the National Assembly based on Vietnam's socio-economic performance in the coming years. This suggest that failure to address mounting inflationary pressures and macroeconomic instability – which is partly a result of the CPV's expansionary policies in recent years – will put the leadership in a difficult position over the coming years. Indeed, we see the National Assembly's role as an effective check against government policies and believe this will help impose accountability on the CPV's policy decisions over the coming years.

Foreign Policy

Strained Relations With China Set To Stay

BMI VIEW

We anticipate further efforts by Hanoi to deepen ties with Washington and the Association of Southeast Asian Nations as a counterbalance against Beijing's growing political clout and military presence in the region. A persistent bilateral trade deficit with China will continue to strain relations as policymakers in Hanoi begin to recognise the threat of losing bargaining power in trade negotiations with China.

Vietnam is struggling to catch up with China's growing economic and political influence in the region. Bilateral relations should remain in a delicate situation over the coming years as Vietnam continues to strengthen ties with the US and Russia in a bid to counter Beijing's political clout. Relations have also been strained in recent years as China has expanded its military presence in the disputed Paracel and Spratly Islands in the South China Sea. On the economic front, concerns over a growing trade deficit with China have resurfaced as policymakers in Hanoi begin to recognise the threat of losing bargaining power in trade negotiations with China.

Territorial Tensions
Map Of South China Sea

Source: BMI

Countering Beijing's Influence

We anticipate further efforts by Hanoi to deepen ties with Washington over the coming years, as Vietnam leans towards the pro-US camp that already includes some of its Association of Southeast Asian Nations (ASEAN) peers such as Indonesia and Thailand. From our perspective, China's growing influence in the region and its expanding military presence in the South China Sea will continue to play a key role in aligning the political interests of Hanoi and Washington. Indeed, we saw a marked improvement in Vietnam-US relations in 2010 as the two countries made a series of symbolic moves in boosting bilateral ties.

In March 2010, the US signed a memorandum of understanding on nuclear cooperation with Vietnam and accelerated negotiations to complete a deal that would allow for the exchange of know-how and cooperation in civilian nuclear technology. Unsurprisingly, the deal came under heavy criticism from China that the US is applying double-standards in its nuclear policies by extending more favourable terms to Vietnam compared with other deals with emerging nuclear nations such as the UAE.

US Secretary of State Hillary Clinton also made two visits to Hanoi in July 2010 for the ASEAN regional forum and in October for the ASEAN and East Asia summit, during which she made a point of reaffirming the importance of bilateral relations between the two countries. The USS Lassen, which docked in Vietnam in 2009, was also viewed a symbolic move by the two countries to strengthen bilateral ties.

Lagging Behind In An Arms Race With China

The revelation of a Chinese stealth fighter jet in the final stages of development in January 2011 is expected to reignite Vietnam's concerns over China's ambitions to modernise its military. More importantly, the pace of China's progress in developing its military capabilities has come as a surprise to Washington. US Defense Secretary Robert Gates commented during a visit to Beijing that China may be ahead in the development of the aircraft than US intelligence had previously predicted. China's military expansion in recent years has prompted Vietnam to respond by upgrading its own military capabilities. Back in December 2009, Vietnam signed a series of major arms deals with Russia that included six Kilo-class submarines and 20 Su-30 fighter-bombers. The deals amounted to around US$2.6bn, the biggest since Moscow pulled its remaining military interests out of Vietnam at the end of the Cold War about 20 years ago. Judging from Vietnam's response to China's growing military presence in previous years, we note that the recent revelation of China's stealth fighter jet could potentially spark another round of arms deals between Vietnam and Russia.

Relations Strained By A Persistent Deficit

In a previous report, we highlighted that Vietnam is increasingly concerned over its persistent bilateral trade deficit with China, which has amounted to more than 10% of GDP in recent years. We also argued that Vietnam would continue to lean towards ASEAN as a counterbalance to China's growing economic influence (*see our online service, February 10 2010, 'Tension With China To Push Hanoi Deeper Into ASEAN Camp'*). Government efforts to narrow the trade deficit with China have been largely unsuccessful in recent years and policymakers are putting the blame on a depressed Chinese yuan that is keeping prices of Chinese exports artificially low. Nonetheless, China remains strong on its stance of allowing the currency to appreciate gradually, undermining Vietnam's efforts to bring the trade deficit back in balance.

While Vietnamese exporters struggle to compete with cheap Chinese exports, bilateral trade is expected to grow at a robust pace over the coming years. Hanoi is beginning to recognise the threat of becoming overly dependent on imports of intermediate goods from China. In contrast, China's economy is considerably less dependent on trade with Vietnam. Hanoi is slowly losing its bargaining power in terms of trade negotiations with Beijing, in our view. Indeed, the growing reliance on Chinese imports has already attracted a degree of attention at the Communist Party of Vietnam's 11th National Congress held in January 2011.

Going forward, we expect the issue of a persistent trade deficit with China to dominate Hanoi's engagement with Beijing on economic negotiations. South East Asia's plan to establish an ASEAN economic community by 2015 could potentially serve as a collective bargaining tool against China, in our view. As such, we expect Vietnam to continue to show support for ASEAN's efforts to promote intra-regional trade and investment.

Long-Term Political Outlook

Key Political Challenges Over The Coming Decade

BMI VIEW

Vietnam's biggest political question over the coming decade is whether one-party rule under the Communist Party of Vietnam will face growing calls for democratisation, as was the case in other major South East Asian countries. While our core scenario envisages the party transforming itself into a technocratic administration, it faces major economic challenges that, if mismanaged, could lead to widespread unrest. On the foreign policy front, we expect an increasingly powerful China to drive Vietnam further into the camp of Asian nations with close relations with the US.

Although Vietnam is a politically stable country, we view the ruling Communist Party of Vietnam (CPV)'s monopoly on political power as unsustainable over the long term. One of the CPV's biggest challenges will be managing Vietnam's transformation into a more pluralistic society over the coming decade and beyond. Indeed, the CPV's strict control of the media and political opinion is already cracking, with a growing number of internet bloggers becoming increasingly critical of government policy.

Challenges And Threats To Stability

Inflation And Devaluation As Drivers Of Discontent: As in neighbouring China, economic growth has brought sizeable material gains for the majority of the population. However, the Vietnamese government's loose fiscal and monetary policies have led to high levels of inflation and repeated devaluations of the dong in recent years, which have eroded the real value of wages and savings. A failure to contain inflation at a reasonable level and uphold the real value of the dong could undermine confidence in the regime.

Divisions Within The Communist Party: High inflation and devaluation have opened schisms within the CPV leadership between proponents of continued economic reform and a more conservative wing that believes a deceleration or even reversal of reform policies would benefit macroeconomic stability.

Ethnic And Regional Tensions: Vietnam is relatively homogenous, with ethnic Viet comprising almost 90% of the population. Ethnic minorities in the Central Highlands have previously objected to government policies promoting migration of ethnic Viet into the highland region. While protests have died down, they could emerge in the future. A potential spark could be the Chinese-financed bauxite mining project in Lam Dong and Dak Nong provinces, which is currently causing widespread environmental damage and thus raising ire among the local population.

There are also continued cultural differences between the population of the Red River Delta around the capital Hanoi in the north and the population of the Mekong Delta in the south, where Ho Chi Minh City (formerly Saigon, the ex-capital of South Vietnam) remains the commercial capital. While the general perception is that northerners are more supportive of socialist rule and the southerners more inclined to support continued economic reform, a strong concept of national unity nevertheless exists in both parts of the country.

Demands For Increased Religious Rights: One of the most concerted challenges against the CPV in recent years has come from Catholics wishing for a stronger recognition of their right to worship in what is still a nominally atheist country. Hanoi has ceded to pressure from the US to allow a higher degree of religious freedom, but is wary of the Catholic church becoming a rallying point of political opposition, as was the case in communist Poland and the Philippines during the Marcos dictatorship. The Vietnamese government has thus slapped heavy sentences on Catholic activists who have extended their fight to encompass increased political freedom.

Relations With China: Relations with China have become increasingly strained in recent years as Beijing has expanded its economic, political and military influence southwards. The main point of contention is the conflicting territorial claims for the Paracel and Spratly Islands in the South China Sea. Vietnam's relations with China have also been strained by the large bilateral trade deficit it runs with its northern neighbour, which amounts to more than 10% of GDP, as well as criticism of the Chinese-financed bauxite mining project.

That said, the regimes in Beijing and Hanoi share the same ideological base and political system, and contacts between their respective politburos have served to decrease tension between them. Nonetheless, we believe Vietnam will seek increasingly close relations with the US – and potentially India and Japan – in the defence sphere as a hedge against China's rising power in the region.

Vietnam's long-term political risk rating of 53.8/100 is weighed down by a score of 27.6 in the 'characteristics of polity' subcomponent. This is due to the limited independence of the judiciary, the ban on political parties other than the CPV and severe limitations on the media and civil society. While these factors may presage stability in the short term, the experience of other South East Asian nations shows that rising wealth and development later lead to calls for political liberalisation. We have thus drawn up three scenarios for Vietnam's political future.

Scenarios For Political Change

Core Scenario – CPV Turns Into A Technocratic Regime: Our core scenario is for the CPV to shift increasingly towards a technocratic form of government aimed at maintaining high economic growth levels and an acceptable distribution of wealth across the population. Ambitious young Vietnamese are already joining the CPV as a career path and as a means to serve their country rather than because of ideological convictions. We thus foresee a continuation of economic reforms in spite of the criticism emanating from older, more traditionally minded party members. However, intermittent periods of harsh repression against pro-democracy activists and other government critics are a strong indication that political liberalisation is not in the offing.

Best Case Scenario – Gradual Political Liberalisation: Our best case scenario is the above scenario combined with a gradual move towards political liberalisation involving an expanded role for the National Assembly, greater scope for differing opinion within the CPV, increased political competition at elections and greater media freedom. This scenario would see Vietnam move from a one-party system towards a dominant-party system of the kind seen in neighbouring Cambodia, Malaysia and Singapore, where elections are held but only the ruling party has a realistic chance of winning them. Looking even further beyond the horizon, the experiences of South Korea, Taiwan and Japan have shown that even dominant-party systems eventually give way to opposition rule. However, in Vietnam's case, this may be more than a decade away.

Worst Case Scenario – Mass Unrest And Violent Suppression: Our worst case scenario involves severe policy missteps that lead to a period of prolonged economic upheaval, with high unemployment and rapid inflation eroding wealth. This would significantly strengthen the case for regime change, as advocated by the pro-democracy movement. Faced with widespread street protests and an all-out challenge to one-party rule, we believe that at least part of the CPV leadership would support a crackdown on demonstrators by security forces in order to stay in power. A violent suppression of street protests as seen in Beijing in 1989 and in Myanmar in 2007 could easily result in a number of deaths and the imposition of sanctions by the international community. If so, Vietnam would likely face not only diplomatic isolation but also economic weakness as exports and foreign direct investment tumble.

Chapter 2:
Economic Outlook

SWOT Analysis

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. The fiscal deficit is dominated by substantial spending on social subsidies that could be difficult to withdraw.
- The heavily managed and weak domestic 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 liberalisation of 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 pressures, 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.

BMI Economic Risk Ratings

Vietnam's short-term economic risk rating of 52.5 primarily reflects a deterioration of external conditions and the fiscal situation as the government has attempted to supplant a sharp reduction in external demand with fiscal stimulus. Vietnam's chronic fiscal and current account deficits also weigh down our long-term economic risk rating, where the 'fiscal' and 'external' components score 30.0 and 33.3 (out of 100) respectively. However, this is partly offset by a robust score of 85.0 in the 'growth' component, reflecting a strong potential for rapid economic expansion, bringing the overall rating to 54.9.

	S-T Economy	Rank	Trend
China	93.1	1	+
Taiwan	84.8	2	=
Hong Kong	82.3	3	=
Singapore	80.0	4	=
South Korea	80.0	4	=
Brunei Darussalam	74.2	6	=
Thailand	72.9	7	=
Malaysia	71.9	8	=
Myanmar	68.1	9	=
Philippines	66.2	10	=
Indonesia	65.8	11	-
Japan	64.6	12	=
India	63.3	13	=
Bangladesh	59.8	14	+
Vietnam	**52.5**	**15**	**+**
Laos	52.3	16	=
Pakistan	51.2	17	+
Sri Lanka	48.1	18	=
Papua New Guinea	42.9	19	=
Bhutan	40.8	20	=
Cambodia	32.1	21	=
North Korea	-	-	-

Regional ave 62.5 / Global ave 54.5 / Emerging Markets ave 53.2

	L-T Economy	Rank	Trend
China	78.3	1	=
Hong Kong	77.6	2	=
Singapore	76.0	3	=
Malaysia	73.8	4	=
Taiwan	73.5	5	=
South Korea	72.6	6	=
Bangladesh	67.2	7	+
Thailand	67.1	8	=
Japan	65.7	9	=
Brunei Darussalam	65.2	10	=
India	60.9	11	=
Myanmar	57.2	12	=
Indonesia	55.9	13	=
Philippines	55.8	14	=
Vietnam	**54.9**	**15**	**=**
Sri Lanka	50.1	16	=
Papua New Guinea	49.3	17	=
Bhutan	45.6	18	=
Laos	45.1	19	=
Pakistan	42.5	20	=
Cambodia	37.0	21	=
North Korea	-	-	-

Regional ave 58.1 / Global ave 52.4 / Emerging Markets ave 50.2

Economic Activity

Real GDP Growth Revised Upwards But To Remain Subdued In 2011

BMI VIEW

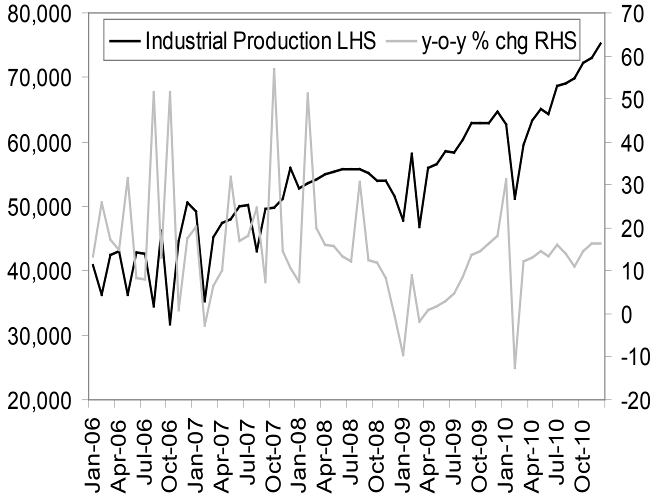
Our view that infrastructure investment would provide support for Vietnam's economic growth in 2010 has played out well. Vietnam's real GDP growth came in at a better-than-expected 6.8% in 2010, led by a strong performance in the construction sector. In 2011, we expect domestic demand to remain robust on the back of rising wages and improving consumer sentiment. However, we expect import growth to continue to outpace that of exports in 2011. In light of a good Q410 result and our Global team's recent upgrade on the US economy, we are revising our real GDP growth forecast upwards from 5.5% to 6.3% in 2011.

In line with our view that investment in infrastructure would continue to provide support for Vietnam's economic growth, real GDP growth came in at a better-than-expected 7.2% year-on-year (y-o-y) in Q410, led by robust growth in the construction sector. The latest Q410 figure effectively translates into real GDP growth of 6.8% for 2010, surpassing the Vietnamese government's target of 6.7%. According to data published by the General Statistics Office, the construction sector grew by 10.1% in 2010 while the electricity, gas and water sector also saw double-digit growth of 11.3%. On the other hand, floods across the region in recent months led to a disappointing 2.5% growth in the agricultural sector. Going into 2011, we expect the construction sector to continue to outperform the manufacturing and agricultural sectors.

From our perspective, the latest figures highlight the fact that expansionary economic policies dictated by the National Assembly continued to have a significant influence on the structure of Vietnam's economic growth in 2010. We believe this will also be the case in 2011 as the government remains focused on upgrading Vietnam's infrastructure and raising electricity production to support economic growth. Despite our positive outlook for infrastructure investment, we continue to see overheating pressures that should prevent growth from reaching the government's 7.5% target in 2011.

Keeping Steady

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



Source: General Statistics Office, BMI

Slow Recovery In Manufacturing Sector

Looking at industrial production growth, we have seen a slow and steady rise from 14.5% y-o-y in October to 16.3% in December. Given that industrial production data have traditionally served as a reliable indicator of the performance of the manufacturing sector, we remain optimistic that the recovery in the manufacturing sector remains on track. That said, we believe the performance of the sector will increasingly rely on demand from Asia rather than the US and eurozone in 2011. The manufacturing sector grew by 8.4% in 2010, far from the sector's pre-crisis growth of 12.4% in 2007. Indeed, we see economic uncertainties in the US and EU as a reason behind the slow recovery. We believe 2011 will be a challenging year for the manufacturing sector due to below-trend economic growth in the US and tightening efforts

TABLE: ECONOMIC ACTIVITY

	2008	2009e	2010e	2011f	2012f	2013f	2014f	2015f
Nominal GDP, VNDbn [2]	1,485,038.0	1,658,389.0	1,953,223.3	2,326,853.6	2,641,667.1	2,985,462.7	3,358,614.4	3,761,091.7
Nominal GDP, US$bn [2]	89.8	92.8	101.9	117.8	133.8	155.1	179.1	206.1
Real GDP growth, % change y-o-y [2]	6.3	5.3	6.8	6.3	7.2	7.2	7.2	7.2
GDP per capita, US$ [2]	1,041	1,063	1,153	1,320	1,483	1,703	1,948	2,220
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	14.0	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

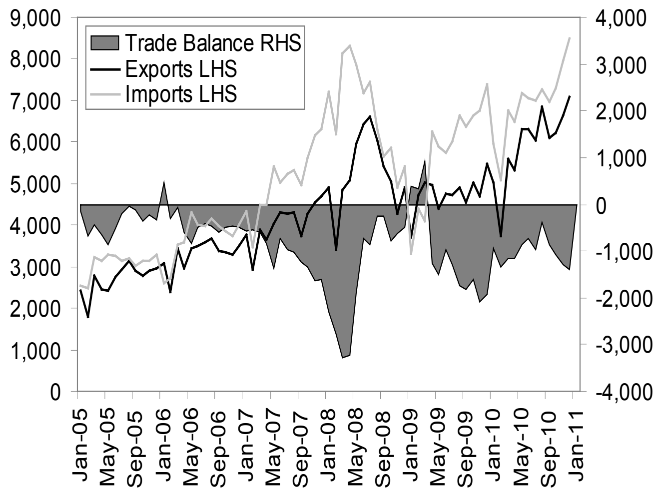
Notes: e/f = BMI estimates/forecasts. 1 At 1994 prices; Sources: 2 General Statistics Office; 3 World Bank/BMI calculation/BMI.

in China amid inflationary pressures. However, an improved outlook for the US economy will nonetheless have a positive impact on exports. As such, we are revising our real GDP growth forecast upwards from 5.5% to 6.3% in 2011.

High Lending Rates Threaten Investment Growth

Aggressive economic policies by the Vietnamese government have led to mounting inflationary pressures in recent months. Consumer price inflation accelerated from 7.6% y-o-y in January 2010 to 11.8% in December, averaging 9.2% for the full year. This contributed to a rise in production costs and higher lending rates for businesses. We expect lending rates, which are currently in the range of 14-17%, to remain elevated and to put a damper on gross fixed capital formation growth in 2011. Furthermore, rising production costs are likely to lead to lower profit margins for businesses, lowering the incentive for businesses to invest in expanding operations. Accordingly, we are forecasting a subdued 7.0% growth in private investments in 2011.

A Drag On Economic Growth
Goods Exports & Imports, US$mn (LHS) & Trade Balance, US$mn (RHS)



Source: General Statistics Office, BMI

Strong Performance In Spite Of Growing Trade Deficit

Despite a widening trade deficit of US$3.8bn in Q410 compared with US$2.2bn in Q310, Vietnam's economy managed to grow by 20.4% quarter-on-quarter in Q410. Although we acknowledge that seasonal factors were largely responsible for the spike in domestic demand – historical data show the final quarter in previous years seeing a significant spike in domestic demand – we believe private consumption will remain robust in the coming months. Judging from the better-than-expected performance in domestic demand in Q410, we believe consumer sentiment will continue to improve, which this in turn supports our view that private consumption will remain strong in 2011. Rising wages is also likely to support consumer spending in the coming months.

We believe that robust private consumption will result in import growth outpacing export growth and, consequently, a deteriorating trade deficit in 2011. The recent rise in crude oil prices represents a threat to the trade deficit as Vietnam remains a significant net importer of refined crude. Should crude prices continue to rise in the coming months, we expect this to have a negative impact on the trade deficit and real GDP growth. We are maintaining our forecast for the trade deficit to widen from an estimated 7.0% of GDP in 2010 to 8.0% of GDP in 2011. Accordingly, we see this as a reason for our subdued real GDP growth forecast of 6.3% in 2011.

Monetary Policy

SBV Under Increasing Pressure To Hike Rates

BMI VIEW

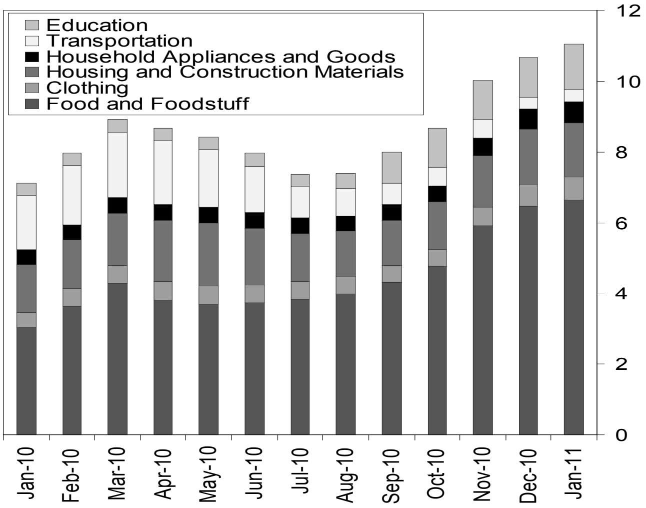
Vietnam's consumer price inflation continued to accelerate in January, supporting our view that the State Bank of Vietnam will be under increasing pressure to tighten monetary policy. We are increasingly concerned that rising food prices could potentially spread across the rest of the economy. Should we see further rises in prices of non-food components of the inflation basket, we warn that the central bank may have to tighten monetary policy aggressively in 2011. As such, we are maintaining our interest rate forecast of 10.00% by end-2011.

Figures released by the General Statistics Office showed that consumer price inflation (CPI) has accelerated consecutively for five months, with the latest CPI figure coming in at 12.2% y-o-y in January. We believe that CPI will continue to accelerate over the coming months as rising food prices, coupled with loose monetary policy by the State Bank of Vietnam (SBV), continue to put upward pressure on inflation expectations. We are already beginning to see a shift in the government's monetary policy focus towards controlling inflation and achieving macroeconomic stability. In fact, we note that concerns over inflation dominated the theme at the Communist Party of Vietnam's 11th National Congress, which ended on January 19. This suggests to us that the central bank, which remains heavily influenced by the politburo's agenda, could be given more room to hike interest rates in 2011.

2011 Money Supply Target Remains Excessively Loose

The SBV has set a new target of 21.0-24.0% for M2 money supply growth in 2011. Compared with M2 growth of 23.0% in 2010, the SBV's new target effectively signals no change to its loose monetary policy stance. We believe that if the central bank successfully meets its money supply growth target in 2011, there could be upside risks to our forecast for CPI to average 11.5% in 2011.

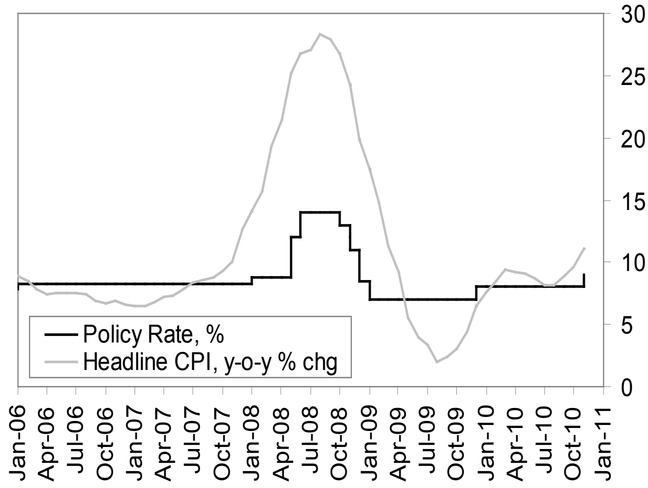
Spreading Across The Economy
Contribution Of Selected CPI Components, pp



Source: General Statistics Office, BMI

We note that the food component, which represents 39.9% of the CPI basket, has been the key driver of inflation in recent months. Looking at the latest figures released by the General Statistics Office, food prices contributed 6.6 percentage points (pp) towards headline CPI in January, up from 6.5pp in December. Although many South East Asian economies are also experiencing the same phenomenon of accelerating food prices, we note that the impact is expected to be much more severe in Vietnam as a result of the country's heavier exposure to food prices in the CPI basket.

Forcing The SBV's Hand
Policy Rate, % & Headline CPI, % chg y-o-y



Source: General Statistics Office, State Bank of Vietnam, BMI

SBV Falling Behind The Curve

We are increasingly concerned that rising food prices could potentially spread across the rest of the economy. As the chart (*left*) shows, among the six components with the greatest contribution to headline CPI, we note that five components except transportation have been rising steadily since mid-2010. Although transport costs appear to be slowing down on a y-o-y basis, we note that on a month-on-month basis, transportation has risen consecutively since October. Back then, we highlighted that Brent Crude prices had traditionally been a reliable indicator for the direction of transport costs and that rising crude prices were becoming a significant threat to inflation (*see our online service, October 4 2010, 'Inflationary Pressures Mount On Surging Food Prices'*). Since then, Brent Crude prices have increased by 15.9% to trade at around US$96.35/bbl at the

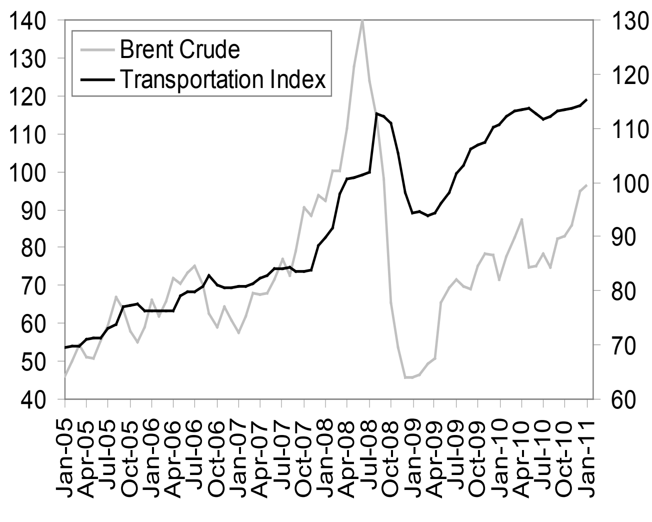
TABLE: MONETARY POLICY

	2008	2009e	2010e	2011f	2012f	2013f	2014f	2015f
Consumer prices, % y-o-y, eop [1,3]	19.9	6.5	11.8	7.2	6.0	6.0	5.0	5.0
Consumer prices, % y-o-y, ave [1,3]	23.0	7.0	9.2	11.5	6.5	6.0	5.5	5.0
M1, VNDbn [4]	1,291,764.0	1,665,307.0	2,031,674.5	2,478,642.9	3,023,944.4	3,689,212.1	4,500,838.8	5,491,023.4
M1, % y-o-y [4]	18.6	28.9	22.0	22.0	22.0	22.0	22.0	22.0
M2, VNDbn [4]	1,622,130.0	2,092,447.0	2,615,558.8	3,217,137.3	3,860,564.7	4,632,677.7	5,559,213.2	6,671,055.8
M2, % y-o-y [4]	20.3	29.0	25.0	23.0	20.0	20.0	20.0	20.0
Central bank policy rate, % [5]	8.50	9.00	9.00	10.00	9.00	8.00	7.00	7.00
Lending rate, %, ave [6]	15.8	10.1	14.0	13.0	12.0	11.0	10.0	9.0
Real lending rate, %, ave [2,7]	-7.2	3.1	4.8	1.5	5.5	5.0	4.5	4.0

Notes: e/f = BMI estimates/forecasts. 1 Base year 2000; 2 Real rate strips out the effects of inflation; Sources: 3 General Statistics Office; 4 IMF, State Bank of Vietnam; 5 State Bank of Vietnam; 6 IMF; 7 IMF/BMI.

time of writing. As the following chart shows, transport costs in Vietnam tend to lag behind movements in Brent Crude prices. Thus, we believe that the sharp spike in Brent Crude price recently could be reflected in an acceleration of transport costs in the coming months.

Watch Out For Higher Fuel Prices
Brent Crude Oil, US$/bbl (LHS) & Transportation Index (RHS)



Source: General Statistics Office, BMI

Should we see further rises in prices of non-food components of the CPI basket over the coming months, we warn that the SBV may have to play catch up with inflation expectations. Such a scenario would in turn suggest that the SBV will have to be more aggressive at tightening monetary policy to bring inflation under control. As such, we are maintaining our interest rate forecast of 10.00% by end-2011.

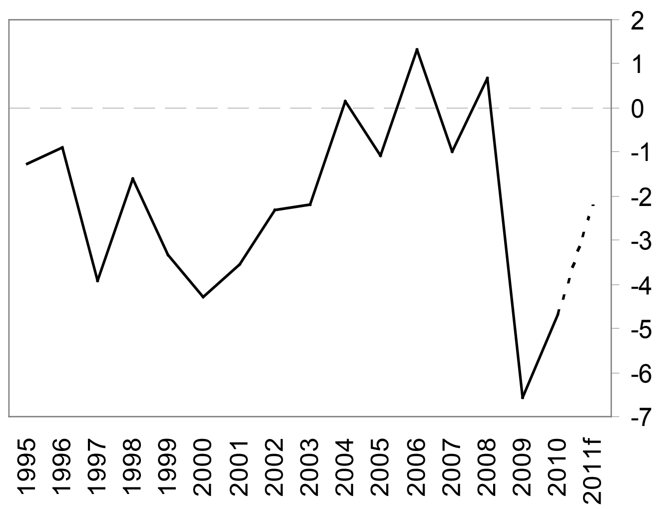
Fiscal Policy

Fiscal Balance Not So Easy

BMI VIEW

In line with our forecasts, Vietnam's fiscal deficit narrowed from 6.6% of GDP in 2009 to 4.7% of GDP in 2010. Despite the narrowing of the fiscal deficit, we are increasingly worried that social expenditures as a percentage of total fiscal expenditure have continued to rise since 2007. We believe that withdrawing subsidies will prove a challenging task for the government over the coming years. We are maintaining our forecast for Vietnam's fiscal deficit to come in at 2.2% of GDP in 2011.

A Long Struggle Ahead
Fiscal Balance, % Of GDP



Source: Ministry of Finance, BMI

Latest figures released by the Ministry of Finance estimated Vietnam's fiscal deficit at around VND91bn (US$4.7bn) in

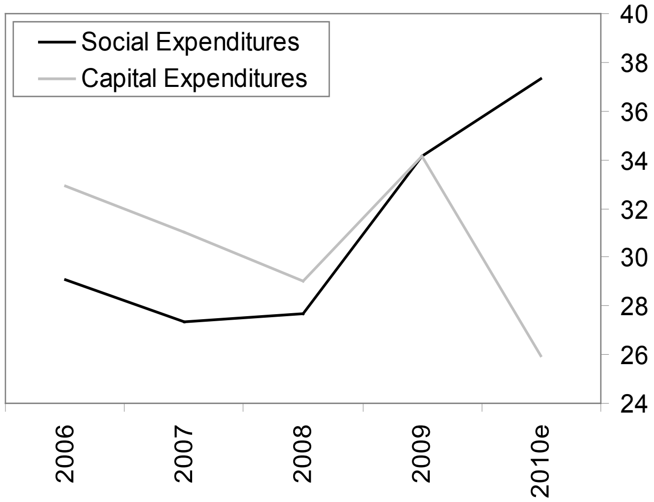
TABLE: FISCAL POLICY

	2008	2009e	2010e	2011f	2012f	2013f	2014f	2015f
Fiscal revenue, VNDbn [1]	434,761.0	442,340.0	528,100.0	596,849.3	675,192.9	764,618.1	866,874.8	984,028.1
Revenue, % of GDP [1]	29.3	26.7	27.0	25.7	25.6	25.6	25.8	26.2
Fiscal expenditure, VNDbn [1]	411,836.0	527,342.0	578,210.0	647,595.2	725,306.6	812,343.4	909,824.6	1,019,003.6
Expenditure, % of GDP [1]	27.7	31.8	29.6	27.8	27.5	27.2	27.1	27.1
Fiscal expenditure, VNDbn [1]	292,374.0	347,381.0	428,210.0	479,595.2	537,146.6	601,604.2	673,796.7	754,652.3
Current expenditure, % of total expenditure [1]	71.0	65.9	74.1	74.1	74.1	74.1	74.1	74.1
Current expenditure, % of GDP [1]	19.7	20.9	21.9	20.6	20.3	20.2	20.1	20.1
Capital expenditure, VNDbn [1]	119,462.0	179,961.0	150,000.0	168,000.0	188,160.0	210,739.2	236,027.9	264,351.3
Capital expenditure, % of total expenditure [1]	29.0	34.1	25.9	25.9	25.9	25.9	25.9	25.9
Capital expenditure, % of GDP [1]	8.0	10.9	7.7	7.2	7.1	7.1	7.0	7.0
Budget balance, VNDbn [1]	9,897.0	-10,8722.0	-91,365.0	-50,745.9	-50,113.7	-47,725.3	-42,949.8	-34,975.5
Budget balance, % of GDP [1]	0.7	-6.6	-4.7	-2.2	-1.9	-1.6	-1.3	-0.9

Notes: e/f = BMI estimates/forecasts. Sources: 1 Asian Development Bank, Ministry of Finance.

2010, down from a deficit of VND109bn in 2009. The latest figure effectively translates into a fiscal deficit of 4.7% of GDP, which is closely in line with our forecast of 4.6%. Although the reduction of the fiscal deficit from 6.6% of GDP in 2009 appears to show that the government is taking appropriate measures to strengthen its balance sheet, we warn that structural weaknesses in the allocation of the fiscal budget remain.

Not A Sign Of Prudence
Share Of Total Fiscal Expenditure, %



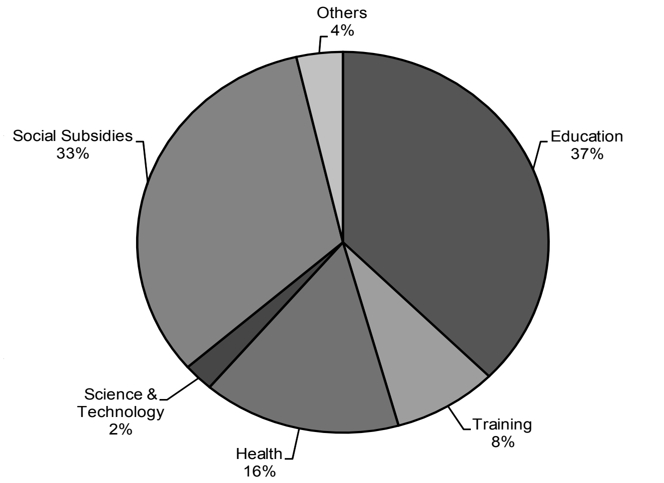
Source: Ministry of Finance, BMI

Reflecting The Imbalanced Economy

From our perspective, the allocation of the fiscal budget often provides an accurate reflection of the government's economic and political agenda. Looking at the allocation of the fiscal budget over the past five years (2006-2010), we saw a steady increase in the share of social expenditure, which was accompanied by a shrinking share of capital expenditure. We believe this accurately reflects the imbalance of the Vietnamese economy, where government subsidies for state-owned enterprises have resulted in uncompetitive industries – the near-bankruptcy of Vietnam's shipbuilding industry group **Vinashin** being a prime example. Meanwhile, the lack of infrastructure investment over the years has led to chronic power shortages, a congested transport network and logistical bottlenecks, threatening Vietnam's competitiveness in the region.

Taking a closer look at the breakdown of government expenditures in 2010, we note that social expenditures as a percentage of total fiscal expenditures have increased steadily from 27.4% in 2007 to 37.3% in 2010 (*see chart above*). Given that government subsidies represent the second largest component of total social expenditures (education being the largest), we believe the global financial crisis was partly responsible for the increase in the allocation of the fiscal budget towards social expenditures in recent years. Another reason behind the increase could be the timing of the Communist Party of Vietnam's 11th National Congress – held every five years to elect the 15-member politburo and set the direction of the government's economic policies – which has discouraged the government from slashing subsidies and financial assistance for the lower-income population.

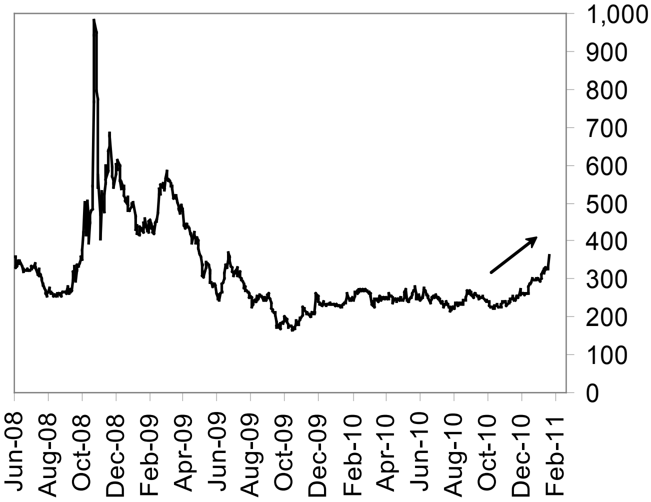
A Reflection Of The Government's Agenda
Share Of Total Social Expenditure, %



Source: Ministry of Finance, BMI

an unpopular choice for the government. As such, we remain sceptical that the government will be successful in reducing subsidies and bringing the fiscal budget back into balance within the short-to-medium term. Moreover, rising food and fuel prices remain a significant threat that could translate into heavier government subsidies in 2011.

Losing Confidence
5-Year Sovereign CDS, bps



Bloomberg, BMI

CDS Market Getting Worried

The sovereign credit default swap (CDS) market has reacted negatively since the Ministry of Finance released data on the government's fiscal position in December 2010. As the following chart shows, the five-year CDS on Vietnamese sovereign debt broke its multi-month highs in December and has continued to trend higher in recent trading sessions. We see this as a clear indication of the financial market's deteriorating confidence in the government's ability to fix its balance sheet in the short-to-medium term. Until we begin to see credible fiscal discipline by the government, we expect a slow struggle for Vietnam's fiscal balance. We are maintaining our forecast for the fiscal deficit to come in at 2.2% of GDP in 2011 and to remain in deficit over the next few years.

Investment Climate

Indonesia And Vietnam Set To Be Favourites For FDI In 2011

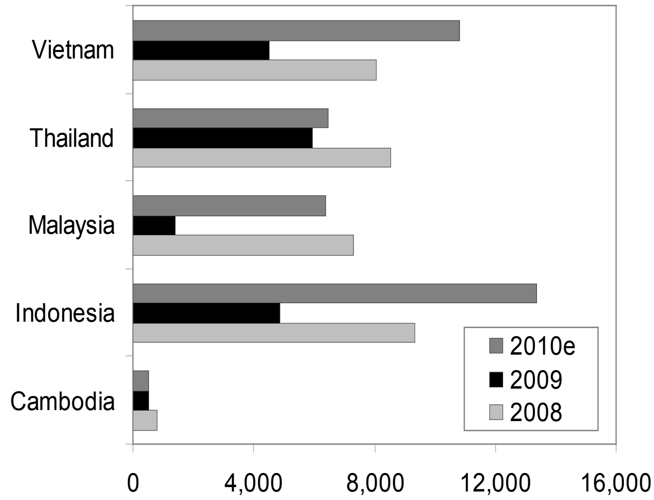
BMI VIEW

South East Asian countries saw a significant rebound in foreign direct investment inflows in 2010 and we expect a robust recovery to continue into 2011. In line with our view that Indonesia and Vietnam's economic growth would outperform the region in 2011 due to favourable demographics and robust domestic demand, we see the two countries as the top favourites for foreign investors. On the other hand, continued risk aversion is likely to put a damper on foreign investment inflows into Cambodia, Myanmar and Laos.

The post-crisis recovery in foreign direct investment (FDI) inflows into South East Asia is expected to continue as macroeconomic conditions remain on a relatively more stable footing than its Western counterparts going into 2011. Focusing on countries within the Association of Southeast Asian Nations (ASEAN), we favour Indonesia and Vietnam as top favourites in terms of attracting FDI in the coming years.

Global FDI flows witnessed a 47.1% decline from US$2.10trn in 2007 to US$1.11trn in 2009 as multinationals delayed investment plans during the course of the global financial crisis. The rush to strengthen balance sheets at the onset of the crisis, coupled with the scarcity of credit, led to delays in investment projects and a slowdown in mergers and acquisitions. We believe these factors were the key reasons behind a global decline in FDI flows. We are beginning to see an encouraging rebound in FDI inflows into ASEAN in 2010, suggesting that investor sentiment in the region is improving. As investor sentiment continues to improve in line with better-than-expected economic growth across ASEAN countries, we expect a robust recovery in FDI in 2011 and 2012.

A Gauge On Investor Sentiment
ASEAN – FDI Inflows For Selected Countries, US$mn



Source: UNCTAD, BMI

Indonesia And Vietnam Seen As Top Favourites Among Multinationals

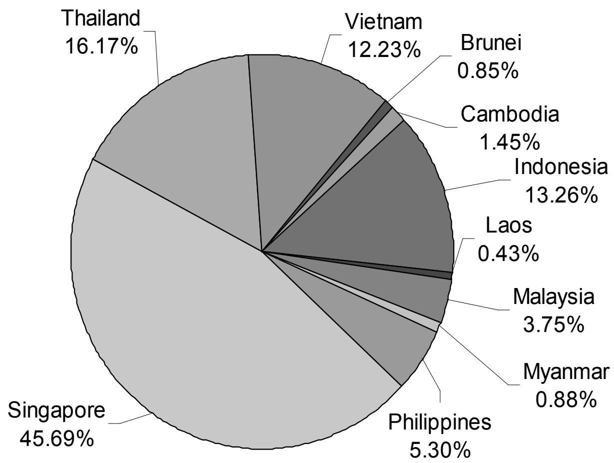
Judging from FDI inflows into ASEAN countries since the beginning of the year, we expect inflows into Vietnam, Indonesia and Singapore in 2010 to have surpassed levels back in 2008 by a considerable margin. Indeed, latest official estimates by government agencies suggest FDI inflows for Indonesia, Vietnam and Singapore could increase by 174%, 140% and 120% respectively. Although we expect growth rates for FDI inflows in 2011 to come in at a more moderate pace, the inflow of FDI in these economies will nonetheless remain robust.

According to a report published by the UN Conference on Trade and Development, multinationals see Vietnam and Indonesia as favoured destinations for FDI in South East Asia in 2011 and 2012. This is in line with our view that these two countries will outperform the region in terms of economic growth. Singapore remains an attractive option for foreign investors due mainly to its advantage in infrastructure, technology and geographical location in the region (*see chart below*). However, we note that Singapore remains heavily exposed to external demand from the US and EU. Given that economic conditions in the US and EU remain uncertain, we believe multinationals will favour countries with superior demographics and strong domestic demand over export-orientated economies in the region.

The remaining ASEAN countries are also expected to see an uptick in FDI inflows in 2010, albeit at a slower pace. In the case of Thailand, although economic data in recent months suggest that domestic demand and exports remain robust, we are maintaining a cautious stance on the country's outlook for business investments due to political risks. Thailand is expected to hold general elections in early 2011 and we expect businesses to delay investment plans until there are more evidence that another round of political unrest can be avoided. Following a severe 81% decline in FDI inflows into Malaysia from US$7.3bn in 2008 to US$1.4bn in 2009, the country is expected to see a 357% increase to US$6.4bn in 2010. Despite the rebound, Malaysia's FDI inflows remain below the US$7.3bn level last seen in 2008. From our perspective, such extreme volatility in FDI inflows highlights the vulnerability of the Malaysian economy towards risk aversion among foreign investors during periods of uncertainty. However, we acknowledge that Malaysia's recently announced 10-year Economic Transformation Programme could help boost the country's attractiveness to foreign investors in the coming years.

Where Is The Money Going?

ASEAN – Share Of FDI Inflows (2009), %



Source: UNCTAD, BMI

LDCs To Underperform In A Challenging Economic Environment In 2011

We expect Cambodia, Myanmar and Laos – classified as Least Developed Countries (LDC) by the UN – to underperform the region in terms of attracting FDI inflows in 2011. We believe risk aversion among multinationals could remain in 2011 and this could put a damper on FDI inflows into LDCs, which have traditionally been heavily dependent on official development assistance and FDI. We expect multinationals to adopt a conservative approach and wait for further evidence of a robust economic recovery in LDCs before shifting funds into these economies. As such, we see a gradual but slow recovery for FDI inflows into Cambodia, Myanmar and Laos in 2011 and 2012.

The Vietnamese Economy To 2020

Rebalancing Needed To Maintain High Growth

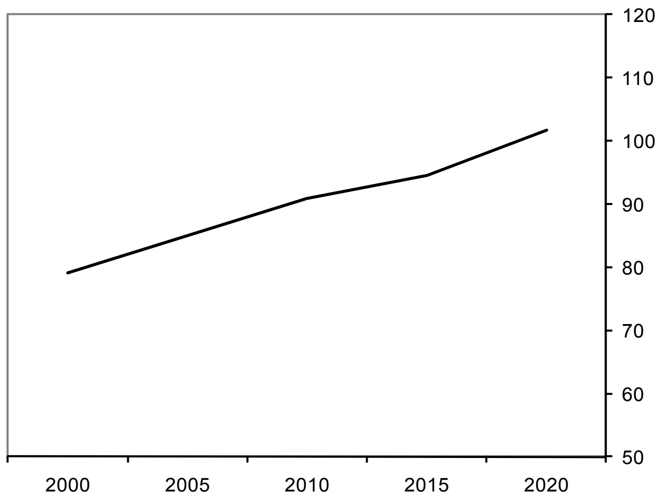
BMI VIEW

We remain positive about Vietnam's growth prospects over the next 10 years. This is because we expect a shift in government policy to accommodate the effects of a less conducive global environment and a need to avoid overheating tendencies such as high inflation and a large trade deficit, which have characterised the Vietnamese economy in recent years.

Vietnam's emergence as one of the most promising economies in Asia, if not the world, stems largely from the Communist Party of Vietnam (CPV)'s adoption of market reform policies in 1986. The gradual but steady shift from a largely agrarian country with a high degree of state ownership and government intervention to a bustling market economy has stimulated foreign investment and domestic entrepreneurship, which are now the prime drivers of growth.

The attractions of Vietnam to foreign as well as domestic investors are clear: a large and young population eager to work hard to improve their lot and open to foreign influences after decades of ineffective ideological indoctrination. Vietnam has enjoyed a growing inflow of direct investment into its fledgling manufacturing sector in recent years as its accession to the WTO in 2007 and low labour costs have made it an attractive outsourcing destination for apparel manufacturers and electronics producers. The development of the foreign-owned manufacturing sector has been spearheaded by Japanese, South Korean and Taiwanese firms, which have become increasingly wary of rising costs of labour on the Chinese mainland, as well as the risks of becoming overly dependent on Beijing in their supply chains.

Vietnam To Enter 100mn Club
Population



Source: UN World Population Prospects, 2006 revision

We expect foreign investment into the manufacturing sector to continue to drive growth over the next 10 years and help Vietnam move up the value-added chain as the advantages of sourcing production in the country become apparent for a wider range of manufacturing firms. However, we believe the global environ-

TABLE: VIETNAM LONG-TERM MACROECONOMIC FORECASTS

	2013f	2014f	2015f	2016f	2017f	2018f	2019f	2020f
Nominal GDP, US$bn [2]	155.1	179.1	206.1	237.3	273.6	315.6	364.6	414.9
Real GDP growth, % change y-o-y [2]	7.2	7.2	7.2	7.2	7.3	7.3	7.3	7.3
Population, mn [3]	91.1	92.0	92.8	93.7	94.6	95.4	96.3	97.1
GDP per capita, US$ [2]	1,703	1,948	2,220	2,532	2,892	3,307	3,787	4,273
Consumer prices, % y-o-y, ave [1,2]	6.0	5.5	5.0	5.0	5.0	5.0	5.0	5.0
Current account, % of GDP [4]	-5.4	-4.9	-4.4	-4.0	-3.6	-3.1	-2.8	-2.4
Exchange rate VND/US$, ave [5]	19,250.00	18,750.00	18,250.00	17,750.00	17,250.00	16,750.00	16,250.00	16,000.00

Notes: f = BMI forecasts. 1 Base year 2000; Sources: 2 General Statistics Office; 3 World Bank/BMI calculation/BMI; 4 Asian Development Bank; 5 BMI.

ment will be less conducive to external demand-driven economies in the years to come, meaning that Vietnam will not be able to reach real GDP growth rates above 8.0% as seen in 2004-2007.

Indeed, the near-exclusive focus of the government on meeting high growth targets through accommodative fiscal and monetary policy has led to serious macroeconomic imbalances in the form of high inflation and ballooning trade and fiscal deficits over 2007-2009. We believe steps will be taken to adjust government policy over 2011-2016 towards achieving more sustainable growth by allowing checks on overheating tendencies such as currency appreciation and inflation-targeting monetary policy. This would inevitably come at the cost of lower growth in the medium term and we expect the government to start targeting annual real GDP growth of 7.0-7.5% over 2011-2016, instead of the previous 8.0-8.5%.

We do not foresee this constituting a turning point in the Vietnamese growth story, merely adjusting growth rates to lower more sustainable trajectories. The main effect will be to decrease the share of net exports from a massive -16.5% of GDP (in nominal terms) in 2008 towards -11.8% in 2013 and -5.7% in 2019 as export growth starts outpacing import growth after private consumption and fixed gross capital formation settle at more sustainable levels. A decreasing trade deficit, combined with continued growth – albeit at a slower pace – of remittances and foreign direct investment, should mean that upside pressure on the dong should resume once the government has tightened its fiscal and monetary policy to curb the stimulus-driven increase in domestic demand in 2009. We thus expect the dong to start to appreciate beyond the initial depreciation needed in 2010. We are currently envisaging a 2.6% depreciation in 2011, to be followed by an average 2.4% appreciation over 2012-2020.

Key Risks: Competition With China, Inflation, Infrastructure And Education

While a shift in economic policy is needed, it is far from guaranteed. Less accommodative fiscal and monetary policy is likely to lead to the elimination of less efficient firms and layoffs – an unappealing prospect for the political leadership. Vietnamese firms are still less efficient than their Chinese counterparts, as evidenced by the large amount of cheap Chinese goods flooding the Vietnamese market and the six-point advantage (51.8 compared with 45.2) China enjoys over Vietnam in our business environment ratings. The massive US$11.1bn bilateral trade deficit in China's favour in 2008 means that the Vietnamese government will be averse to taking any steps that will impair the relative cost-competitiveness of domestic firms.

An appreciating currency would dampen inflationary pressures and we foresee consumer price inflation stabilising at around 5% annually from 2013 onwards. However, this is conditional on the government resolving bottlenecks in infrastructure and power supply. Vietnam's limited road, rail and port capacity is still putting it at a disadvantage compared with China when it comes to foreign investment in export-focused manufacturing. Moreover, the continued divide between demand and supply of energy and resulting power cuts is a key threat to both growth and inflation. Energy policy is an area that will have to be addressed with more resolve than at present, as the government has impaired investment in power generation by its reluctance to expose state-owned **EVN** to competition.

Continued reform of the economy through the ongoing 'equitisation' process of raising efficiency at state-owned enterprises and transferring ownership to private hands will also be required to reach annual GDP growth of 7%, as well as a concerted effort to improve standards at all levels of the education system. Skilled staff are becoming increasingly difficult to find, resulting in upward pressure on wages and increased costs for firms, particularly in the fledgling financial sector. Vietnam will need to increase the number of high-standard university graduates in areas such as finance and science if it wants to avoid becoming trapped in low-value manufacturing.

BMI's long-term macroeconomic forecasts are based on a variety of quantitative and qualitative factors. Our 10-year forecasts assume in most cases that growth eventually converges to a long-term trend, with economic potential being determined by factors such as capital investment, demographics and productivity growth. Because quantitative frameworks often fail to capture key dynamics behind long-term growth determinants, our forecasts also reflect analysts' in-depth knowledge of subjective factors such as institutional strength and political stability. We assess trends in the composition of the economy on a GDP by expenditure basis in order to determine the degree to which private and government consumption, fixed investment and the export sector will drive growth in the future. Taken together, these factors feed into our projections for exchange rates, external account balances and interest rates.

SWOT Analysis

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, as well as 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 know-how.
- 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.

BMI Business Environment Risk Ratings

Vietnam's business environment rating of 45.2 is constrained by an 'infrastructure' rating of 47.8, with the massive US bombing during the Vietnam War putting the road and rail network decades behind peer nations. Moreover, the 'institutions' score of 36.7 reflects the vestiges of a planned economy still present in many government bodies and state-owned enterprises in spite of the ongoing economic reform process. Indeed, the winds of change are noticeable in the 'market orientation' score of 51.0, which reflects an increasing degree of trade and financial market integration with the outside world.

	Business Environment	Rank	Trend
Singapore	80.8	1	=
Hong Kong	78.7	2	=
Japan	71.4	3	=
Malaysia	63.4	4	=
Taiwan	62.7	5	=
Thailand	62.2	6	=
South Korea	60.6	7	=
China	51.8	8	=
Philippines	49.9	9	=
Vietnam	**45.2**	**10**	**=**
India	44.1	11	=
Sri Lanka	42.7	12	=
Brunei Darussalam	41.0	13	=
Indonesia	40.2	14	=
Papua New Guinea	39.4	15	=
Pakistan	36.7	16	=
Cambodia	35.5	17	=
Bhutan	32.0	18	=
Bangladesh	30.9	19	=
Laos	26.4	20	=
Myanmar	-	-	-
North Korea	-	-	-

Regional ave 45.1 / Global ave 45.0 / Emerging Markets ave 40.6

Investment Climate

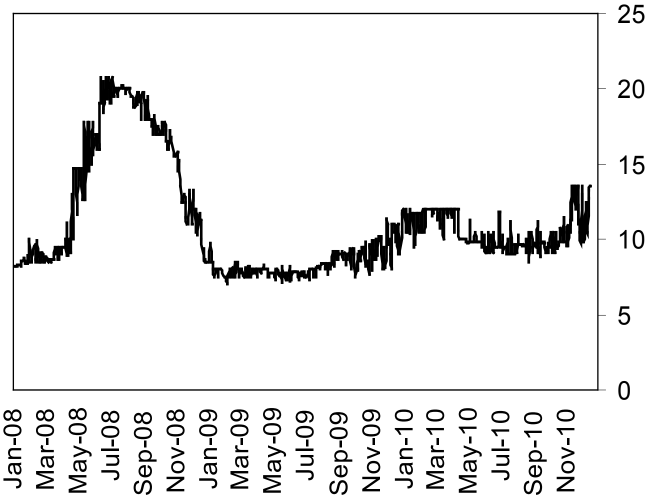
Lending Rates Set To Climb Despite SBV Intervention

BMI VIEW

Despite the State Bank of Vietnam's decision to impose a 14.0% ceiling on local currency deposit rates, we believe the central bank's failure to anchor inflation expectations will continue to put upward pressure on interest rates. Spreads between lending rates and deposit rates could widen as markets start to price in a risk premium for lending rates due to deteriorating macroeconomic conditions in Vietnam. We warn that businesses could face financing difficulties should lending rates continue to climb over the coming months.

In an attempt to arrest the recent spike in interest rates, the State Bank of Vietnam (SBV) announced its decision to impose a 14.0% ceiling on local currency deposit rates on December 15 2010. The announcement came after the central bank reached an agreement with members of the Vietnam Banks Association to prevent banks from entering a race to raise deposit rates. We note that previous attempts by the SBV to keep interest rates low have been unsuccessful as commercial banks introduced promotional perks and bonus rates to circumvent the stipulated ceiling rate. We believe this will continue to be the case until we see the SBV taking a stronger stance on enforcing the interest rate cap on commercial banks.

A Precarious Sign
VND 3-Month Deposit Rate, %



Bloomberg, BMI

Back in August, we highlighted that commercial banks were having trouble attracting funds without offering higher interest rates to depositors (*see our online service, August 10 2010, 'Weak Credit Growth To Depress Banking Sector Profits'*). We argued that persistently high consumer price inflation (CPI) was a key factor behind higher interest rates and warned of the consequences of inflation accelerating towards the end of the year. Since then, Vietnam's monthly CPI readings have accelerated from 8.2% y-o-y in August 2010 to 12.2% in January 2011, significantly above the SBV's inflation target of 8.0%. We believe the SBV's failure in anchoring inflation expectations will continue to put upward pressure on deposit rates as depositors demand higher returns for holding the Vietnamese dong. According to local media reports, deposit rates reached as high as 18.0% on December 9, before the SBV intervened and demanded commercial banks to halt promotional campaigns offering higher deposit rates. Not surprisingly, lending rates for dong-denominated loans spiked to a high of 20.0% in response to rising deposit rates.

We warn that not only are lending rates likely to remain elevated on the back of inflationary pressures in 2011, there are also risks that the money market could start to price in a risk premium for lending rates due to deteriorating macroeconomic conditions in Vietnam. Rising production costs and exchange rate uncertainties are potential threats to corporate earnings in the coming months. Furthermore, the government's reluctance in addressing Vietnam's persistent current account and fiscal deficits is likely to pose further problems for the economy. This suggests that spreads between lending rates and deposit rates – which have narrowed from 3.4% at the onset of the global financial crisis to around 2.0% currently – could widen to reflect growing economic uncertainties in the coming months.

We expect business conditions to remain difficult as lending rates remain elevated in the short-to-medium term. Businesses with tight profit margins, in particular, could struggle to stay profitable if they fail to pass on higher production and financing costs to the consumer. We warn that businesses may begin to face financing difficulties should lending rates continue to climb over the coming months.

Business Environment Outlook

Introduction

Vietnam's large and inexpensive workforce remains its largest attraction for foreign investors, although there is an increasing occurrence of foreign direct investment (FDI) projects aimed at tapping the country's growing consumer market. There is still a large degree of state intervention in the economy, but the government has been gradually moving towards a market economy since 1986, with WTO accession in 2007 being the greatest achievement so far. The country's decrepit infrastructure continues to be an impediment for many foreign investors, but we see this as a diminishing problem because the government is investing heavily in new roads, railways and ports.

Institutions

Legal Framework

Vietnam has a two-tier courts system, with courts of first instances and courts of appeal. The court system consists of the supreme court, the provincial people's courts and the district people's courts. The Vietnamese legal code is currently in a state of flux and the authorities are drafting a unified legal framework for the conduct of business.

Most of the legal documents in force relating to business were issued in the early 1990s under market-led reform programmes. However, Vietnam rewrote almost all of its laws and regulations affecting commercial activity and judicial procedures during 2002-2006. Despite some progress in protecting intellectual property rights, the overall legal system in Vietnam is regarded as excessively cumbersome.

Vietnam's judicial system lacks transparency and there are widespread concerns about the independence of the judiciary. Both local and foreign firms prefer to resort to arbitration or other non-judicial means as a result of weaknesses in the judicial system – there is a general lack of confidence that the judiciary is capable of interpreting and enforcing the law.

Vietnam's legal system remains underdeveloped and, largely, biased against foreign entities. The court system provides inadequate redress for commercial disputes, while contracts are difficult to enforce, particularly if a party is non-Vietnamese. Foreigners also see the commercial arbitration system as weak. When disputes arise, foreign investors tend to try to negotiate or include dispute resolution procedures in their contracts; however, even these are far from fail-safe.

TABLE: BMI BUSINESS AND OPERATION RISK RATINGS

	Infrastructure Rating	Institutions Rating	Market Orientation Rating	Business Environment
Afghanistan	26.6	24.7	20.5	23.9
Australia	75.0	78.2	70.1	74.4
Bangladesh	41.6	21.8	29.3	30.9
Bhutan	23.0	48.5	24.4	32.0
Cambodia	31.4	24.2	50.9	35.5
China	56.3	52.4	46.6	51.8
Hong Kong	70.0	80.7	85.2	78.7
India	47.4	42.0	42.9	44.1
Indonesia	37.1	31.2	52.3	40.2
Japan	78.3	80.1	55.9	71.4
Laos	36.8	22.6	19.8	26.4
Malaysia	55.3	66.9	67.9	63.4
Maldives	40.3	52.5	30.7	41.2
Nepal	28.1	32.6	23.2	27.9
New Zealand	77.4	91.0	77.1	81.8
Pakistan	35.5	32.9	41.7	36.7
Philippines	50.7	39.0	60.0	49.9
Singapore	79.0	83.9	79.4	80.8
South Korea	71.2	52.7	53.5	60.6
Sri Lanka	45.7	42.5	40.0	42.7
Taiwan	60.6	67.0	60.4	62.7
Thailand	59.5	59.3	67.8	62.2
Vietnam	**47.8**	**36.7**	**51.0**	**45.2**

Source: BMI. Scores out of 100, with 100 representing the best score available for each indicator

Foreign and domestic arbitral awards are legally enforceable in Vietnam since it acceded to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards in 1995. Local courts must respect awards rendered by a recognised international arbitration institution. However, this provides no assurance that contracts will be honoured. Non-judicial means are therefore frequently used to enforce debt obligations.

Firms generally avoid the judicial system because the process is lengthy and expensive, decisions are considered arbitrary and enforcement mechanisms are ineffective. Smaller companies rely on personal relationships while larger foreign companies may make use of their access to government to ensure contract enforcement.

Property Rights

The 2006 Uniform Enterprise Law has allowed foreign investors to form any type of company instead of only limited liability companies. In general, foreign companies and the private sector are at a disadvantage compared with state-owned companies in terms of access to land, which is still viewed as the property of 'the people'. Legislation has, however, progressively enhanced the status of private investors in recent years. The 1992 constitution granted stronger land rights to individuals, including rights over commercial and personal property. Private land use rights (LURs) may now be granted for up to 50 years. Since July 1 2004, the Land Law has allowed local private companies with long-term LURs to lease land to foreign investors.

Intellectual Property Rights

The enforcement of intellectual property rights (IPRs) is wholly inadequate, with widespread pirating of products, particularly software, music and videos. The requirements of WTO accession mean that the government will have to beef up IPR protection substantially. In July 2006, a new Intellectual Property Law came into effect, designed to clarify the responsibility of government agencies charged with protecting IPRs, though doubts remain over the effectiveness of its implementation. The police service is generally slow to act on administrative orders where trademarks have been infringed. Often violators will seek to extract a pay-off in compensation for ceasing the infringement. The US State Department has kept Vietnam on its 2009 'Special 301 Report' watch-list of countries with inadequate protection of IPRs, despite improvements in the

TABLE: BMI LEGAL FRAMEWORK RATING

	Investor Protection Score	Rule Of Law Score	Contract Enforceability Score	Corruption Score
Afghanistan	1.2	13.7	29.2	6.3
Australia	52.9	91.8	76.5	92.8
Bangladesh	33.0	28.5	4.6	25.4
Bhutan	12.7	52.9	99.1	65.6
Cambodia	16.7	14.8	40.4	21.3
China	58.5	26.8	86.4	29.3
Hong Kong	90.5	44.9	84.5	81.8
India	64.2	65.4	11.3	45.3
Indonesia	34.7	37.3	23.3	37.8
Japan	82.5	82.1	75.9	90.0
Laos	1.2	11.1	50.6	6.2
Malaysia	76.9	56.5	43.9	45.8
Maldives	40.1	41.7	57.7	46.4
Nepal	44.5	27.0	35.8	25.7
New Zealand	92.4	92.7	83.7	96.6
Pakistan	46.5	15.1	35.7	14.1
Philippines	38.7	48.5	33.9	25.1
Singapore	95.6	72.6	76.7	60.1
South Korea	11.1	77.0	40.3	68.4
Sri Lanka	51.4	52.3	35.3	26.1
Taiwan	64.2	72.4	70.2	72.5
Thailand	63.9	37.7	79.3	38.0
Vietnam	**31.9**	**24.7**	**66.9**	**17.4**

Source: BMI. Scores out of 100, with 100 representing the best score available for each indicator

enforcement of IPRs.

Corruption

Investors see official corruption as one of the biggest hindrances to running a business in Vietnam. Joint ventures with state-owned enterprises are particularly prone to corruption and abuse, though surveys indicate that while corruption affecting businesses is quite prevalent, the amounts involved are usually quite small. However, rapid economic growth provides opportunities for graft to grow more quickly than government systems evolve. Vietnam scored 2.7 out of 10 in Transparency International's 2010 Corruption Perceptions Index, placing it in joint 116th place among the 178 countries surveyed.

One of the best tools in restricting opportunities for corruption has been the expansion of the 'one-stop shop' network – single agencies that deal with applications for a range of activities, including construction permits, LUR certificates, business registrations and approvals for local and foreign investments.

The Law on Corruption Prevention and Control was passed by the National Assembly in November 2005. A central anti-corruption steering committee was established in 2006, comprising representatives from the government, the National Assembly, state procurator, court and police. The committee is headed by the prime minister and has the authority to suspend ministers and chairs of people's committees and people's councils if suspected of wrongdoing. The committee discovered 584 cases of alleged corruption involving close to 1,300 people in 2007. Among the most noteworthy convictions of corrupt officials was that of former deputy trade minister Mai Van Dau, who was handed a 14-year prison term in March 2007 for accepting bribes in return for export licences.

Japan and Vietnam have established a joint committee for fighting corruption concerning the use of Japan's official development assistance (ODA) in Vietnam, after two Ho Chi Minh City officials were convicted of accepting bribes from a Japanese firm in September 2009. Japan and Vietnam have also worked on a joint initiative to improve regulations on bidding, purchase and implementation of all ODA projects.

The burden of red tape is amplified by the overlapping of government approvals. Vietnam ranks poorly in the length of time it takes to close a business. It can take about five years to close a business, compared with an average of 3.4 years in East Asia & Pacific and 1.5 years in OECD states.

Infrastructure

Physical Infrastructure

Vietnam's infrastructure rating is 47.8, placing the country in 68th place in our rankings. The country's inadequate infrastructure has become a major grievance for foreign investors and may thus impair future FDI. Our 'transport infrastructure' rating for Vietnam stands at 69.1 but is set to improve as the government, thanks to development assistance from international donors, is investing heavily in constructing new roads, railways, ports and power plants. These projects include the US$33bn 1,600km high-speed railway currently being planned, with Japanese funding, between Hanoi and Ho Chi Minh City, which will cut travel time to less than 10 hours when completed.

As an example of progress already made, more than 90% of rural households now have electricity, compared with just over 50% 10 years ago. Rapid industrialisation of the economy has, however, seen power demand increase by 15-17% per year, outpacing the expansion of capacity. Vietnam is estimated to have produced 69.7bn kilowatt hours of electricity in the first 10 months of 2009, up 12.3% from a year earlier, according to the General Statistics Office. Several ongoing construction projects of power plants have been hit by delays – due to slow land clearance, delayed equipment supplies and poor contractor performance – and power blackouts and brownouts are therefore likely to remain a problem. Our 'technological' infrastructure rating for Vietnam stands at 25.0, placing Vietnam in 85th place in our rankings.

FDI has also helped improve Vietnam's telecommunications system, with foreign groups investing heavily in fanning out 3G telecom and broadband networks over the most populous parts of the country.

Labour Force

Vietnam's large, well-educated and inexpensive labour force remains one of the country's chief attractions to foreign investors. The labour pool is increasing by up to 1.5mn a year, while wage costs are still low compared with other countries in the region, although wage growth has picked up pace in recent years. The General Statistics Office estimated the number of employed at 45.0mn in 2008. The unemployment rate is expected to hit 6% in 2011.

Vietnam's reform-driven economic growth has resulted in a restructuring of the labour market, with a shift away from agricultural employment to non-farm employment. The General Statistics Office estimated that farmers constituted 52% of the workforce in 2008, with close to 21% working in industry and construction and close to 27% working in the service sector.

Managerial talent and skilled workers are generally in short supply, which has the effect of raising costs. The expanding financial sector is particularly plagued by labour shortages and is said to be in need of tens of thousands of skilled personnel by 2010. Foreign companies are becoming increasingly troubled by an excessive turnover of qualified workers, which is driving up salaries for skilled personnel. Foreign companies have previously been the prime choice of Vietnamese professionals as they pay 14% more than domestic firms on average, according to a 2007 survey by human resources consultancy **Navigos Group**. Working for domestic firms is, however, becoming increasingly popular as they are currently closing the salary gap with foreign firms.

Labour shortages and a sharply progressive income tax system have pushed up the costs for skilled personnel. Vietnam has, on the other hand, maintained its cost advantage in manufacturing wages. The Japan External Trade Organization found in a survey in November 2006 that monthly salaries for ordinary workers ranged from US$87-198 around Hanoi in northern Vietnam and US$122-216 in Ho Chi Minh City in the southern Mekong Delta region. This can be compared with an average salary for workers in Thailand of US$164 per month and US$134-446 in China's Guangzhou province, the source of much of Chinese manufacturing output. Although wages are rising – by 19.5% between April 2007 and March 2008, according to Navigos – we believe Vietnamese labour is still very competitively priced, in particular after the imposition of the Chinese Labour Contract Law on January 1 2008, which is estimated to have raised labour costs in China by 5-40% and which has prompted many South Korean and Taiwanese firms to consider moving factories to Vietnam.

The regulatory burden in Vietnam's labour market has traditionally been high, but is easing over time. In 2003, legislation was introduced that allowed foreign companies to recruit staff directly, as long as they provide government agencies with a list of recruited workers. However, the requirement to use em-

TABLE: LABOUR FORCE QUALITY

	Literacy Rate,%	Labour Market Rigidity Score	Female Labour Participation, %
Afghanistan	28.1	20.0	n/a
Australia	99.0	24.0	45.3
Bangladesh	47.9	28.0	39.8
Bhutan	47.0	7.0	31.7
Cambodia	73.6	36.0	48.8
China	90.9	31.0	45.9
Hong Kong	93.5	0.0	46.1
India	61.0	30.0	28.3
Indonesia	90.4	40.0	37.0
Japan	99.0	16.0	41.6
Laos	68.7	20.0	50.7
Malaysia	88.7	10.0	35.2
Maldives	96.3	18.0	41.1
Nepal	48.6	46.0	45.0
New Zealand	99.0	7.0	46.1
Pakistan	49.9	43.0	18.7
Philippines	92.6	29.0	38.3
Singapore	92.5	0.0	41.3
South Korea	97.9	10.0	41.3
Sri Lanka	90.7	20.0	39.8
Taiwan	96.1	46.0	20.9
Thailand	92.6	11.0	46.3
Vietnam	**90.3**	**21.0**	**n/a**

Source: BMI/World Bank/ILO. Labour Market Rigidity score from Ease of Doing Business report, 1 = highest score ployment service agencies continues to apply to branches and representative offices of foreign companies.

One of the main regulatory burdens is the social protection system, which imposes a compulsory social insurance contribution scheme in which employers must pay in 15% of the salary, with employees proving 5%. Regulations for hiring workers are significantly more onerous than the East Asia & Pacific average. Whereas the hiring cost is 17% of the salary in Vietnam, it is only 5% in Thailand, for example. The imposition of the Chinese Labour Contract Law in 2008 has, however, made many foreign companies view Vietnamese labour market regulation more favourably. Employers are required by law to establish labour unions within six months of setting up and these must be members of the Vietnam General Confederation of Labour. While most factories have trade unions, many of these do not operate in practice. Trade unions are more active in the public sector, with only one-third of foreign companies having collective agreements with their workforce.

Vietnam does not have a bad industrial relations record. There were about 650 wildcat strikes in 2008, up from 541 in 2007. Most strikes were at foreign-invested firms in the textiles and apparel sector, despite working conditions often being better at these firms than at state-owned enterprises. Most strikes have resulted from legal or contractual breaches, including failure to pay wages and benefits, social insurance contributions or severance pay at termination.

The sharp uptrend in consumer price inflation, especially of essential goods such as food, fuel and housing, prompted increased labour unrest in late 2007 and early 2008 as workers demanded higher wages. The increasingly pressed economic conditions for labourers prompted tens of thousands of workers to go on strike in Ho Chi Minh City and Dong Nai province in January 2008. Lower inflation and tougher labour market conditions have dampened strike action in 2009. The latest available figures from Vietnam's national trade union showed there were 46 wildcat strikes in Q109, compared with 113 cases in Q108.

The government has raised the monthly minimum wage rate for workers at foreign-invested enterprises from VND920,000-1,200,000 (US$51-67), dependent on economic zone, to VND1,000,000-1,340,000 (US$55-74) from January 1 2010. The 13-15% imposed increases were lower than the 20-38% increase in the minimum wage rate for state- and domestic-employed workers to VND730,000-980,000 (US$40-55). This follows the government's roadmap to introduce a universal minimum pay rate for all enterprises by 2012.

TABLE: ASIA, ANNUAL FDI INFLOWS

	2006		2007		2008	
	US$bn	Per Capita	US$bn	Per Capita	US$bn	Per Capita
Australia	25.74	1,255.4	22.27	1,075.7	46.77	2,227.3
Bangladesh	0.79	5.7	0.67	4.7	1.09	7.6
Cambodia	0.48	34.2	0.87	60.3	0.82	55.8
China	72.72	55.3	83.52	62.5	108.31	80.4
Hong Kong	45.05	6,520.6	59.90	8,602.3	63.00	9,000.4
India	19.66	17.3	22.95	19.9	41.55	36.0
Indonesia	4.91	21.5	6.93	29.9	7.92	33.8
Malaysia	6.05	231.6	8.40	316.2	8.05	298.3
Pakistan	4.27	27.5	5.33	34.0	5.44	33.8
Philippines	2.92	33.9	2.93	33.3	1.52	16.9
Singapore	24.74	5,646.5	24.14	5,441.2	22.72	4,695.1
South Korea	4.88	101.6	2.63	54.6	7.60	156.4
Sri Lanka	0.48	24.0	0.53	26.0	0.75	38.8
Taiwan	7.42	324.0	8.16	354.8	5.43	236.2
Thailand	9.01	142.0	9.58	149.9	10.09	156.9
Vietnam	**2.36**	**27.5**	**6.74**	**77.5**	**8.05**	**92.7**

Source: UNCTAD, BMI.

Market Orientation

Foreign Investment Policy

Increased FDI is an integral part of Vietnam's ambitious economic expansion plans and, with ratings agencies pushing their grades higher, the country looks like a solid investment destination, especially for manufacturing. The Planning and Investment Ministry reported that new pledges would reach US$20.0bn in 2011, considerably higher than the US$17.2bn figure for 2010.

The rising levels of official development assistance pledged by multilateral donors are also important, but have been outpaced by inflows from foreign private sources over the last five years. But, as the country tries to transform from a centralised to a more market-oriented economy, the investment framework is still poorly developed in many areas, with bureaucracy and a lack of transparency cited among the major problems.

Despite ambitious targets for foreign investment as an important source of fuel for economic expansion plans, a number of barriers to investment remains. An opaque legal system, an inflexible financial system, corruption, a lack of regulatory transparency and consistency, a ponderous bureaucracy and complex land purchase rules are among areas criticised by foreign investors.

The government has been introducing and amending legislation in an effort to remedy these perceived shortcomings.

Key legislation includes:

- The Law on Foreign Investment (1989), which has been amended several times to make FDI more attractive.

- Government decree 24 of 2000, which carries a pledge to avoid expropriation, and guarantees the right to repatriate profits. It also outlines the government's intention to treat private and state sectors equally.

- A revised bankruptcy law and a Law on Competition, both passed by the National Assembly in 2004, in a bid to improve the FDI climate. Fully owned foreign banks are now allowed to compete on an equal footing with domestic banks.

TABLE: TRADE AND INVESTMENT RATINGS

	Openness To Investment Score	Openness To Trade Score
Afghanistan	34.7	6.2
Australia	68.6	35.1
Bangladesh	13.8	34.3
Bhutan	33.7	24.6
Cambodia	82.6	81.6
China	39.9	65.5
Hong Kong	96.8	97.7
India	36.8	38.9
Indonesia	39.4	60.0
Japan	5.6	34.4
Laos	35.9	17.7
Malaysia	47.5	97.2
Maldives	27.5	43.0
Nepal	46.8	20.9
New Zealand	71.4	76.1
Pakistan	59.6	51.4
Philippines	59.5	62.1
Singapore	67.9	99.6
South Korea	4.9	77.5
Sri Lanka	22.3	57.3
Taiwan	0.0	87.0
Thailand	54.8	89.0
Vietnam	**80.7**	**86.1**

Source: BMI. Scores out of 100, with 100 representing the best score available for each indicator

The Vietnamese legal code is currently in a state of flux and the authorities are drafting a unified legal framework for the conduct of business. A new Common Investment Law and a Unified Enterprise Law came into effect in July 2006, as did a new Intellectual Property Law designed to clarify the responsibility of government agencies charged with protecting IPRs, but doubts remain over the effectiveness of its implementation.

The main forms of foreign investment are:

- Joint venture agreements, under which foreign and domestic firms share capital and profits.

- Business cooperation contracts, which allow a foreign company to carry out business in cooperation with a Vietnamese firm through capital investment and revenue sharing, but without gaining right of establishment or ownership.

- Wholly foreign-owned enterprises are becoming more common, especially those involving industrial production for export.

- Build-operate-transfer agreements are the least common form of FDI and have a reputation among foreign investors of causing regulatory and financing problems.

Foreign portfolio investment is permitted only in small quantities, with aggregate foreign ownership of listed companies capped at 49%. Foreign ownership of banks is capped at 10% per investor and 30% in aggregate. Moreover, many of the shares listed on the Ho Chi Minh City Stock Exchange are too illiquid to attract foreign investors. Investments in export processing zones (EPZs), industrial zones (IZs) and high-technology zones attract tax and other incentives, and offer a ready-made operational infrastructure that may be difficult to arrange outside.

EPZ investments carry 10-12% profit tax. The first established was the Tan Thuan zone near Ho Chi Minh City in 1991, where more than 100 manufacturers currently operate. A number of others have since been built, though they have not been as successful as hoped, partly because all produce from EPZs must be exported.

IZs are for use by firms in construction, manufacturing, processing or assembly of industrial products, often food processing and textiles production. IZ firms pay a 10% profit tax and get refunds if profits are reinvested. IZ firms may produce for the domestic market as well as for the export market. Most FDI into Vietnam comes from North East Asia, notably Taiwan, South Korea, Japan and China/Hong Kong. Canada and the US are the largest non-Asian FDI sources. Leading sectors for FDI are manufacturing, other industry and oil & gas.

Foreign Trade Regime

Although high tariffs, customs bureaucracy and legal inadequacies have provided significant trade barriers, the opening up of Vietnam's economy has been accompanied by concrete measures to meet the requirements of the WTO and other international trade organisations. Vietnam has committed to bound tariff rates (or legal ceilings) on most products ranging from zero to 35%. Reductions in most bound rates from 17.4% on average in 2007 to 13.6% are to be phased in gradually.

Vietnam became a member of the WTO in January 2007. A bilateral trade agreement with the US in effect since December 2001 has substantially lowered tariffs on US industrial and agricultural products, removed non-tariff barriers on US service providers and eliminated barriers to US exports in key areas such as pharmaceuticals and petroleum products.

The Vietnam-Japan Economic Partnership Agreement came into effect on July 1 2009 and has already aided an increase in

TABLE: VIETNAM TOP EXPORT DESTINATIONS

	2002	2003	2004	2005	2006	2007	2008	2009
United States	2,453.2	3,939.6	5,024.8	5,924.0	7,845.1	10,104.5	11,868.5	11,355.8
Japan	2,437.0	2,908.6	3,542.1	4,340.3	5,240.1	6,090.0	8,537.9	6,291.8
China,P.R.: Mainland	1,518.3	1,883.1	2,899.1	3,228.1	3,242.8	3,646.1	4,535.7	4,909.0
Switzerland	66.7	74.7	120.2	103.9	155.7	236.9	516.9	2,486.5
Australia	1,328.3	1,420.9	1,884.7	2,722.8	3,744.7	3,802.2	4,225.2	2,276.7
TOTAL	32,346.5	39,327.6	51,145.6	62,489.3	77,568.1	94,633.4	119,125.2	110,610.2
TOP 5	23,179.1	28,947.9	37,570.2	45,322.3	56,089.2	68,390.5	88,144.1	82,139.4
% from top 5 trade partners	71.7	73.6	73.5	72.5	72.3	72.3	74.0	74.3

Source: IMF, Direction of Trade Statistics.

garment exports to Japan. Vietnam is currently in talks with Chile and the EU, opening up avenues for further bilateral free trade agreements (FTAs) that would strengthen Vietnam's external sector.

Vietnam is a member of the Association of Southeast Asian Nations (ASEAN) – with Brunei, the Philippines, Indonesia, Laos, Myanmar, Malaysia, Singapore, Thailand and Cambodia – as well as the linked ASEAN free trade area. Vietnam is thus party to negotiations on FTAs being conducted by ASEAN, such as talks with the EU, China, Australia and New Zealand.

Vietnam is, in addition, preparing for talks over FTAs with Chile and Japan. Import tariffs are high by regional standards, averaging 16.8% in 2007, according to the WTO. Vietnam will continue to dismantle tariffs in a bid to meet its WTO accession goals, although some key sectors remain protected.

Vietnam has agreed to comply with ASEAN's Common Effective Preferential Tariff scheme on manufactured goods within the ASEAN region, which calls for rates to be brought down to the 0-5% range.

The legislation providing the framework for the trade regime is 1998's Law to Amend the Import and Export Tariffs Law. However, given the ASEAN and WTO requirements, the tariff structure is in a constant state of flux. To reduce the rising costs of a range of products, Vietnam cut import tariffs in October 2007 by 30-60% on many food and dairy products.

Tax Regime

Since 2003, corporate tax has been charged at a unified rate for both domestic firms and foreign investors. From the start of 2005, a self-assessment regime has been in effect. The previous tax audit system has been superseded by a tax investigation system.

Corporate Tax: The main corporate tax rate is 25%, but firms involved in prospecting, exploration and mining of petroleum, gas and other rare and precious natural resources are subject to rates of 32-50%. Resident firms are taxed on global income. Non-resident firms are taxed only on Vietnamese-sourced income. A surtax of 10- 25% is charged progressively on income from land use rights.

Individual Tax: The National Assembly passed Vietnam's first-ever personal income tax bill on November 20 2007. The bill, which became effective on January 1 2009, replaces a previous system in which expatriates and domestics were taxed at different levels. The new bill provides a common set of rules for individuals resident in Vietnam for 183 days or more in a 12-month period. However, the bill is also applicable to those having a permanent residence in Vietnam – a definition that includes a rented house. How this paragraph will be interpreted is still unclear, but could extend tax liabilities to expatriates and locals who reside in Vietnam for fewer than 183 days per year. The new bill stipulates that personal income is to be taxed at a rate of 5-35%, with a personal allowance of VND48mn (US$2,800) and an additional allowance of VND19mn (US$1,120) per dependent. As such, the new bill reduces the highest marginal tax level applicable to expatriates from 40% to 35%. A new feature in the bill compared with previous legislation is that it covers non-employment income such as interest, dividends, capital gains on real estate and securities investment.

Indirect Tax: The main value-added tax (VAT) rate is 10%. A 5% rate is charged on some goods, including computers and accessories, construction, machinery, chemicals, coal and metallurgy products. Exported goods and software and services exported to firms in export processing zones carry a zero VAT rate. Registration is obligatory for businesses. VAT taxation is also subject to an ongoing revision by the National Assembly.

Capital Gains: Usually taxed as income at corporate rate. Gains by foreign investors on the transfer of an interest in a foreign or Vietnamese enterprise attract a 25% tax. Gains by individuals on the transfer of a home or on land use rights are taxed progressively up to 60%.

Operational Risk

Security Risk

Vietnam is generally a very safe country for foreign residents and travellers. Petty street crime is rising in the major cities, but there have been very few serious offences against foreigners reported. Unexploded mines and ordnance are a continuing hazard, particularly in central Vietnam and along the Laos border.

The poor standard of roads and other public infrastructure is also a safety risk, as is the poor level of driving, which makes traffic accidents one of the most prominent health risks for both foreigners and nationals.

Chapter 5:
Key Sectors

Defence

Executive Summary

On August 17 2010, Vietnam and the US held defence talks for the first time. Vietnam's Deputy Defence Minister Nguyen Chi Vinh met with US Deputy Assistant Secretary of Defence for South and Southeast Asia Robert Scher. Scher later said that they discussed marine security, international peacekeeping, search and rescue operations, humanitarian and disaster relief operations and language training. Additionally, they talked about unexploded ordnance and herbicides left over from the Vietnam War, as well as servicemen listed as missing-in-action. Both sides stated that although the dispute with China regarding the South China Sea was not the main subject of the dialogue, the dispute had to be peacefully negotiated to sustain regional stability.

At the ASEAN Regional Forum in July 2010, the US had already made it clear that it would negotiate on a multi-lateral basis to mediate in disputes in South East Asia. This is obviously an effort to counter China's ambitions to dominate the South China Sea, over much of which it claims sovereignty. In the short-to-medium term, though, access to water from the Mekong river, which reaches the sea in southern Vietnam, will be a key foreign relations issue for Vietnam.

Vietnam faces the challenge of modernising its large armed forces, but without the resources that are available to its richer neighbours. For the time being, Russia remains the main source of equipment and materiel. However, as a part of its policies to develop relations with countries in South East Asia, India has also emerged as a significant supplier of parts for the ships in Vietnam's navy. In November 2010, the government of Vietnam made it clear that foreign navies may avail themselves of the facilities at the base at Cam Ranh Bay. The base was used by the US navy during the Vietnam War and subsequently by the Soviet navy. It remains to be seen whether the base can become a significant source of revenue for the Vietnamese.

The government set a real GDP growth target of 6.5% for 2010. Economic indicators in July also reinforced the government's aggressive target, after industrial production came in at a better-than-expected 16.0% y-o-y in July. To a certain extent, the encouraging numbers helped to alleviate concerns that weakening external demand from the US and EU would be a drag on the economy. Industrial production accelerated after slowing down for three consecutive months.

However, we expect loan growth to remain weak on a historical basis in H210 due to the threat of higher inflation. Therefore, we do not see business investments continuing to contribute significantly to industrial production growth. Instead, we see private consumption and government-supported infrastructure investment as the main drivers of economic growth in H210.

Regardless of the ongoing disagreements with China, in the longer term, our core political scenario is for the Communist Party of Vietnam (CPV) to shift increasingly towards a technocratic form of government, aimed at maintaining high economic growth levels and an acceptable distribution of wealth across the population. We thus foresee a continuation of economic reforms despite criticism from more traditionally minded party members. However, intermittent periods of harsh repression against pro-democracy activists and other government critics are a strong indication that political liberalisation is not in the offing.

Market Overview

A former Soviet proxy, Vietnam has failed to develop its own domestic defence industry adequately. Hindering its development has been its long history of conflict, meagre resources, lack of domestic know-how and military doctrine of guerrilla and defensive warfare strategies, which are still being overcome. Most Vietnamese arms were purchased from the Soviets, except for a few newly acquired platforms from North Korea, Russia and a small number from India.

Perhaps the largest inhibiting factor preventing the industry's development is capital. With Vietnam so far behind regional leaders economically, it lacks the required industrial and scientific base necessary for any credible defence industry. However, future purchases, expected to come in the next decade, may include technology transfers, allowing Vietnam to jump ahead generations and to provide the foundation for a domestic industry.

Vietnam maintains a small domestic defence industry capable of supplying small arms, minor weaponry and ammunition. For more technologically advanced production, Vietnam relies on reverse engineering and this technique has been employed to keep the nation's fleet of ageing Soviet aircraft in use prior to an agreement with India. All defence production is facilitated by state enterprises, and there is little if any research and development (R&D) done within the country aimed at creating new platforms. However, through a focused procurement programme, the Vietnamese defence industry will benefit from exposure to new technology.

Like most other sectors of the economy, Vietnam's defence industry is looking for technological transfers. Opportunities seem possible with companies from India, the UK, Russia and France. However, the larger issue remains funding. With few resources directed towards the massive military and just a small percentage of the total budget allocated to new purchases, Vietnam remains temporarily handcuffed until the economy expands to such a point that significant money is allocated to the defence budget.

Industry Trends And Developments: Vietnam's defence industry is largely underdeveloped compared to other neighbouring states, especially Singapore and Australia. Due to the weak indigenous defence industry, Vietnam imports most of its defence systems, with Russia, Poland and Israel providing the bulk of Vietnam's arms acquisitions. French defence company **Thales** is set to penetrate the Vietnamese defence and security market, especially in the area of light arms. Specifically, Thales is seeking to provide technology that can integrate with the Russian designed AK-630 naval Gatling gun. Thales has already successfully integrated its technology with Poland's **Orkan** naval missile craft. However, there are a number of obstacles hindering the development of a robust defence and security industry in Vietnam.

In 2008, Vietnam's defence industry continued to mature. In Q108, the government directed that all military-owned defence industries will be managed by the government by the end of 2012. There are some 140 defence firms managed by the military. The change in ownership is framed in the Defence Industry Ordinance, which states that the role of the indigenous defence industry is to support economic and social development in addition to the defence of Vietnam. The government stated that the military's management of the defence firms and military issues were overloading the armed forces. However, it is likely that the move was also driven by the need for Vietnam's defence industry to mature more rapidly.

In December 2009, it was reported by Janes that the Vietnamese government had urged the 'rapid development' of its state-owned defence industries to supply the army with the most modern military equipment. No details were revealed about how it is planning to develop those capabilities.

Arms Trade Overview: Vietnam's ageing platforms require replacements if the military is to have any operational capacity within the next decade. The almost total absence of any large-scale defence industry translates into the nation's need for foreign purchases. Historical suppliers Russia and India will likely remain the primary sources of new purchases, as both countries offer technologically advanced systems for a relatively low price in comparison to Western goods. However, there is the opportunity for UK and US firms, provided that they can offer incentives to Hanoi.

As noted above, in December 2009, Vietnam ordered from Russia six diesel-electric Kilo-class Project 636 submarines (at US$2bn in total) and 12 Su-30 fighter jets. This is in addition to an earlier contract for 12 Su-30MK2 fighter aircraft signed in January 2009. (Source: DefenseNews, January 21 2010)

Vietnam's Ministry of Defence has signed a contract with **Viking Air** of Canada to purchase six DHC-6 Twin Otter Series 400 aircraft for Vietnam's navy.

In Q207, Vietnam's defence export structure received a boost when the US announced that it intended to lift the arms trade sanctions placed on the country, after the International Traffic in Armed Regulations amendment enabled the US to embark on examining two-way trade with Vietnam on non-lethal defence systems. Items that are not included in the new agreement range from non-lethal crowd defence articles to night-vision systems used by security forces. It is likely that in the initial stages of the arms trade relationship will be asymmetrical, with Vietnam probably importing most of the arms from the US. However, as the Vietnamese defence industry matures, the country could boost its arms exports, particularly in the area of small arms and light weapons (SALW). Vietnam holds a comparative advantage in the labour-intensive SALW industry. As stated, Vietnam's defence systems are old and need spare parts from older systems, which the US is unlikely to produce. Therefore, Russia is likely to remain Vietnam's main arms trading partner in the foreseeable future.

Procurement Trends And Developments: With Vietnam's recent economic growth and a replacement date of 2020 for most major platforms, there are opportunities for military sales. Vietnam will need to replace: armoured personnel carriers, battle tanks, artillery, fighters, helicopters, transports, surface assets and anti-missile systems. More specifically, maritime disputes present increased opportunities for at-sea clashes, with leading planners most likely to concentrate on adding naval assets, especially for the under-resourced coastguard.

Trade and barter agreements present an interesting opportunity for foreign suppliers. Such deals have proved successful in the cases of Indonesia and Malaysia, who have suffered from funding issues in the past. Those firms hoping to compete with **Rosoboronexport** must consider this fact when competing for contracts.

In recent years, there has been a noticeable increase in the number of large arms deals and growing defence budgets amongst Asia Pacific states. The South East Asian region has stood out in particular, as many South East Asian states are attempting to revive their ageing Soviet-era defence platforms. Defence platforms that have received the most attention include submarines, fighter jets and missile systems such as the Brahmos cruise-missile. These defence platforms all focus on maintaining superior combat and strike capability based on stealth, a key feature of fifth generation technology.

There are several drivers for the shift towards an arms build-up. First, China's peaceful rise has not necessarily been reflected in its handling of key territorial disputes, such as the Spratly Islands. South East Asian states are aware that a dispute over the 'One China' policy is likely to emerge over Taiwan. Another key driver is that, internally, many South East Asian states have experienced increasing internal instability – such as the Philippines, Thailand and Indonesia. For many states the increased purchase of arms is as much for internal protection as it is for external protection. The question remains as to where Vietnam fits into this regional trend.

Given that Vietnam is on relatively friendly diplomatic terms with China, it does not necessarily have to be as concerned with the latter's rise. Moreover, Vietnam does not bear any significant territorial grudges towards any neighbours more powerful than itself. Finally, the country is not experiencing any strong or sustained internal dissent like in Thailand or Indonesia. In these cases the governments have had to resort to purchasing armoured personnel carriers and sophisticated communications equipment to control their respective insurgencies.

In recent years, India has become a key player in assisting the revitalisation of Vietnam's armed capabilities. In Q108, India announced plans to provide 5,000 spare parts to Vietnam to revive its Petya-class frigates. The frigates form a core part of Vietnam's maritime capability, having been used regularly to patrol the coast and the Spratly Islands. However, the fleet is ageing rapidly. The Petya-class frigates were acquired from India in 1978, with an additional three frigates acquired between 1983 and 1984. India was able to acquire the 5,000 spare parts from stripping its own Petya-class fleet. The last upgrade of Vietnam's Petya-class fleet occurred between 1994 and 1999, when the mortar system was upgraded with 25mm and 37mm guns. From India's perspective, the move is in keeping with its 'Look East' policy.

Industry Forecast

In terms of civilian and possible dual use areas, Vietnam's aerospace industry presents the most easily realised opportunities. The industry has been growing by 10-15% annually and has made several recent purchases from non-traditional suppliers. As air traveller numbers continue to increase, new planes and infrastructure will be needed to accommodate demand.

The state-owned Civil Aviation Administration of Vietnam handles civilian air purchases. The administration is scheduled to receive US$4.5bn for infrastructure and US$5bn for new aircraft by 2010. Money for purchases will come from the state budget, development assistance and joint partnerships. Japan, Europe and especially the US are the largest players in the industry, and the US market share is expected to grow as the two nations continue to normalise relations. Recent activity in the sector has included **Vietnam Airlines** adding to its fleet of 25 aircraft, which includes five **Boeing** 767-300s, 10 **Airbus** A-320s and two Airbus A-321s, by signing a contract to buy four Boeing 777-200ERs. However, the best opportunity for contracts is located in the spares market and aiding the nation in its multi-billion infrastructure development plans.

Although Vietnam continues to have little or no indigenous defence industry, change could be just a decade away. The military needs to add new platforms to all services to maintain training programmes and operational capacity. This need could be met by defence agreements with Russia, India and possibly the UK or South Korea. New large-scale contracts could form the backbone of a defence industry that would be well positioned to sell arms to questionable states such as Cuba and Burma. However, for this to happen, foreign partners must be willing to transfer technology or sell licensing agreements to Hanoi. More importantly, the CPV will have to find funding or pursue non-traditional payment options. Whether the CPV will make the development of this industry a national priority remains in question.

Government Expenditure On Defence Industry: Vietnam's economy has been one of the region's fastest growing, and it is important to note that Hanoi's purchase of foreign goods, especially for the military, has been contingent on its economic growth. With new and possibly sustained growth, Vietnam could be entering a potential spending phase similar to the one recorded in the pre-financial crisis years.

Hanoi announced plans in Q107 to reform many state-owned enterprises (SOEs) throughout the country. Although the pace of reform is behind schedule, something that should come as no surprise, the banking sector, utilities, post, telecommunications, chemicals, insurance, and manufacturing sectors have been identified as profitable locations for foreign direct investment and possible partnerships. In many of these sectors, foreign investors will be offered the opportunity to buy shares in SOEs. However, corruption and the opaque nature of business suggest that these would be high-risk plays – especially without a proven, workable legal framework to define business practices.

In the meantime, Vietnam remains a predominately agrarian society, with some 65% of the labour force employed in the sector, which includes forestry, fisheries and agriculture. The sector accounts for 23% of GDP. Vietnam's staple crops include coffee, rice and pepper; along with aquaculture exports, it continues to be a world production leader in these goods. In relation to regional economies, Vietnam's per capita GDP, net export values, and net GDP lag far behind regional competitors the Philippines, Thailand and Indonesia.

Much like China, Vietnam has a glut of SOEs. Though accounting for 40% of industrial output, SOEs do not receive foreign investment and hence are languishing in terms of technological upgrades. It is likely that in the next decade Hanoi will sell many SOEs to raise foreign capital or, in the case of mining operations and other capital intensive industries, form partnerships between SOEs and foreign investors, who will need to offer expertise and R&D monies.

Meanwhile, private enterprises in the country account for roughly 25% of GDP, but for obvious reasons they are one of the fastest growth sectors and employ 400% more people than the state sector. One sector, which will be key to watch, is tourism. With Thailand facing insurgency in the south, China becoming more expensive along its rapidly evolving coast, Indonesia and the Philippines stigmatised by their association with terrorism, and with the cost of living increases in Malaysia, Vietnam has the potential to emerge as a safe, cheap tourist destination. Its lengthy coastline, numerous parks, wartime legacy, central location and cheap living costs will likely transform the nation into a tourist mecca in the decade to come.

TABLE: VIETNAM'S DEFENCE EXPENDITURE, 2008-2015

	2008	2009	2010e	2011f	2012f	2013f	2014f	2015f
VNDmn	34,848,000	36,180,000	49,553,355	58,307,249	65,821,278	74,476,375	83,887,711	94,058,003
– % change y-o-y	21.27	3.82	36.96	17.67	12.89	13.15	12.64	12.12
– % of GDP	2.40	2.50	2.60	2.60	2.60	2.60	2.60	2.60
– VND per capita of population	404,219	414,498	560,799	653,146	729,946	817,825	912,297	1,013,229
US$mn	2,120.64	2,034.05	2,580.90	2,952.27	3,332.72	3,868.90	4,474.01	5,153.86
– % change y-o-y	18.64	-4.08	26.89	14.39	12.89	16.09	15.64	15.20
– US$ per capita of population	24.60	23.30	29.21	33.07	36.96	42.48	48.66	55.52
EURmn	1,442.61	1,452.89	1,940.53	2,186.86	2,624.19	3,095.12	3,579.21	4,123.09
– % change y-o-y	10.62	0.71	33.56	12.69	20.00	17.95	15.64	15.20
– EUR per capita of population	16.73	16.65	21.96	24.50	29.10	33.99	38.92	44.42
US$mn, constant prices	2,138	2,073	2,382	2,553	2,729	3,004	3,323	3,662
– % change y-o-y	-1.47	-3.04	14.89	7.19	6.89	10.09	10.64	10.20
– constant US$ per capita of population	24.80	23.75	26.95	28.60	30.26	32.99	36.14	39.45

e/f = BMI estimate/forecast. Source: SIPRI

Real Estate

Executive Summary

Vietnam's commercial real estate market has been overshadowed by a property glut. Rental rates fell by double-digit rates through 2009 – in each of the three cities for which we gathered data (Hanoi, Ho Chi Minh City and Da Nang) and across all three sub-sectors. Vacancy rates are generally running at around 30%.

Normally, in an economy that has been growing so quickly that the authorities are tightening both fiscal and monetary policy in order to curb inflationary pressures, rents and capital values would fall until much of the vacant space is absorbed.

Although the government intervened to re-regulate the commercial real estate sector in early 2010, it was not clear that this process of adjustment was under way in Vietnam. At present, there are clear signs that the market is stabilising but uncertainties still remain. Our in-country sources indicated that Da Nang office and Hanoi industrial rents had increased dramatically since 2009. Elsewhere, rents tracked sideways or rose by single digit amounts. Our sources anticipate that rents will continue to move sideways through 2011 before picking up towards the end of the forecast period in 2015. They are less optimistic about the prospects for higher rents in Hanoi than in Ho Chi Minh City or Da Nang.

Our view is that the government has allowed market forces to operate in at least some of the market. One of the key findings from our mid-2010 interviews was that yields had risen sharply in the office and industrial sub-sectors of Hanoi and Da Nang. The implication is that there has been a major adjustment in these sub-sectors – in the form of a slump in capital values.

It may well be that 2010 comes to be seen as the year in which the key trends in Vietnam's commercial real estate sector became much clearer. A substantial over-supply of property is being absorbed – although official intervention is still preventing across the board adjustments in rents, yields and capital values. Conditions in particular sub-sectors remain volatile – but yields are in general likely to move sideways or downwards over the coming four years.

Market Overview

Real Estate Market Overview – Key Issues: From the point of view of owners, investors and most other protagonists in Vietnam's commercial real estate sector, the general economic outlook is benign. However, a past construction boom has resulted in massive over-supply, which has resulted in a slippage in rental rates, and high vacancy rates through 2009.

The government has intervened in the market place. Approvals for projects, which had been progressing too slowly, have been revoked. This may be a measure to limit speculation. More likely, it is a move to control the direction of rents and values. Our in-country sources suggest that rental rates have basically stabilised in 2010 and will rise further in 2011. We assume that this is the result of official government policy – rather than a true reflection of absorption of excess space. As a consequence, we presume that vacancy rates will remain high for some time.

Industry Forecast

Real Estate Outlook – Supply And Demand: There is clearly an over-supply of commercial property in Vietnam. Our sources in Hanoi and Da Nang reported early in 2010 that office and retail rents fell by 10-20% over the course of 2009 (and by more in the case of Hanoi office space). In Ho Chi Minh City, rents slipped by 25-30% in all three sub-sectors.

As we discuss in the Real Estate Market Overview, the problem is not that Vietnam is sliding into recession or financial crisis. The State Bank of Vietnam is tightening policy to rein in excess demand and to curb inflationary pressures. Like Indonesia, Vietnam has passed through the global financial crisis largely unscathed.

The conclusion, therefore, must be that there has been significant over-building in all sub-sectors and in all three main cities. Vacancy rates are running at 30-40% (except in the industrial sub-sector in Ho Chi Minh City, where they are 15-20%).

Relative to other countries whose real estate sectors are profiled by **BMI**, Vietnam stands out because the government appears to be taking steps to manipulate the market. Our sources report that permits for projects which have been proceeding slowly have been revoked. The government and its agencies are seen as major sources of demand.

Our interviews with our in-country sources confirmed that rents had tracked sideways in most sub-sectors in Vietnam (and risen sharply in one or two). As discussed below, our sources are looking for rents to rise slightly in Ho Chi Minh City and Da Nang, but not Hanoi, over 2011.

The specific comments from our in-country sources in early

2010 were as follows:

'Rental rates in Ho Chi Minh City were 25-30% lower in 2009 than they had been in 2008. The fall in the property market was because of the government's intervention. The Ministry of Finance is revoking [sic] from the entrepreneurs [and is giving it back to the government for public usage].'

'We expect rental rates in Ho Chi Minh City to rise this year [by 5%]... The rise is expected because demand for commercial real estate exceeds supply. The central government is [resuming] available land and, at the same time, is revoking permits for existing projects.'

Vacancy rates in Ho Chi Minh City are running at around 30% in the office sub-sector, 25-30% in the retail sub-sector and 15-20% in the industrial sub-sector. 'We are looking for a 15-20% rise in rental rates in 2011. This is because the rental rates [are at the lowest possible level].'

'The Ho Chi Minh City market does not seem promising for new projects. There are no new projects in Ho Chi Minh City. The existing projects are being revoked. We are not expecting any new projects this year.'

'We are expecting rental rates [in Hanoi] to rise by 5% in 2010. Rental rates may increase as the government is revoking (sic) projects from entrepreneurs. This will lead to an increase in demand which will be greater than the supply [of commercial property].'

Vacancy rates in Hanoi are currently running at 35-40% across all three sub-sectors.

'The launch of three projects – namely Plaschem (Long Bien District), CEO Tower (Tu Liem District) and Handiresco Tower (Ba Dinh District) has lifted Hanoi's total office space to 500,000 square metres, including 12 Grade A buildings, 30 Grade B buildings and 32 Grace C buildings. These commercial towers have been launched jointly by government agencies and private entrepreneurs.'

'We are expecting a 15% rise in rental rates in Hanoi in 2011.'

'The government is taking over all the new commercial projects that are under construction across Vietnam. Besides these projects, we are unaware of any further projects that are under construction in and around Hanoi.'

Commercial rents in Da Nang are expected to rise by 5% in 2010. 'The increase in rental rates should be due to the programme of the central government, which is trying to develop the available land for public convenience.'

'We expect a 15% rise in rental rates [in Da Nang] in 2011. This is because rental rates are at their lowest possible rates currently.'

Rents And Yields: During 2009, yields rose in Da Nang (in spite of the slump in rental rates). They fell slightly in Ho Chi Minh City and Hanoi. As noted above, the two key characteristics of the commercial real estate market as a whole have been over-supply and (apparently) government intervention to stabilise the market. We conclude that (although it was not specially mentioned by our sources in that city), prices and capital values fell

TABLE: VIETNAM REAL ESTATE MARKETS – FORECAST NET YIELD, 2009-2015 (%)

	2009	2010f	2011f	2012f	2013f	2014f	2015f
Offices							
Hanoi	6-9	10-14	10-14	8-10	8-10	8-10	8-10
Da Nang	7-8	12-14	12-14	8-10	8-10	8-10	8-10
Ho Chi Minh City	6-8	6-8	6-8	6-8	6-8	6-8	6-8
Retail							
Hanoi	8-10	6-8	6-8	6-8	6-8	6-8	6-8
Da Nang	6-9	6-8	6-8	6-8	6-8	6-8	6-8
Ho Chi Minh City	8-10	8-10	8-10	8-10	8-10	8-10	8-10
Industrial							
Hanoi	7-9	10-14	10-14	8-10	8-10	8-10	8-10
Da Nang	7-9	10-14	10-14	8-10	8-10	8-10	8-10
Ho Chi Minh City	8.0-9.0	8.0-9.0	8.0-9.0	8.5	8.4	8.3	8.3

f = forecast. Source: BMI

in Da Nang. The government's activities may have prevented a fall in prices and capital values in Ho Chi Minh City and Hanoi.

In mid-2010, our sources indicated that rents had risen very sharply in two sub-sectors – Da Nang offices and Hanoi industrial. Rents have risen by 32% and 43% respectively. There were small rises in the rental rates in all three sub-sectors of Ho Chi Minh City. Our sources suggested that rents should rise by 5-10% across the board in Da Nang and Ho Chi Minh City in 2011. However, rents in Hanoi are forecast to move sideways.

Crucially, our sources indicated that yields had risen sharply by mid-2010 in the office and industrial sub-sectors of Hanoi and Da Nang. The obvious conclusion is that there has been a fall in capital values in these cities (and/or that such a fall has been permitted by the government). At this stage, we envisage that yields in the office and industrial sub-sectors of Hanoi and Da Nang will slip gradually over the next four years. However, we expect that yields in other sub-sectors will track sideways. This outcome is consistent with our general view of Vietnam as a market for commercial real estate where participants see capital growth as being the main source of investment return.

Construction Industry Outlook – Inflationary Concerns Lower Short-term Growth Prospects: We have downgraded our forecast for real value growth in Vietnam's construction industry in 2010 to 6.5% y-o-y, reaching VND127trn (US$6.6bn), due to short-term concerns regarding increasing inflationary pressures and exposure to an expected global slowdown in 2011. However, our long-term outlook for strong demand to drive growth in Vietnam's construction and infrastructure sectors remains unchanged.

Short-Term Concerns Inhibiting Growth: Q310 was a strong growth period for the Vietnamese economy despite a rise in inflation to 8.9% from 8.2% in the second quarter. Vietnam registered a real GDP growth of 7.4% y-o-y compared with a real growth rate of 6.3% in Q210. However, we believe that a further surge in inflation will force the country's central bank to hike interest rates over the coming quarters. This would lead to an increase in the cost of operations and business materials which in turn would have a dampening effect on construction activity. We have therefore priced in this downside risk in our forecast. Construction industry value, which grew by 11.3% y-o-y in 2009, is expected to fall to 6.5% in 2010 and 4.8% in 2011.

However, once inflation levels in Vietnam have moderated, interest rates will likely be allowed to decline to more sustainable levels, and we expect to see an uptick in construction activity for the rest of our forecast period (2012-2015). The construction sector will reach an average growth of 6.3% y-o-y between 2012 and 2015, and remain along those lines to the end of our forecast period.

According to our forecasts, infrastructure will on average account for 46.1% of the construction industry's total value between 2010 and 2015. The potential of the sector is reflected in **BMI**'s Project Database, which lists more than 70 infrastructure projects currently underway or under consideration in Vietnam. As such, although rising interest rates will impact infrastructure growth rates in 2010-2012, we believe that the large number of projects already in the pipeline for Vietnam's infrastructure – especially in the transport sector – will sustain growth in the infrastructure industry beyond 2010.

Transport Sector To Maintain Dominance Despite Power Outages: The transport sector continues to form the majority of infrastructure investment in Vietnam throughout our forecast period, forecast to account for 71% in 2015. Vietnam still suffers from a significant deficit in transportation infrastructure, and we see reason for the Vietnamese government to continue to develop this sub-sector over the medium term. This is reflected in our forecast for the value of the transport infrastructure industry to grow by an average of 5.8% y-o-y between 2010 and 2015.

The energy and utilities sector is seeing more moderate levels of growth, and **BMI** is forecasting the industry's value to grow by 2.7% y-o-y on average between 2010 and 2014. Yet we believe there is much scope for upside revision as Vietnam is currently suffering from serious power outages due to severe droughts that have exposed the unreliability of the country's hydropower dams. The Vietnamese government is looking to swiftly resolve this problem and has initiated a number of proposals to build coal-fired power plants and wind farms.

Chapter 6:
BMI Global Assumptions

Global Outlook

Growth Solidifies, But Inflation Poses A Threat

The global economic outlook continues to improve. Since the last update of our Global Assumptions we have raised our growth forecasts for the US, China and Japan, while our global inflation and growth projections have also increased. Our global real GDP growth forecast for 2011 has risen to 3.6% from 3.3%, which would put the rate of economic expansion closer to the long-term average.

Stronger growth pressures, as well as supply-side considerations, are boosting consumer prices worldwide. Accordingly, our global consumer price inflation forecast for 2011 has increased to 3.2% (from 2.9%), while for 2012 it has risen to 3.4% (from 3.0%). Our core scenario is that headline inflation should not be so much of a worry as we approach H211. This is because high agricultural prices, which are at the root of elevated food inflation, are set to come down, according to our Commodities team. Energy prices have soared in recent months, but our Oil & Gas team believes that there is sufficient available production capacity to alleviate fears of a super-spike, and prices should remain relatively contained. Furthermore, the arithmetic of higher prices in H210 and steady prices in H211 dictate that year-on-year inflation will not be as much of a problem later in the year. Nonetheless, upside risks from supply shocks remain prevalent. With emerging market policymakers increasingly wary of increasing inflation, and with monetary policy unlikely to become any looser in developed states, we expect global monetary conditions to tighten. The global recovery should be

TABLE: GLOBAL ASSUMPTIONS

		2009	2010e	2011f	2012f	2013f	2014f	2015f
Real GDP Growth (%)								
	US	-2.6	2.9	3.1	2.9	2.8	2.5	2.4
	Eurozone	-4.1	1.8	1.6	1.9	2.0	1.9	1.9
	Japan	-5.2	4.0	1.6	1.2	1.3	1.2	1.2
	China	8.7	10.2	8.3	8.1	7.6	7.0	7.0
	World	-1.7	4.1	3.6	3.7	3.8	3.8	3.7
Consumer Inflation (%, ave)								
	US	-0.4	1.6	1.4	1.8	1.9	2.0	2.2
	Eurozone	0.3	1.5	2.1	1.8	1.9	1.9	1.8
	Japan	-1.3	-1.0	-0.5	0.0	0.5	1.3	1.8
	China	-0.7	3.3	4.3	3.2	3.0	3.0	2.9
	World	1.9	2.9	3.2	3.4	3.4	3.4	3.4
Interest Rates (%, eop)								
	Fed Funds Rate	0.00	0.00	0.00	2.50	4.00	4.25	4.25
	ECB Refinancing Rate	1.00	1.00	1.00	2.50	3.00	4.00	4.00
	Japan Overnight Call Rate	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Exchange Rates (ave)								
	US$/EUR	1.40	1.33	1.35	1.27	1.25	1.25	1.25
	JPY/US$	93.60	87.00	89.00	92.50	95.00	100.00	105.00
	CNY/US$	6.83	6.79	6.55	6.43	6.29	6.13	5.98
Oil Prices (ave)								
	OPEC Basket (US$/bbl)	60.86	77.00	80.00	85.00	90.00	90.00	90.00
	Brent Crude (US$/bbl)	61.51	79.00	82.00	87.00	93.00	93.00	93.00

Source: BMI

robust at this point to withstand a withdrawal of stimulus, but there is potential for downside growth risks in 2012.

Developed States

Our forecast for developed states real GDP growth in 2011 has risen to 2.3%, from 2.1%. This takes into account primarily improvements in our US and Japan outlooks. In the US, growth will be boosted by payroll tax cuts announced in December 2010, with loose monetary and fiscal policy keeping the dollar weak and business investment underpinned. Additionally, Q410 real GDP data were solid, and continued to point to a recovery that is being led by investment and exports. Our 2011 real GDP forecast has been bumped up to 3.1% from 2.8%, while the increase in our 2012 projection to 2.9% from 2.5% underlines our increasing conviction that the recovery is becoming more sustainable. On balance, the risks to these growth forecasts are to the upside.

Meanwhile, we are upgrading our 2011 growth forecast for Japan from 0.9% to 1.6% (from an estimated 4.0% in 2010), owing largely to an improvement in the external outlook and the strong growth momentum with which the economy ended Q410. Net exports should contribute positively to GDP this year, rather than being flat, while investment is likely to come in higher than previously expected. That said, consumption will continue to disappoint as fears over rising taxes and government spending cuts weigh on sentiment over the medium term.

Emerging Markets

We are forecasting 5.5% growth in emerging markets in 2011, which represents an upgrade from 5.2% in our previous set of projections. This is due primarily to an increase in our 2011

TABLE: GLOBAL & REGIONAL REAL GDP GROWTH % CHG Y-O-Y

		2010e	2011f	2012f	2013f
World		4.1	3.6	3.7	3.8
Developed states		2.6	2.3	2.3	2.4
Emerging markets		6.7	5.5	5.6	5.6
Asia ex-Japan		7.8	6.2	7.2	6.8
Latin America		4.2	3.5	3.4	3.3
Emerging Europe		4.0	4.3	4.6	4.9
Sub-Saharan Africa		5.5	5.9	6.2	6.0
Middle East & North Africa		4.0	3.7	3.9	3.8
Developed Market Exchange Rates (ave)					
Eurozone	US$/EUR	1.33	1.35	1.27	1.25
Japan	JPY/US$	88.91	88.00	90.75	93.75
Switzerland	CHF/US$	1.04	1.03	1.02	1.01
United Kingdom	US$/GBP	1.55	1.71	1.78	1.80
Emerging Market Exchange Rates (ave)					
China	CNY/US$	6.79	6.55	6.43	6.29
South Korea	KRW/US$	1,156.37	1,120.00	1,050.00	1,025.00
India	INR/US$	45.86	46.41	47.50	45.00
Brazil	BRL/US$	1.76	1.73	1.73	1.64
Mexico	MXN/US$	12.63	11.93	11.25	10.75
Russia	RUB/US$	30.37	29.49	27.23	25.75
Turkey	TRY/US$	1.50	1.49	1.45	1.41
South Africa	ZAR/US$	7.30	6.49	6.40	6.27

Source: BMI

TABLE: CONSENSUS FORECASTS

		US	Eurozone	Japan	Brazil	China	Russia	India
2011	Bloomberg consensus	3.1	1.6	1.4	4.5	9.5	4.2	N/A
	BMI	3.1	1.5	1.6	4.5	8.3	4.3	8.1
2012	Bloomberg consensus	3.2	1.7	2.0	N/A	N/A	4.1	N/A
	BMI	2.9	1.9	1.2	4.8	8.1	4.4	8.4

Source: BMI

real GDP forecast for China to 8.3% from 7.5%. While this still represents a slowdown from 10.2% growth in 2010, a number of factors on the external front and the domestic policy arena suggest that the slowdown will be less pronounced than previously envisioned. However, we have downgraded our 2012 forecast from 8.5% to 8.1%, as we continue to expect a retrenchment in credit growth and fiscal stimulus.

Emerging Europe, led by strong growth in Turkey and Russia, is forecast to grow at a 4.3% pace in 2011, while Latin America will see growth slow slightly to 3.5%, from 4.2% in 2010. The Middle East and North Africa will see relatively steady growth in 2011, at 3.7% (compared with 4.0% in 2010), while Sub-Saharan Africa will pick up the pace slightly, to 5.9%, from 5.5% in 2010.

Chapter 7:

Sector Forecast Appendix

TABLE: AUTOS SECTOR KEY INDICATORS

	2007	2008	2009	2010e	2011f	2012f	2013f	2014f	2015f
Vehicle production, units [1]	23,478	33,018	33,689	37,199	40,322	43,872	48,170	52,805	57,789
Vehicle production, units mn [1]	0.02	0.03	0.03	0.04	0.04	0.04	0.05	0.05	0.06
Passenger car production, units [2]	22,542	31,684	32,805	36,315	39,438	42,988	47,286	51,921	56,905
Passenger car production, units mn [2]	0.02	0.03	0.03	0.04	0.04	0.04	0.05	0.05	0.06
Commercial vehicle production, units [1]	936	1334	884	884	884	884	884	884	884
Commercial vehicle production, units, % chg y-o-y [1]	197.1	42.5	-33.7	0.0	0.0	0.0	0.0	0.0	0.0
Vehicle sales, units [3]	80,392	111,946	119,460	112,224	118,824	126,562	138,656	159,496	181,478
Vehicle sales, units, % chg y-o-y [3]	96.8	39.2	6.7	-6.1	5.9	6.5	9.6	15.0	13.8
Passenger car sales, units [4]	40,115	50,874	62,723	57,778	58,934	61,880	66,212	74,157	82,315
Passenger car sales, units, % chg y-o-y [3]	71.9	26.8	23.3	-7.9	2.0	5.0	7.0	12.0	11.0
Commercial vehicle sales, units [5]	40,277	61,072	56,737	54,446	59,891	64,682	72,444	85,339	99,164
Commercial vehicle sales, units, % chg y-o-y [5]	129.9	51.6	-7.1	-4.0	10.0	8.0	12.0	17.8	16.2
Passenger car density, cars per 1,000 of population [6]	9.9	13.0	13.2	13.6	14.2	14.6	15.0	15.5	16.0

Notes: e/f = BMI estimates/forecasts. Sources: 1 OICA/BMI calculation; 2 OICA; 3 VAMA/BMI calculation; 4 VAMA; 5 ACEA/BMI calculation; 6 ACEA & Eurostat.

TABLE: FOOD AND DRINK SECTOR KEY INDICATORS

	2007	2008	2009	2010e	2011f	2012f	2013f	2014f	2015f
Food consumption, US$bn [1,4]	12.7	14.6	14.3	15.0	17.5	19.2	21.6	24.3	27.2
Food consumption VNDbn [4]	209,427.4	239,970.5	255,243.5	288,312.2	344,695.2	378,840.9	415,535.3	454,832.2	496,660.5
Per capita food consumption US$ [1,4]	148.9	168.2	164.4	169.9	195.5	212.7	237.0	263.8	293.2
Confectionery sales, US$mn [1,5]	272.1	300.5	291.2	291.1	312.0	337.1	374.3	415.8	461.8
Confectionery sales, VNDmn [5]	4,471,359.1	4,938,856.1	5,180,212.3	5,589,384.1	6,162,767.0	6,656,945.1	7,205,880.1	7,796,731.3	8,428,342.7
Alcoholic drinks sales, US$mn [1,6]	1,512.0	1,633.0	1,577.3	1,561.9	1,664.0	1,785.0	1,975.7	2,187.9	2,423.2
Alcoholic drink sales, VNDmn [6]	24,846,361.3	26,834,070.2	28,055,193.4	29,988,441.7	32,864,486.4	35,253,485.3	38,031,443.9	41,023,429.4	44,223,537.0
Soft drinks sales, US$mn [2,7]	307.7	324.2	311.7	319.1	358.1	384.7	424.1	467.7	515.7
Soft drink sales, VNDmn [3,7]	5,056,406.5	5,327,108.8	5,544,000.0	6,126,106.4	7,072,386.5	7,598,305.1	8,163,946.1	8,768,928.7	9,412,179.1
Total mass grocery retail sales, US$bn [1,7]	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.4	0.4
Total mass grocery retail sales, VNDbn [7]	2,925.0	3,533.0	3,823.9	4,437.7	5,247.2	5,863.5	6,552.7	7,293.6	8,085.0
Exports of food and drink, US$mn [8]	9,074	10,585	9,706	10,713	11,516	12,587	13,883	15,335	16,961
Imports of food and drink, US$mn [8]	3,065	3,479	3,206	3,354	3,638	3,982	4,363	4,786	5,256
Food and drink trade balance US$mn [8]	6,009.5	7,106.0	6,500.0	7,359.1	7,878.6	8,605.5	9,520.3	10,548.7	11,704.8

Notes: e/f = BMI estimates/forecasts. 1 US$ forecast using moving FX rates; 2 US$ forecast using moving FX rates. Figures include both on-trade and off-trade sales. Volume data are calculated using per capita consumption and population data while value is calculated using historic average price estimates; 3 Figures include both on-trade and off-trade sales. Volume data are calculated using per capita consumption and population data while value is calculated using historic average price estimates; Sources: 4 General Statistics Office, BMI; 5 General Statistics Office, company information, trade press, BMI; 6 General Statistics Office, company information, BMI; 7 Company information, trade press, BMI; 8 UNCTAD, Central Statistics Organisation, BMI.

TABLE: OIL AND GAS SECTOR KEY INDICATORS

	2007	2008	2009	2010e	2011f	2012f	2013f	2014f	2015f
Proven oil reserves, bn barrels [1]	3.410	4.730	4.500	4.500	4.600	4.700	4.650	4.560	4.470
Oil production, 000b/d [1]	337.0	317.0	345.0	355.0	390.0	390.0	385.0	372.0	365.0
Oil consumption, 000b/d [1]	298.1	333.9	345.0	365.7	384.0	403.2	427.4	453.0	480.2
Oil refinery capacity, 000b/d [2]	-	0.0	140.0	140.0	140.0	140.0	140.0	340.0	540.0
Oil exports, US$mn [1]	8,497.2	10,885.0	4,865.0	6,436.2	7,708.8	8,190.6	8,035.5	2,047.7	-3,754.0
Petroleum exports, US$mn [3]	6,436.25	6,436.25	6,436.25	6,436.25	6,436.25	6,436.25	6,436.25	6,436.25	6,436.25
Import of refined products, 000b/d [1]	298.1	333.9	219.0	239.7	258.0	277.2	301.4	147.0	-5.8
Proven gas reserves, bcm [1]	477.0	557.0	682.0	682.0	690.0	670.0	660.0	650.0	630.0
Gas production, bcm [1]	7.1	7.9	8.0	9.1	10.0	11.7	15.0	20.0	22.0
Gas consumption, bcm [1]	7.1	7.9	8.0	9.1	10.0	11.7	14.0	16.0	18.0

Notes: e/f = BMI estimates/forecasts. Sources: 1 BP Statistical Review of World Energy, June 2010; 2 EIA/BMI research; 3 BMI calculation.

TABLE: INFRASTRUCTURE SECTOR KEY INDICATORS

	2007	2008	2009	2010e	2011f	2012f	2013f	2014f	2015f
Construction industry value, VNDbn [1]	79,712.00	95,696.00	110,255.00	139,162.00	166,994.40	188,346.00	211,458.73	236,314.62	262,865.65
Construction industry value, US$bn [1]	5.0	5.8	6.2	7.3	8.5	9.5	11.0	12.6	14.4
Construction industry, real growth, % y-o-y [1]	12.15	-0.38	11.36	10.06	8.50	6.29	6.27	6.25	6.24
Construction industry value, % GDP [1]	7.0	6.4	6.7	7.1	7.2	7.1	7.1	7.0	7.0

Notes: e/f BMI = estimates/forecasts. Sources: 1 Vietnam General Statistics Office.

TABLE: PHARMACEUTICALS SECTOR KEY INDICATORS

	2009	2010e	2011f	2012f	2013f	2014f	2015f
Pharmaceuticals sales, US$bn [1,3]	1.538	1.713	1.952	2.261	2.662	3.105	3.560
Pharmaceutical sales, US$bn, % y-o-y [1,3]	9.9	11.3	14.0	15.8	17.8	16.6	14.7
Pharmaceutical sales, VNDbn [1,3]	27,360.8	32,886.0	38,550.3	44,656.5	51,251.1	58,217.7	64,974.9
Pharmaceutical sales, VNDbn, % y-o-y [1,3]	18.9	20.2	17.2	15.8	14.8	13.6	11.6
Health expenditure, US$bn [1,4]	7.28	7.89	8.98	10.33	12.11	14.07	16.22
Health expenditure, US$bn, % y-o-y [1,4]	11.2	8.4	13.8	15.0	17.1	16.2	15.3
Health expenditure, VNDbn [1,4]	129,491.07	151,515.75	177,443.39	204,103.94	233,032.81	263,792.61	295,993.23
Health expenditure, VND bn, % y-o-y [1,4]	20.3	17.0	17.1	15.0	14.2	13.2	12.2
Non-communicable diseases, DALYs [2,5]	6,795,379.7	6,840,703.9	6,884,944.9	6,928,101.6	6,970,172.8	7,011,157.4	7,051,054.5

Notes: e/f = BMI estimates/forecasts. 1 Last updated: 09/02/2011; 2 Data are DALYS, disability-adjusted life years; Sources: 3 Drug Administration of Vietnam, Vietnam Ministry of Health, domestic companies, local press, BMI; 4 World Health Organization (WHO), BMI; 5 WHO, World Bank, IMF, BMI.

TABLE: TELECOMS SECTOR KEY INDICATORS

	2008	2009	2010e	2011f	2012f	2013f	2014f	2015f
Number of main telephone lines in service ('000) [1]	13,180.0	18,100.0	16,136.8	16,230.9	16,142.2	16,044.1	15,846.0	15,523.0
Number of main telephone lines in service, % change y-o-y [1]	15.2	37.3	-10.8	0.6	-0.6	-0.6	-1.2	-2.0
Number of main telephone lines/100 inhabitants [1]	15.3	20.7	18.3	18.2	17.9	17.6	17.2	16.7
Number of mobile phone subscribers ('000) [1]	69,070.0	110,800.0	155,522.3	184,492.0	200,186.8	213,521.4	224,312.0	233,942.0
Number of mobile phone subscribers, % change y-o-y [1]	92.9	60.4	40.4	18.6	8.5	6.7	5.0	4.3
Number of mobile phone subscribers/100 inhabitants [1]	80.1	126.9	176.0	206.7	222.0	234.5	243.9	252.0
Number of mobile phone subscribers/100 inhabitants [1]	80.1	126.9	176.0	206.7	222.0	234.5	243.9	252.0
Number of internet users ('000) [1]	20,834.0	22,780.0	27,139.9	31,093.3	33,366.4	34,966.6	35,641.0	36,108.0
Number of internet users, % change y-o-y [1]	12.3	9.3	19.1	14.6	7.3	4.8	1.9	1.3
Number of internet users/100 inhabitants [1]	24.2	26.1	30.7	34.8	37.0	38.4	38.8	38.9
Number of broadband internet subscribers ('000) [1]	2,049.0	2,967.0	3,759.8	4,829.1	6,202.8	8,118.5	10,216.0	12,843.0
Number of broadband internet subscribers, % change y-o-y [1]	58.4	44.8	26.7	28.4	28.4	30.9	25.8	25.7

Notes: e/f = BMI estimates/forecasts. Sources: 1 World Bank (International Telecommunications Union), BMI research.

TABLE: DEFENCE AND SECURITY SECTOR KEY INDICATORS

	2009	2010e	2011f	2012f	2013f	2014f	2015f
Defence expenditure, VNDmn [1]	36,180,000.0	50,270,441.0	59,077,008.0	66,677,265.0	75,335,502.0	84,729,578.0	94,858,052.0
Defence expenditure, VND, % change y-o-y [1]	3.8	39.0	17.5	12.9	13.0	12.5	12.0
Defence expenditure, % of GDP [2]	2.5	2.6	2.6	2.6	2.6	2.6	2.6
Defence expenditure, VND per capita of population [2]	414,497.6	568,914.7	661,768.9	739,438.4	827,258.7	921,452.8	1,021,846.9
Defence expenditure, US$mn, constant prices [1]	2,073.0	2,420.0	2,590.0	2,768.0	3,042.0	3,361.0	3,698.0
Defence expenditure, US$, constant prices % change y-o-y [1]	-3.0	17.0	7.0	7.0	10.0	10.5	10.0
Defence expenditure, constant US$ per capita of population [1]	23.8	27.4	29.0	30.7	33.4	36.5	39.8

Notes: e/f = BMI estimates/forecasts. Sources: 1 SIPRI/BMI; 2 SIPRI, BMI calulation.

TABLE: FREIGHT KEY INDICATORS

	2010e	2011f	2012f	2013f	2014f	2015f
Port of Ho Chi Minh City (Saigon New) container throughput, TEU	2,769,858.7	2,890,345.4	3,028,622.3	3,186,421.0	3,355,700.8	3,640,308.3
Port of Ho Chi Minh City (Saigon New) container throughput, TEU, % y-o-y	13.89	4.35	4.78	5.21	5.31	8.48
Air freight tonnes (000)	140.54	147.91	156.38	165.85	175.98	180.40
Air freight tonnes % change y-o-y	2.13	5.25	5.72	6.06	6.10	2.51
Rail freight tonnes (000)	7,924.43	8,307.32	8,746.60	9,238.56	9,764.03	9,942.30
Rail freight tonnes % change y-o-y	-1.78	4.83	5.29	5.62	5.69	1.83
Road freight tonnes (000)	461,256.12	491,103.26	525,345.72	563,695.58	604,656.75	624,535.89
Road freight tonnes % change y-o-y	-6.75	6.47	6.97	7.30	7.27	3.29

Source: Port Authority/National Statistics/BMI.

Mermaid House, 2 Puddle Dock,
London EC4V 3DS
Tel: +44 (0)20 7248 0468
Fax: +44 (0)20 7248 0467
Email: subs@businessmonitor.com
Website: www.businessmonitor.com

Analyst: Andy Wang
Key Sector Analyst: Andrew Hutchings
Editor: Kelvin Tan
Sub-Editor: Maria Iu
Subscriptions Manager: Katie Patton
Marketing Manager: Joanna Ashton
Production: Lisa Church, Chuoc Lam
Publishers: Richard Londesborough, Jonathan Feroze