Q1 2013

www.businessmonitor.com

VIETNAM

FREIGHT TRANSPORT REPORT

INCLUDES BMI'S FORECASTS

ISSN 1750-5364

Published by Business Monitor International Ltd.

VIETNAM FREIGHT TRANSPORT REPORT Q1 2013

INCLUDES 5-YEAR FORECASTS TO 2017

Part of BMI's Industry Report & Forecasts Series

Published by: **Business Monitor International**

Copy deadline: November 2012

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

CONTENTS

BMI Industry View

We do not envisage a strong pickup in Vietnamese exports due to growing evidence of a lacklustre recovery in global demand in 2013, which will have a knock-on effect on the country's freight industry. Additionally, Vietnam's main export partners, the US, China and Japan, are all finding it hard to shake off the economic hangover of 2012. That said, Vietnam's economy remains on track for a robust recovery in 2013, and we view consensus estimates on growth as being overly pessimistic. Also, looking at the breakdown of exports, we are seeing encouraging evidence that Vietnam is becoming less reliant on refined crude imports (dominantly petroleum imports) and could soon become a net exporter of crude oil over the coming years.

By mode, the largest growth is set to occur in the maritime sector, with the country's biggest port, Ho Chi Minh City, set to enjoy year-on-year (y-o-y) growth of more than 7.50% in 2013. Air and road freight sectors will both see annual growth of more than 6% this year, while propping up the freight mix will be rail.

There are encouraging signs that China is seeking to strengthen ties with its Asian neighbours, providing a boost to infrastructure. The Yuxi-Mengzi railway line, which will start operating in Q412 and was funded by Chinese investment, will eventually run between the Yunnan province in China and Laos, Singapore, Thailand and Vietnam. Vietnam still suffers from a significant deficit in transportation infrastructure, and we believe the Vietnamese government will continue to develop this sector over the medium term.

Headline Industry Data

- 2013 rail freight tonnage is set to increase by 3.12% to 8.71mn tonnes.
- 2013 air freight tonnage is forecast to rise by 6.06% to 220,620 tonnes.
- Tonnage handled at the Port of Ho Chi Minh City in 2012 is forecast to grow 7.56% in 2013, whereas tonnage handled at the Port of Da Nang is forecast to increase 4.33%.
- 2013 road freight tonnage is forecast to grow by 6.85% to 713.01mn tonnes.
- 2013 total trade is forecast to rise by 5.70%.

Key Industry Trends

Vinalines' Woes Continue

We believe that **Vietnam National Shipping Lines**' (Vinalines) losses sustained in the first half of 2012 are largely due to the twin factors of corruption and financial mismanagement. Although the shipping sector has been hard hit by global economic headwinds in recent times, Vinalines' heavy exposure to

Vietnam's domestic transport sector, which has been performing well recently, indicates that the company's struggles go beyond the troubles facing the global industry.

Dachser Builds Presence In Vietnam With Joint Venture

Dachser, a Germany-based logistics company, has taken another step towards expanding its operations in the Far East by creating a new Vietnamese operation, which has branch offices in Ho Chi Minh City and Hanoi, reported Handy Shipping Guide in October. The Hong Kong arm of Dachser, **Dachser Far East**, will be the major shareholder in the new joint venture with **Dachser Vietnam** to provide freight forwarding and logistics. The company currently operates in nine Asian countries.

Chinese Rail Investment Boosts Vietnam

Vietnam should benefit from the news that the 141km line from Yuxi to Mengzi, China, was completed on August 14, 2012, linking China to the Vietnamese border in the near future. The new route, which is primarily going to focus on rail freight, was funded jointly by the Chinese Ministry of Railways and Yunnan province at a cost of CNY4.5bn, with services expected to begin by the end of 2012.

Key Risks To Outlook

We note that the trend of interest from major freight companies in the intra-Asia market, first seen in the container shipping sector, is now picking up pace in the air cargo market. **Air China Cargo**, the freight subsidiary of **Air China**, is reportedly preparing to launch a cargo service linking China with Vietnam, the airline's second cargo venture into Asia in 2012.

According to Air China Cargo's chief operating officer, Titus Diu, the carrier is to launch an all-cargo service in Q312 linking Shanghai with Ho Chi Minh City in Vietnam via Singapore, followed by a direct flight back to Shanghai.

Although we expect Vietnam's economy to perform well over the short term – indeed, we are maintaining our view that real GDP growth will come in strong at 7.0% in 2013, and believe that signs of an improving economic outlook over the coming months will soon reignite bullish sentiment towards Vietnam's growth prospects – external factors do have a big bearing.

With the US by far and away Vietnam's largest export partner, the Asian country's fortunes are very much intertwined with the global superpower. It will come as a negative then that we maintain our 2.0% real GDP growth forecast for the US for 2012 and our 2.1% projection for 2013. The economy is running dangerously close to 'stall speed', by which we mean that any major unanticipated headwind would be enough to push the economy into recession. The knock-on effect on Vietnam's freight industry would therefore be detrimental, as demand slows.

SWOT Analysis

Vietnam Freight Transport SWOT	
Strengths	▪ Vietnam's strong domestic growth rate, coupled with its geography – it stretches for thousands of kilometres on a north-south axis, creating a need for long-distance freight haulage. ▪ Recovery of the nation's ports in 2010 is expected to continue over the mid-term to 2016. ▪ Vietnam's location on the South China Sea gives the country access to the main inter-Asian shipping routes, as well as access to the developing land transport links with ASEAN countries, allowing the country scope to develop its trade logistics.
Weaknesses	▪ The generally poor state of the road network. Despite new highway construction, only 13.5% of the network is considered to be in good condition. Just 26% of the network has two or more lanes and only 29% is tarred. ▪ Traditionally low investment in rail, with the potential for cost-effective bulk rail freight being underutilised. ▪ Decades of under-investment have left the country with a port infrastructure system that is poor by international standards. Overcapacity is therefore a growing problem.
Opportunities	▪ The beginnings of local commercial vehicle production, which will help improve the stock of lorries used by road haulage companies. ▪ Chinese investment could bring about much needed improvements in the rail sector. ▪ Growing international interest in Vietnam as a growth market within the box shipping sector.
Threats	▪ Vietnam risks losing out to neighbouring countries if it is unable to develop its infrastructure to keep up with the pace of demand. ▪ Vietnam is vulnerable to any slowdown in Chinese investment. Indeed, the Chinese government issued a warning to foreign shipping companies operating in the South China Sea in mid-April 2012, following an incident which saw the Philippine navy frigate Gregorio del Pilar involved in a stand-off with two Chinese surveillance vessels after it had intercepted Chinese fishing vessels traversing the region. ▪ A drop in international demand for exports would negatively affect Vietnam's freight transport sector.

Vietnam Political SWOT	
Strengths	▪ The Communist Party of Vietnam remains committed to market-oriented reforms and we do not expect major shifts in policy direction over the next five years. The one-party system is generally conducive to short-term political stability. ▪ Relations with the US have witnessed a marked improvement, and Washington sees Hanoi as a potential geopolitical ally in South East Asia.
Weaknesses	▪ Corruption among government officials poses a major threat to the legitimacy of the ruling Communist Party. ▪ There is increasing (albeit still limited) public dissatisfaction with the leadership's tight control over political dissent.
Opportunities	▪ The government recognises the threat 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 2012 are likely to weigh on public acceptance of the one-party system, and street demonstrations to protest economic conditions could develop into a full-on challenge of undemocractic rule. ▪ Although strong domestic control will ensure little change to Vietnam's political scene in the next few years, over the longer term, the one-party-state will probably be unsustainable. ▪ Relations with China have deteriorated over recent years due to Beijing's more assertive stance over disputed islands in the South China Sea and domestic criticism of a large Chinese investment into a bauxite mining project in the central highlands, which could potentially cause wide-scale environmental damage.

Vietnam Economic SWOT	
Strengths	▪ Vietnam has been one of the fastest-growing economies in Asia in recent years, with GDP growth averaging 7.1% annually between 2000 and 2011. ▪ The economic boom has lifted many Vietnamese out of poverty, with the official poverty rate in the country falling from 58% in 1993 to 14.0% in 2010.
Weaknesses	▪ Vietnam still suffers from substantial trade, current account and fiscal deficits, leaving the economy vulnerable to global economic uncertainties in 2012. The fiscal deficit is dominated by substantial spending on social subsidies that could be difficult to withdraw. ▪ The heavily-managed and weak currency reduces incentives to improve quality of exports, and also keeps import costs high, contributing to inflationary pressures.
Opportunities	▪ WTO membership has given Vietnam access to both foreign markets and capital, while making Vietnamese enterprises stronger through increased competition. ▪ The government will in spite of the current macroeconomic woes, continue to move forward with market reforms, including privatisation of state-owned enterprises, and liberalising the banking sector. ▪ Urbanisation will continue to be a long-term growth driver. The UN forecasts the urban population rising from 29% of the population to more than 50% by the early 2040s.
Threats	▪ Inflation and deficit concerns have caused some investors to re-assess their hitherto upbeat view of Vietnam. If the government focuses too much on stimulating growth and fails to root out inflationary pressure, it risks prolonging macroeconomic instability, which could lead to a potential crisis. ▪ Prolonged macroeconomic instability could prompt the authorities to put reforms on hold as they struggle to stabilise the economy

Vietnam Business Environment SWOT	
Strengths	▪ Vietnam has a large, skilled and low-cost workforce, that has made the country attractive to foreign investors. ▪ Vietnam's location – its proximity to China and South East Asia, and its good sea links – makes it a good base for foreign companies to export to the rest of Asia, and beyond.
Weaknesses	▪ Vietnam's infrastructure is still weak. Roads, railways and ports are inadequate to cope with the country's economic growth and links with the outside world. ▪ Vietnam remains one of the world's most corrupt countries. According to Transparency International's 2011 Corruption Perceptions Index, Vietnam ranks 112 out of 183 countries.
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.

Industry Trends And Developments

Maritime

Vinalines' Woes Continue

BMI believes that **Vietnam National Shipping Lines**' (Vinalines) losses in the first half of 2012 are largely attributable to internal problems of corruption and financial mismanagement. While the shipping industry has suffered from depressed rates and low demand in 2012, Vinalines' heavy exposure to Vietnam's domestic transport sector, which has been performing well recently, indicates that the firm's struggles go beyond the troubles facing the global industry.

Vinalines, a Vietnam-based shipping company, has announced a loss of US$69.2mn in the first half of 2012, more than double its loss of US$31.4mn in H111. Vinalines cites several reasons for the largest first-half loss in the company's history, including falling demand for freight transportation and declining freight rates. Revenues fell 3% year-on-year (y-o-y) in H112 to US$556.8mn, with total freight transportation amounting to 15.3mn tonnes, a y-o-y decrease of 15%.

Vinalines is Vietnam's largest commercial shipping line, and caters primarily for domestic trade in dry bulk, container and oil transport, although it does serve intra-Asia trade as well.

BMI highlights that, while the global shipping industry has struggled in 2012, Vietnam's shipping sector has performed well. Vietnam's second largest port, the Port of Da Nang, recorded 19% y-o-y tonnage throughput growth in the first four months of 2012 (latest available data), handling 1.84mn tonnes. Over the same period, container throughput grew by 27% y-o-y to 55,650 twenty-foot equivalent units (TEUs).

BMI believes that Vinalines' losses are largely attributable to the company's internal difficulties, which have caused it both legal and financial troubles. An investigation into alleged misappropriation of funds concluded that the company had spent a total of US$22.8mn on a 43-year-old floating dock, without submitting the project to the government for consideration – a requirement for the state-owned company.

Vinalines also had seven ships detained in the first four months of 2012, partly as a result of the inability of clients to pay for their charters, demonstrating that the company has to an extent been a victim of the shipping industry's woes. However, some ships were detained because they did not meet technical requirements.

Additionally, a number of former Vinalines executives are now wanted for allegedly committing 'grave violations' of the laws on bidding and investment, as well as causing substantial losses to state coffers from 2007-2010. Four Vinalines officials were arrested in February 2012 for falsifying documents to drive up the price of steel needed to repair the recently acquired floating dock, and then pocketing a total of US$139,000 from the scheme.

In light of the numerous troubles Vinalines has faced in 2012, we reiterate our stance that the company's losses are not due wholly to the difficult operating environment in the shipping industry today. Although this has played a role, the firm's struggles with corruption and general mismanagement must also shoulder the blame.

Van Phong Port Project Halted

Following three years of delays and due to state overseers failing to raise US$3.6bn in foreign and national investment, the construction of Van Phong International Transshipment Port has been halted at the behest of the Vietnamese Transport Ministry. The decision to shelve the planned port – originally proposed to be completed by 2020 – was undertaken by the Vietnamese Deputy Prime Minister Hoang Trung Hai, and was made public in September 2012.

The estimated cost of the project was set to be US$3.6bn and the construction work would have included 37 wharves at length of 12.5km. The initial stage of the project began in October 2009 and was pencilled in to be completed by the end of 2012. However, financial mismanagement meant that the project fell way behind schedule. Vinalines, the project's investor, was urged to alter its plans by the Vietnamese government and so the company came up with the idea of expanding the port in order to handle container vessels up to 12,000TEUs.

The deputy prime minister asked the Transport Ministry to look into the feasibility of raising domestic and foreign investment to fund the project, which is located in Hon Gom peninsula. The Van Phong port has become the target for criticism, as Vietnam's attractiveness for potential investors weakens. The Van Phong site was described as too far from any major manufacturing companies, and the state's role in neglecting better infrastructure at strategic locations is being highlighted.

Multimodal

Dachser Builds Presence In Vietnam With Joint Venture

Germany-based logistics firm **Dachser** is expanding its operations in the Far East by creating a new Vietnamese operation having branch offices in Ho Chi Minh City and Hanoi, reported Handy Shipping Guide in October. The Hong Kong arm of Dachser, **Dachser Far East** will be the major shareholder in the new joint venture with **Dachser Vietnam** to provide freight forwarding and logistics. The company operates in nine Asian countries.

Dachser Vietnam's range of services extend from air to sea freight, from customs clearance to a wide range of other logistics amenities. The company has stated that it is set to open a second branch office in the Vietnamese capital Hanoi by the end of the year.

Thomas Reuter, managing director Dachser Air & Sea Logistics, explained: 'Through our commitment in Vietnam we are present for our customers in one of the most productive and strongest growth markets in the region.'

Rail

Chinese Rail Investment Boosts Vietnam

Vietnam looks well placed to benefit from the news that the 141km line from Yuxi to Mengzi, China, was completed on August 14, 2012, linking China to the Vietnamese border in the near future.

The new route, which is primarily going to focus on rail freight, was funded jointly by the Chinese Ministry of Railways and Yunnan province at a cost of CNY4.5bn, with services expected to begin by the end of 2012. Cross-border infrastructure will be ramped up by the line extension that will link Mengzi to the Vietnamese border town of Lao Cai and, furthermore, sections of the Pan-Asia network are planned in Laos and Thailand, and, potentially, as far as Singapore.

China Daily reports that the trains used on the route will have a maximum speed of 120km per hour and the line will cut through some 35 tunnels, while crossing 61 bridges.

China's vice minister for railways, Lu Dongfu, explained that the investment comes at a crucial time and that projects currently taking place in Yunnan will form part of a national strategy that involves opening up the south west of the country to trade opportunities both at home and abroad.

Road

Sino-Vietnamese Relations Strengthened Further

Vietnam's relationship with China appeared to strengthen some more with the September announcement that 10 direct passenger and freight vehicle services between the two Asian countries were to be introduced, Transport Weekly reported.

This will encompass five from south China's Guangxi region – Nanning to Hanoi, Nanning to Haiphong, Guilin to Hanoi, Congzuo to Halong and Baise to Cao Bang.

Market Overview

Robust Recovery Imminent

Vietnam's economy remains on track for a robust recovery in 2013, and we view consensus estimates on growth as being overly pessimistic. Latest economic indicators support our view that economic conditions in Vietnam are improving; we are maintaining our view that real GDP growth will come in strong at 7.0% in 2013, and that it looks impressive over the forecast period to 2017.

Healthy Medium Term Ahead

Vietnam Real GDP growth, % change y-o-y

e/f= BMI estimate/ forecast. Source: Asian Development Bank, General Statistics Office

That said, economic headwinds that hit in 2012 in the US and eurozone should continue to act as a dampener on external demand throughout 2013 to some extent, especially in the case of the US, which is by some distance Vietnam's top export partner. Also, another of Vietnam's largest export partners, China, is set to see a cooling of GDP growth in both 2012 and 2013, as is Japan. This suggests that production activity in the manufacturing sector and other export-based industries could face difficulties, with a negative effect on the freight transport industry expected as a result.

The US economy's pace of growth is set to slow over the next 10 years to a long-term rate of 2.4% as deleveraging from a massive credit binge takes its toll. Nonetheless, **BMI** believes that the US is going to remain the world's greatest economic power over our 10-year forecast period to 2022 and beyond. It must be remembered that if the US sneezes, then Vietnam catches a cold. This is true in the freight industry as a slowing in external demand will have a detrimental effect.

Retail sales in Vietnam have moderated considerably since November 2010, when the State Bank of Vietnam (SBV) initiated its monetary tightening cycle. Retail sales growth slowed from 32.5% in November 2010 to 22.6% in June 2011, indicating that the measures have dampened private consumption growth. Nonetheless, retail sales remain at double-digit growth rates, indicating that private consumption growth remains resilient. This supports our view that private consumption would remain resilient on the back of robust labour market conditions and rising wages in Vietnam, boding well for containerised imports. However, public spending cuts and a subdued outlook on gross fixed capital formation (GFCF) growth due to high lending rates would lead to continued moderation in domestic demand throughout the year.

Prior to 2007, policymakers outlined that foreign direct investment (FDI) inflows into the export sector should gradually reduce the state's role in driving the economy, providing a spur for Vietnam's freight industry. However, recent economic data suggest that this has not been the case. While exports have risen from 76.9% of GDP in 2007 to 80.7% in 2011, mainly driven by private sector export of processed food, agricultural products and mined resources to South East Asian countries, state-owned enterprises' share of the economy has remained stubbornly high at 33.7% of GDP in 2011, compared with 35.9% in 2007.

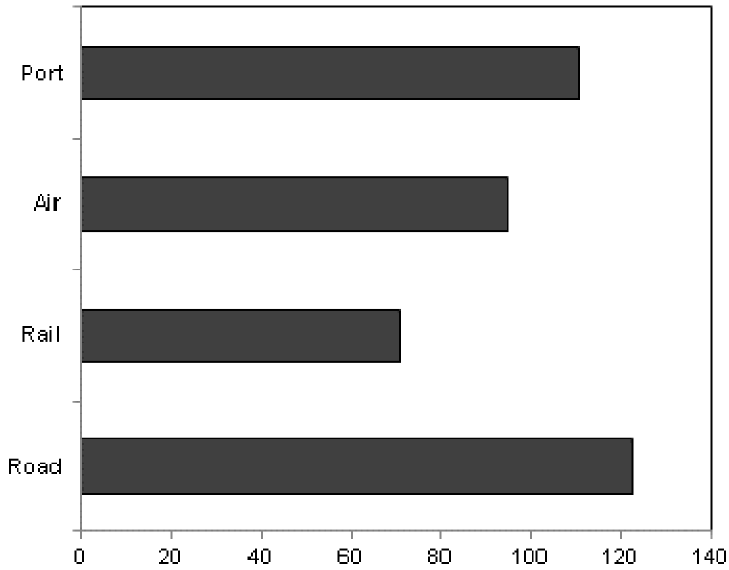
The total share of the state's ownership in the economy is even larger at around 39% of GDP, when taking into account of joint-stock companies – in which the state holds a controlling stake – while the private sector is allowed to invest and share in the profits. From our perspective, further measures to reduce the state's control over the economy, and allowing the private sector to allocate capital more efficiently, will play a key role in determining the country's growth prospects over the medium term.

Road Freight Remains The Dominant Force In Tonnage Terms

Road transport is the most advanced in terms of freight sector privatisation and is by far the dominant mode for freight in Vietnam, with a market share of around 75% of domestic cargo. Few foreign companies are present in the market and there are many small, family-owned road freight companies operating informally.

Investment Needed Across The Board

Vietnam Transport Infrastructure Rankings



** Rail infrastructure is measured out of 123. Source: Global Economic Forums Competitiveness Index*

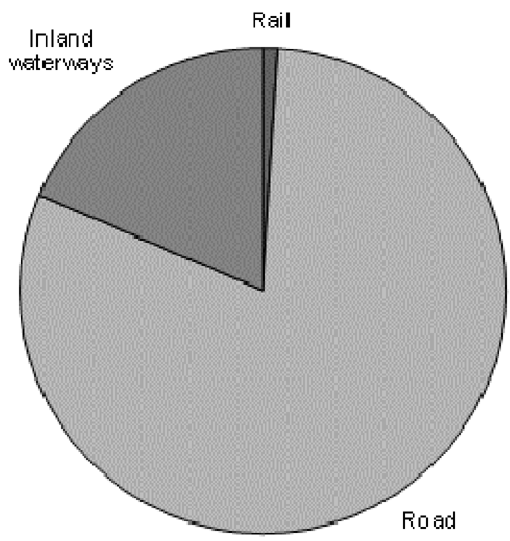
Vietnam has a national road network of 180,549km, according to the latest data provided by the CIA's World Factbook. **BMI** believes the sector requires substantial investment as the quality of Vietnam's road infrastructure was judged by the World Economic Forum (WEF) to be very poor, ranking 123rd out of 142 countries surveyed in its Global Competitiveness Report 2011-2012.

Vietnam's railway transport sector has just one operator, the **Vietnam Railway Corporation** (VRC), established in April 2003 as a state corporation operating railway transport and related services. Vietnam's rail network totals 2,632km. The network is of mixed-gauge, comprising 2,105km of 1.000m gauge and 527km of 1.435m gauge.

Latest data puts the total amount of airports in Vietnam with paved runways at 37, with seven unpaved. This total puts the country in a poor 97th place in comparison with other countries.

Road Dominates Freight Mix

Vietnam Freight Transport Mode Breakdown (% of Total 2013f)



Source: General Statistics Office of Vietnam

Vietnam's dense river and canal network provides the country with a highly developed inland waterway system of 17,702km. This is the second largest sub-sector involved in domestic cargo transport, accounting for 25-30% of total transport volumes.

Vietnam's seaport network comprises of many small and medium-sized entities, with inefficient distribution. Most large ports are located on rivers, like Hai Phong and Ho Chi Minh City, with limited depth at the entrance. Some ports are located in big cities, thus making it difficult to connect with other modes of transport for cargo transfer due to traffic congestion.

Vietnam's port infrastructure is poor by international standards. The WEF's 2011 Global Competitiveness Report ranks it 111th out of 142 countries, placing it 12th in the region, just one place ahead of the Philippines, the regional underperformer.

Investment And Development Outlook

The appreciation that the Vietnamese transport sector requires vast levels of investment is underlined by the fact that the majority of infrastructure investment in Vietnam over the next 10 years will be in the transport sphere, accounting for 65% by the end of 2021. Vietnam still suffers from a significant deficit in transportation infrastructure, and we believe the Vietnamese government will continue to develop this sector over the medium term. This is reflected in our forecast for transport infrastructure industry value, which is expected to grow by an average of 3.5% year-on-year (y-o-y) between 2012 and 2016.

According to our key infrastructure projects database, there are US$171bn-worth of infrastructure projects planned or currently under way in Vietnam's transport sector. One of the most expensive of these is a US$3.6bn plan to build the Van Phong International Entrepot. The project will begin with the construction of two deep water ports in Dam Mon that will be able to accommodate container ships with tonnage of 9,000 twenty-foot equivalent units (TEUs) and the capacity to handle 0.5mn TEUs per year. The project is currently suspended, however, due to an ongoing review of geological conditions at the site.

The air freight sector will undoubtedly benefit from the planned construction work on a new passenger terminal at Long Thanh international airport. Costing an estimated US$6.7bn, the work would also incorporate a new runway, providing capacity for 100mn passengers a year. A tender for investment consultancy work was under development as of December 2011.

Industry Forecast

Macroeconomic Outlook

Global Headwinds Prove A Threat To Trade

BMI forecasts Vietnam's real GDP growth figure to increase by 7.0% in 2013, beating last year's estimate of 5.3%. 2012's figure was downgraded due to the escalating headwinds in the US, eurozone and China, the top export partners of Vietnam. The manufacturing sector continues to see a decline in export orders. To put into perspective the critical role that the manufacturing sector plays in driving the economy, we highlight that this sector alone accounts for around 22% of GDP, and manufactured goods make up slightly more than 50% of total exports. Given that a large proportion of the sector's output is exported, a slowdown in manufacturing activity suggests that producers are anticipating weaker demand for Vietnamese exports.

Road Freight

Road Freight Dominates The Mix

As we head into the first quarter of 2013, our forecast for the road freight sector is healthy, both over the short term and the forecast period to 2017. For 2013 we see Vietnam's largest sector in terms of tonnage handled recording y-o-y growth of 6.85%, slightly down on last year's 7.13%. **BMI** is predicting average annual growth over our forecast period of 6.53%, which would see tonnage rise from 2013's projected 713.01mn tonnes to 915.41mn tonnes by end-2017. In terms of tonnes/kilometres, we expect 2013's growth figure to come in at 7.04%, reaching 42,334mn tonnes/km.

Table: Road Freight, 2010-2017

	2010	2011e	2012f	2013f	2014f	2015f	2016f	2017f
Road freight, '000 tonnes	585,024.50	622,880.48	667,309.81	713,010.21	760,113.51	809,749.09	861,716.94	915,412.63
- % change y-o-y	13.90	6.47	7.13	6.85	6.61	6.53	6.42	6.23
Road freight, mn tonnes/km	34,467.73	36,840.47	39,548.98	42,334.97	45,206.48	48,232.37	51,400.44	54,673.84
- % change y-o-y	13.90	6.88	7.35	7.04	6.78	6.69	6.57	6.37

e/f = BMI estimate/forecast. Source: General Statistics Office of Vietnam

Rail Freight

Rail Lags Behind The Rest

The Vietnamese rail freight sector is once again the freight mix's worst performer, with 2013's y-o-y growth set to come in at a steady if uninspiring 3.12% to reach 8.71mn tonnes. This is a very similar figure to 2012's 3.13%, and this level of growth is set to continue to the end of our forecast period, with average annual growth forecast at 3.18%. On the plus side, this modest growth does represent a welcome return to steady growth after the contractions experienced between 2007 and 2010. Indeed, the sector only returned to positive growth as recently as 2011.

Table: Rail Freight, 2010-2017

	2010	2011e	2012f	2013f	2014f	2015f	2016f	2017f
Rail freight, '000 tonnes	7,809.92	8,187.28	8,443.54	8,707.14	8,978.82	9,265.12	9,564.86	9,874.57
- % change y-o-y	-3.20	4.83	3.13	3.12	3.12	3.19	3.24	3.24
Rail freight, mn tonnes/km	3,901.00	4,085.13	4,330.43	4,582.75	4,842.81	5,116.86	5,403.78	5,700.24
- % change y-o-y	2.52	4.72	6.00	5.83	5.67	5.66	5.61	5.49

e/f = BMI estimate/forecast. Source: General Statistics Office of Vietnam

Air Freight

Growth Steady, But Work Still To Be Done

Once more, it can be said that the air freight sector is set to follow the lead of the road sector rather than the rail sector over the mid term. **BMI** predicts healthy growth in 2013 for the sector, with similar annual growth in 2013 (6.06%) as we estimate for 2012 (6.26%). Over the mid term, y-o-y growth is set to remain more or less in this ballpark, averaging 5.85% to reach 276,430 tonnes by the end of 2017, up from 2013's forecast 220,620 tonnes.

Table: Air Freight, 2010-2017

	2010	2011e	2012f	2013f	2014f	2015f	2016f	2017f
Air freight, '000 tonnes	186.00	195.76	208.01	220.62	233.61	247.29	261.62	276.43
- % change y-o-y	33.24	5.25	6.26	6.06	5.89	5.86	5.79	5.66
Air freight, mn tonnes/km	428.00	448.89	475.98	503.83	532.55	562.81	594.49	627.22
- % change y-o-y	35.19	4.88	6.03	5.85	5.70	5.68	5.63	5.51

e/f = BMI estimate/forecast. Source: General Statistics Office of Vietnam

Maritime And Inland Waterways

Ho Chi Minh The Outperformer

We have pencilled in y-o-y tonnage throughput growth at the Port of Ho Chi Minh to come in at a very healthy 7.56% in 2013, to reach 38.75mn tonnes, which is slightly down on 2012's y-o-y increase of 7.71%. Over our forecast period, impressive growth will be the order of the day for the Port of Ho Chi Minh City. Tonnage throughput will average 6.76% to reach just under 50mn tonnes over this period. The country's other main port at Da Nang is set to see y-o-y growth of 4.33%, with the average annual figure set to come in at 4.08%.

Meanwhile, inland waterways will also enjoy relatively healthy growth of 5.21% over the medium term, coming in slightly better than our forecast growth of 5.32% for 2013.

Table: Maritime Freight, 2010-2017

	2010	2011e	2012f	2013f	2014f	2015f	2016f	2017f
Port of Ho Chi Minh City (Saigon New) throughput, tonnes '000	31,132.00	33,450.71	36,029.40	38,753.08	41,430.13	44,197.60	47,055.05	49,958.68
- % change y-o-y	62.65	7.45	7.71	7.56	6.91	6.68	6.47	6.17
Port of Da Nang throughput, tonnes '000	3,303.04	3,868.00	3,987.31	4,160.05	4,329.82	4,505.33	4,686.55	4,870.69
- % change y-o-y	5.46	17.10	3.08	4.33	4.08	4.05	4.02	3.93

e/f = BMI estimate/forecast. Source: Port authorities

Table: Inland Waterway Freight, 2010-2017

	2010	2011e	2012f	2013f	2014f	2015f	2016f	2017f
Inland waterway freight, '000 tonnes	142,201.44	148,378.09	156,468.67	164,790.71	173,368.22	182,406.86	191,870.21	201,648.19
- % change y-o-y	4.80	4.34	5.45	5.32	5.21	5.21	5.19	5.10
Inland waterway freight, mn tonnes/km	25,593.49	26,752.09	28,197.00	29,683.25	31,215.13	32,829.36	34,519.43	36,265.70
- % change y-o-y	0.90	4.53	5.40	5.27	5.16	5.17	5.15	5.06

e/f = BMI estimate/forecast. Source: General Statistics Office of Vietnam

Trade

Table: Trade Overview, 2010-2017

Real	2010	2011e	2012f	2013f	2014f	2015f	2016f	2017f
Imports, real growth, % y-o-y	14.71	2.94	6.15	4.90	4.50	4.40	4.30	4.20
Exports, real growth, % y-o-y	15.41	11.42	5.10	6.50	6.10	6.00	5.90	5.65
Total trade, real growth, % y-o-y	15.06	7.18	5.63	5.70	5.30	5.20	5.10	4.93
Nominal								
Imports, US$bn	90.90	111.98	127.23	143.54	161.19	179.17	198.46	218.22
- % change y-o-y	24.06	23.18	13.62	12.82	12.30	11.15	10.77	9.96
Exports, US$bn	80.27	106.80	120.15	137.62	156.91	177.08	199.16	222.04
- % change y-o-y	26.14	33.06	12.49	14.54	14.02	12.85	12.47	11.49
Total trade, US$bn	171.17	218.78	247.37	281.16	318.11	356.25	397.62	440.26
- % change y-o-y	25.03	27.81	13.07	13.66	13.14	11.99	11.61	10.72

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

Table: Key Trade Indicators, 2010-2015

	2010	2011e	2012f	2013f	2014f	2015f	2016f	2017f
Agricultural raw materials								
Imports, US$mn	2,666.48	3,758.86	4,238.34	4,866.17	5,559.43	6,284.22	7,089.69	7,903.67
- % change y-o-y	28.31	40.97	12.76	14.81	14.25	13.04	12.82	11.48
Exports, US$mn	3,436.62	3,385.63	3,883.30	4,415.68	4,991.89	5,578.54	6,301.92	6,881.27
- % change y-o-y	116.99	-1.48	14.70	13.71	13.05	11.75	12.97	9.19
Ores and metals								
Exports, US$mn	594.33	800.03	908.14	1,049.70	1,206.02	1,369.44	1,547.45	1,733.38
- % change y-o-y	44.06	34.61	13.51	15.59	14.89	13.55	13.00	12.02
Imports, US$mn	3,300.36	4,357.33	5,000.94	5,689.45	6,434.64	7,193.33	7,962.67	8,828.01
- % change y-o-y	19.18	32.03	14.77	13.77	13.10	11.79	10.70	10.87
Iron and steel								
Exports, US$mn	1,622.95	2,018.59	2,318.42	2,711.02	3,144.54	3,597.76	4,143.84	4,624.67
- % change y-o-y	202.25	24.38	14.85	16.93	15.99	14.41	15.18	11.60
Imports, US$mn	60,547.73	74,629.91	84,820.99	95,722.98	107,522.45	119,535.57	132,178.89	145,560.05
- % change y-o-y	17.80	23.26	13.66	12.85	12.33	11.17	10.58	10.12
Manufactured goods								
Exports, US$mn	40,806.05	54,678.39	61,826.95	71,187.25	81,523.21	92,329.02	104,018.94	116,366.62
- % change y-o-y	21.60	34.00	13.07	15.14	14.52	13.25	12.66	11.87
Imports, US$mn	59,491.63	73,261.81	83,225.94	93,885.15	105,421.85	117,167.44	129,681.44	142,658.73
- % change y-o-y	24.01	23.15	13.60	12.81	12.29	11.14	10.68	10.01
Fuel								
Exports, US$mn	11,085.59	17,200.25	19,267.69	21,974.79	24,964.07	28,089.23	31,606.81	35,087.03
- % change y-o-y	30.31	55.16	12.02	14.05	13.60	12.52	12.52	11.01
Imports, US$mn	9,659.44	14,041.36	16,015.62	18,127.59	20,413.44	22,740.67	25,251.92	27,801.10
- % change y-o-y	28.84	45.36	14.06	13.19	12.61	11.40	11.04	10.10

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

Table: Main Import Partners (US$mn), 2002-2009

	2002	2003	2004	2005	2006	2007	2008	2009
China, P.R.: Mainland	2,158.84	3,138.55	4,595.10	5,899.70	7,391.30	12,710.00	15,652.10	16,441.00
Japan	2,504.65	2,982.06	3,552.60	4,074.10	4,702.10	6,188.90	0.00	7,468.09
Korea	2,279.60	2,625.44	3,359.40	3,594.10	3,908.40	5,340.40	7,066.30	6,976.36
Thailand	955.24	1,282.19	1,858.60	2,374.10	3,034.40	3744.20	4,905.60	4,514.07
Singapore	2,533.49	2,875.82	3,618.40	4,482.30	6,273.90	7,613.70	9,392.50	4,248.36

Source: IMF's Direction of Trade Statistics

Table: Main Export Partners (US$mn), 2002-2009

	2002	2003	2004	2005	2006	2007	2008	2009
United States	2,453.15	3,939.56	5,024.80	5,924.00	7,845.10	10,104.50	11,868.50	11,355.80
Japan	2,436.96	2,908.60	3,542.10	4,340.30	5,240.10	6,090.00	8,537.90	6,291.81
China, P.R.: Mainland	1,518.33	1,883.12	2,899.10	3,228.10	3,242.80	3,646.10	4,535.70	4,909.03
Switzerland	66.67	74.67	120.20	103.90	155.70	236.90	516.90	2,486.49
Australia	1,328.33	1,420.86	1,884.70	2,722.80	3,744.70	3,802.20	4,225.20	2,276.72

Source: IMF's Direction of Trade Statistics

Global Oil Products Price Outlook

BMI View: We *forecast that crude prices will fall steadily through 2016, which will have a knock-on effect on refined fuel products. Lower prices, as well as lower demand amid a global growth slowdown, will lead to a shrinking of the high margins refiners have enjoyed in 2012. This will benefit consumers as relatively cheaper fuels will relieve some of the pressure on slumping demand.*

Since we last published our Global Oil Products Outlook in June 2012, crude prices have enjoyed a multi-month rally, before retracing and entering a period of volatile, sideways trading in recent weeks. We forecast sustained volatility throughout the rest of 2012, and despite considerable political risks to the upside, downward pressure due to weak global demand will push crude prices lower in 2013. The primary drivers of this scenario remain unchanged: a sustained deterioration in the eurozone debt crisis, a hard landing in China, and a weak recovery in the US. Moreover, a market which just months ago looked dangerously tight now seems to be fairly well supplied; Iraqi output continues to rise, Saudi output remains close to 10mn barrels a day (b/d), and US crude production is forecast to continue rising on the back of increased unconventional production and more deepwater blocks being opened to offshore drilling.

In light of these developments, we left our benchmark crude forecasts unchanged in October 2012. Although US$110/bbl average for Brent in 2012 may end up being slightly lower than the realised average for the year, September's average of US$113.03/bbl was only a US$1.00 increase on the price in August *(see our online service, October 3 2012, 'Weak Demand Will Battle Supply Fears In Controlling Prices)*. This confirms our view that the market has already priced-in government stimulus to support the global economy, including QE3 in the US and supply outages in Iran due to Western sanctions. Our US$102 average for Brent in 2013 remains in place as well, as we expect a further weakening of demand throughout next year. Similarly, our forecasts for WTI remain on hold at US$95 in 2012 and will fall to US$92/bbl in 2013.

Our refined products forecasts methodology is based on estimating the future spreads between each product and its regional benchmark: WTI for products sold at New York, Brent for Rotterdam and Dubai for Singapore. We had adjusted our spreads in June 2012, primarily at the light end of the barrel in Europe and Asia. No further changes have been made to the spreads since.

Table: BMI's Refined Products Forecasts							
	2010	**2011**	**2012f**	**2013f**	**2014f**	**2015f**	**2016f**
Crude Benchmarks							
Brent	80.26	111.05	110.00	102.00	99.00	98.00	96.00
WTI	79.51	95.05	95.00	92.00	91.00	91.00	92.00
Dubai	78.10	106.15	107.25	99.25	96.50	95.50	93.50
Jet Fuel							
Rotterdam	91.32	127.91	128.48	119.93	116.39	114.87	112.36
New York	91.87	128.24	128.97	126.21	118.21	116.21	115.21
Singapore	90.07	125.67	126.25	111.25	107.66	105.88	103.15
Global Average	**91.09**	**127.27**	**127.90**	**119.13**	**114.09**	**112.32**	**110.24**
Gasoil/Diesel							
Rotterdam	90.28	125.59	126.50	117.68	113.89	112.15	109.44
New York	90.70	124.72	127.98	121.68	115.68	113.68	112.68
Singapore	90.26	126.26	126.50	111.70	107.90	105.99	102.94
Global Average	**90.42**	**125.52**	**126.99**	**117.02**	**112.49**	**110.61**	**108.35**
Gasoline							
Rotterdam	85.78	114.47	118.00	109.44	105.95	104.49	102.06
New York	89.14	119.30	119.25	117.75	111.75	109.75	108.75
Singapore	88.43	119.91	121.15	111.76	107.76	105.63	102.62
Global Average	**87.79**	**117.89**	**119.47**	**112.98**	**108.48**	**106.62**	**104.48**
Naphtha							
Rotterdam	81.01	106.07	107.51	100.76	99.50	97.00	95.10
Singapore	78.94	102.46	103.30	97.67	96.83	94.11	92.25
Global Average	**79.97**	**104.26**	**105.41**	**99.22**	**98.17**	**95.55**	**93.67**
Bunker Fuel 180							
Rotterdam	70.89	97.27	100.00	93.00	90.90	90.71	89.44
New York	73.64	101.09	104.00	99.10	93.10	91.10	90.10
Singapore	71.97	100.14	103.34	95.73	93.34	92.65	90.94
Global Average	**72.17**	**99.50**	**102.45**	**95.94**	**92.44**	**91.49**	**90.16**
Bunker Fuel 380							
Rotterdam	68.46	94.03	97.23	90.07	88.22	87.98	86.95
New York	70.76	97.13	101.00	96.18	90.18	88.18	87.18
Singapore	70.86	98.94	101.84	94.83	92.44	91.75	90.04

Table: BMI's Refined Products Forecasts

	2010	2011	2012f	2013f	2014f	2015f	2016f
Global	**70.03**	**96.70**	**100.03**	**93.70**	**90.28**	**89.30**	**88.06**
Bunker Fuel Average							
Rotterdam	69.68	95.65	98.62	91.54	89.56	89.35	88.19
New York	72.20	99.11	102.50	97.64	91.64	89.64	88.64
Singapore	71.41	99.54	102.59	95.28	92.89	92.20	90.49
Global Average	**71.10**	**98.10**	**101.24**	**94.82**	**91.36**	**90.40**	**89.11**

**f = forecast. Source: Bloomberg, BMI*

Our fuels price forecasts are indicative of a symbolically striking, albeit small, divergence with our benchmark crude forecasts: with the exception of New York Gasoline prices, all of our refined fuels forecasts for 2012 are higher than the 2011 averages, while our benchmark forecasts indicate marginally lower average prices in 2012. This discrepancy is noteworthy, and underscores the improvement in the outlook for refiners through 2012 at the expense of their customers, as well as a much-awaited recovery in refining margins takes place. Of course, this comes with a caveat. As will be discussed further on, we see a lot of regional discrepancies in profitability, meaning broad generalisations should be made cautiously.

The recovery in refining margins has been especially pertinent in the US, as those refiners with access to cheap unconventional production have benefitted significantly *(see our online service, August 3 2012, 'Refiners Enjoying Strong Margins... For Now')*. However, we expect the outperformance of US refiners to moderate in line with a forecast narrowing of the Brent-WTI spread. Indeed, we forecast the Brent-WTI spread will shrink from US$15 in 2012 to US$10 and then US$8 in 2013 and 2014 respectively, as additional oil transportation infrastructure comes online in the US.

With regard to customers, we have identified the four main markets using the products they each utilise most often: kerosene in the aviation sector; gasoline and diesel for retail users and land freight operators; naphtha in the petrochemicals industry; and bunker fuel for the shipping sector. All of these sectors are set to suffer from record-high fuel prices in both the short term and the longer term. Indeed, although we anticipate prices will begin to recede in 2013, our forecasts suggest that they will remain elevated above 2010 levels for the foreseeable future due to high crude prices and wider crack spreads.

Customers will be offered some relief in 2013, as crude and fuels prices begin to recede from their 2011 and 2012 highs, although refiners will see a narrowing of spreads as a result. Our forecasts suggest a sustained, slow and painstaking recovery process that will see many plants struggle, particularly in mature markets, characterised by overcapacity. This is representative of a move away from the supportive price dynamics that refiners are experiencing in the second half of 2012, particularly in the US, which had allowed for some recovery in the segment.

Consumers will be grateful for falling diesel and gasoline prices over the coming years, although European and Asian prices will fall faster than those in the United States. Falling prices may delay the rise of alternative fuels, however, including some early movement towards LNG and biofuels, which we have seen in the shipping and airfreight industries.

Refiners: Faltering Light At The End Of The Tunnel

With regard to downstream operators, **BMI** sees three main geographical blocks emerging: North America, emerging markets and Europe.

In the US, cheap domestic crudes in the Midwest, Rockies and on the Gulf Coast have generated very high margins. The country's evolution into a net exporter of refined products is also highly supportive of refiners, which enjoyed record-high utilisation rates of more than 90% in the summer of 2012.

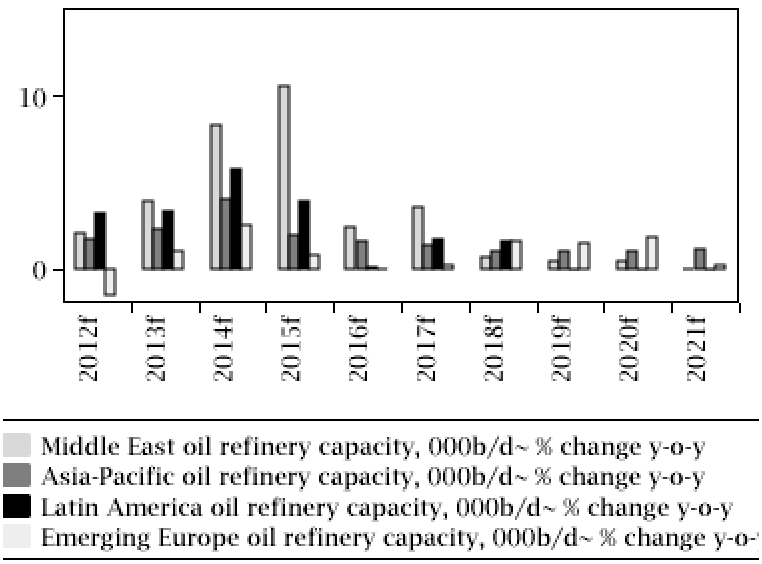
These benefits have not been shared with those on the East Coast, however. This is despite signs that the downstream decline suffered in the Northeast is now being contained. Some of the most promising signals include **Delta Air Lines'** purchase of the 185,000b/d Trainer Refinery in Pennsylvania for US$150mn in May 2012, and the creation of a joint venture (JV) by private equity fund **Carlyle Group** to acquire the 335,000b/d Philadelphia refinery *(see our online service, May 1 2012, 'Delta Flies In To Rescue Pennsylvanian Downstream' and July 9 2012 'Indian Summer For East Coast Refining').*

However, these remain highly unorthodox investments which fail to address the region's lack of competiveness, raising the possibility that such moves may not succeed as hoped and that the plants might eventually shut down in the coming years. This risk remains particularly true at a time when our forecasts suggest further shrinking crack spreads, including a 30% fall in the jet fuel spread, a 36% fall in the diesel spread, and a 9% fall in the gasoline spread between 2012 and 2016.

Despite high margins, Gulf Coast refiners must still address many challenges. The most prominent of these is the inadequacy of the region's high-complexity infrastructure, which has been adapted for the processing of heavy crudes amid the growing domestic supply of light shale oil. Processing light crudes would leave many new and expensive units underutilised. Therefore, the Rockies and Midwest downstream sectors are best placed to benefit from the current US downstream trends as they have access to secure feedstock from Canadian tar sands, adequate infrastructure, and a captured local market.

Emerging Downstream Powers

Refining Capacity, Percentage Change (y-o-y)



F=forecast, Source: BMI

Emerging Markets

The multi-year trend for rising crude prices has forced many governments to revise their fuel subsidies, or spend an increasingly large amount of money on maintaining them. Although we still expect many refiners to incur losses in 2012, as they will still be expected to perform their 'national duty' and provide cheap energy to fuel growth, their prospects are clearly improving. Indeed, Brazil, India, Iran, Nigeria, Indonesia and China, among others, have all – or are expected to – liberalise prices (to different degrees). In other states, particularly those in the Middle East, fears of domestic unrest since the Arab Spring have stalled fuel and further price liberalisation.

This price effect is nonetheless likely to be offset by the significant expansion in refining capacity which is expected to take place over the coming years. Indeed, OPEC has estimated a 1.3mn b/d and a 1.7mn b/d increase in global refinery capacity in 2012 and 2013, the lion's share of which will be located in non-Organisation for Economic Cooperation and Development (OECD) countries. The diversity of planned projects underscores this trend: in July 2012 **Sinopec** announced plans to build a 642,000b/d refinery in Jiangsu province *(see our online service, July 10 2012, 'Downstream Ambitions May Lead To Drowning')*. If realised, this facility would be the nation's largest. Additional refinery projects are being financed around the world, including recent examples ranging from a US$3.6bn refinery in Egypt, a US$6.5bn refinery in Nicaragua, and US$25bn in downstream investments in Qatar. With all of this new investment into downstream capacity, there is an emerging risk of overcapacity, particularly as demand growth continues to slow.

Importantly, cracks are beginning to show with regard to investment in the maintenance of downstream capacity in some emerging markets. The most recent and glaring example of this was the Amuay refinery explosion in Venezuela, which poses considerable risks to our forecasts for the downstream segment *(see our online service, August 27 2012, 'Refinery Blast Presents Downside Risk To Forecasts').* While an extreme example, it underscores the need for ongoing investment into maintenance at existing plants amid a broad-based push for the expansion of nameplate refinery capacity worldwide.

Europe

The outlook for Europe is much bleaker, with low margins and slumping demand forcing many plants to shut down or be mothballed *(see our online service, April 18 2012, 'Eni's Stoppage Signals More Woes For Europe's Refiners').* Europe's largest independent refiner, **Petroplus**, was forced to file for insolvency in January 2012 *(see our online service, January 4 2012, 'Credit Crisis To Trigger Downstream Supply Squeeze').* High financing costs are also becoming a significant issue, as the eurozone debt crisis weighs on credit in addition to demand. Furthermore, neighbouring emerging markets, rather than offering greater potential for the export of volumes, are a source of competition, as Russia, the Middle East, North Africa and even India, enjoy cheap feedstock and are constantly raising capacity and standards. Mediterranean refiners will continue to suffer much more than their north-western European counterparts, as they are more exposed to this direct competition.

Jet Fuel: Middle East Posts Strongest Demand As Global Air Traffic Slumps

We forecast that jet fuel prices will fall steadily through to 2016, in line with our other fuel products forecasts. Between 2012 and 2016, prices are forecast to fall 4% in Singapore, 3% in Rotterdam, and 2% in New York.

According to the International Air Transport Association (IATA), seasonally adjusted air passenger traffic has remained flat since June, and carriers are moderating their rates of capacity expansion to account for approximately 4.1% growth. European growth remained strong (despite the economic situation) due primarily to the demand for international routes, while the Middle East and Latin America posted the largest amount of growth. The weakest growth areas were the Asia Pacific and North America.

Table: Middle East Outperforms In Terms of Passenger Growth

	Africa	Asia/ Pacific	Europe	Latin America	Middle East	North America	Global
YTD passenger growth	8.3	5.4	6.2	9.1	16.9	1.4	6.6

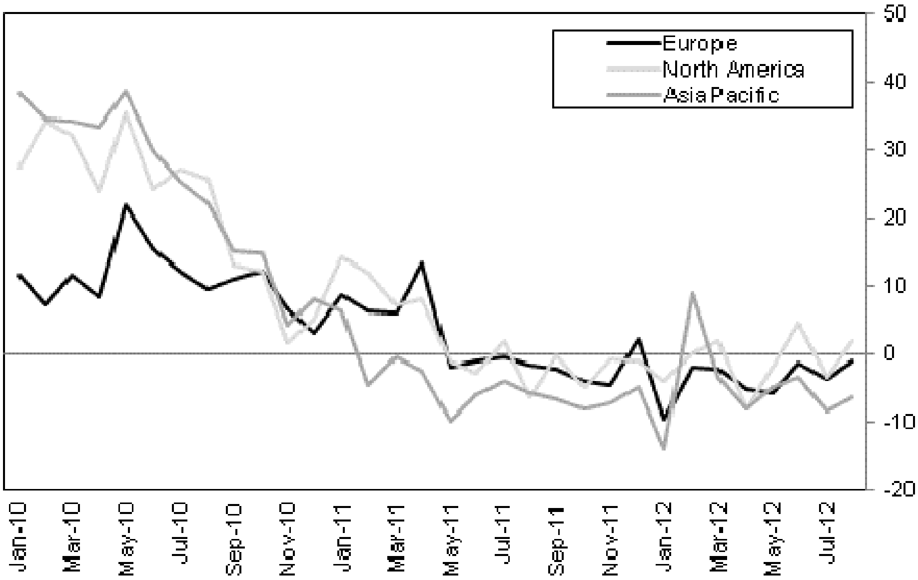
Source: IATA

In contrast to passenger traffic, air freight volumes were down 0.8% y-o-y in August, although certain regions are maintaining elevated demand relative to others. While Asia-Pacific registered the biggest decline, with a 5.5% drop in volumes, the largest amounts of air freight transport were recorded in the Middle East and Africa.

This ties-in with what we have been seeing with companies operating out of the Asia-Pacific region to Europe. The fall in demand for air-freighted electronic goods, coupled with the rise in jet fuel prices, has hit operators hard. Indeed, with the US recovery since the global economic crisis of 2008/2009 remaining sluggish at best, and the eurozone entering recession, in part because of its inability to deal with its sovereign debt crises convincingly, global demand for air freight has fallen.

Asia-Pacific Records Biggest Slump

International Air Freight Traffic, Percentage Growth (y-o-y)



Source: IATA, Bloomberg

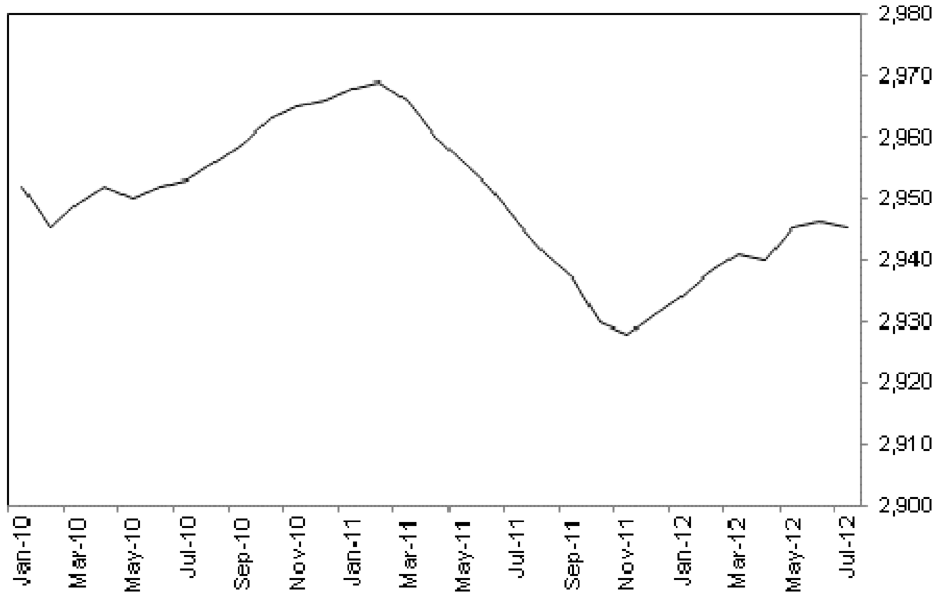
Gasoline And Diesel: Demand Destruction Takes A Toll

Our average global gasoline price for 2012 now stands at US$119.47/bbl compared to our previous forecast of US$123.86/bbl. Despite the downward revision, the new figure corresponds to a 1.3% y-o-y rise, significant enough to cause demand destruction. This has been particularly notable in the US where, according to the Energy Information Administration (EIA), gasoline prices in October 2012 were nearly 11% higher than October 2011, with consumption falling nearly 4%, from 8.96mn b/d to 8.63mn b/d.

Miles travelled in the US slowed throughout 2012, as highlighted in our previous Global Oil Products Outlook. Year-on-year growth declined by 0.03% in July, with the strongest drop-off in growth posted in the northeast, which registered a 0.06% decline. This is in line with our demand destruction scenario. Meanwhile, y-o-y growth is positive at 0.09%, although a further slowdown over the coming months could drag that number down.

A Slight Rebound

Annual Vehicle-Distance Travelled (Billion Miles)



Source: US Federal Highway Administration

In Europe, demand destruction has mostly been the result of the ongoing debt crisis, and the austerity measures that have been introduced. However, retail prices for both gasoline and diesel remain high as the shutdown of many refineries across the continent has caused supply to shrink. The 2012 average diesel price is currently 2.5% higher than the 2011 average, at US$935/metric tonne.

In the medium-to-long term both sectors offer opportunities. Growth in diesel demand will continue to be buoyed by tightening fuels standards across the globe. **Hart Energy** estimates that diesel engines carry vehicles 25% further per tank than gasoline engines. Although diesel only powers about 3% of US passenger vehicles, this figure could reach 8% by 2025, according to Allen Schaeffer, executive director of the Diesel Technology Forum. Meanwhile, gasoline production could be boosted by the growing availability of cheap unconventional light oil production. The case for growth in car fuels consumption is weakest in Europe where austerity measures and the ongoing debt crisis will continue to take their toll.

Naphtha: Asia Stays Afloat While Europe Sinks

Unlike light and middle-distillates, naphtha trends closer to benchmark crudes. We are projecting an average global price of US$105.41/bbl in 2012 compared to US$104.26/bbl in 2011. The rise in prices will be fuelled both by higher crude prices and by narrowing spreads. According to our forecasts, Rotterdam will see its naphtha crack spread (compared to Brent) increase from US$-4.98/bbl in 2011 to US$0.50/bbl in 2014, while Singapore will see its naphtha crack spread rise (compared to Dubai Fateh) from US$-3.69/bbl in 2011 to US$0.33/bbl in 2014.

A stronger appreciation of naphtha in Europe will hurt the continent's already-ailing petrochemicals markets. In reality, naphtha's relatively small price differential with regional benchmark crudes implies similar trends for profit margins in the petrochemicals industry and in the refining sector.

Much like the downstream segment, the European petrochemicals industry is facing a cyclical downturn, which implies that Indian and Middle Eastern operators could strengthen their presence on the continent. Furthermore, as our Asian naphtha forecast is indexed to Dubai Fateh crude, Middle Eastern petrochemicals operators will benefit from lower feedstock costs than their European counterparts that use Brent-indexed naphtha.

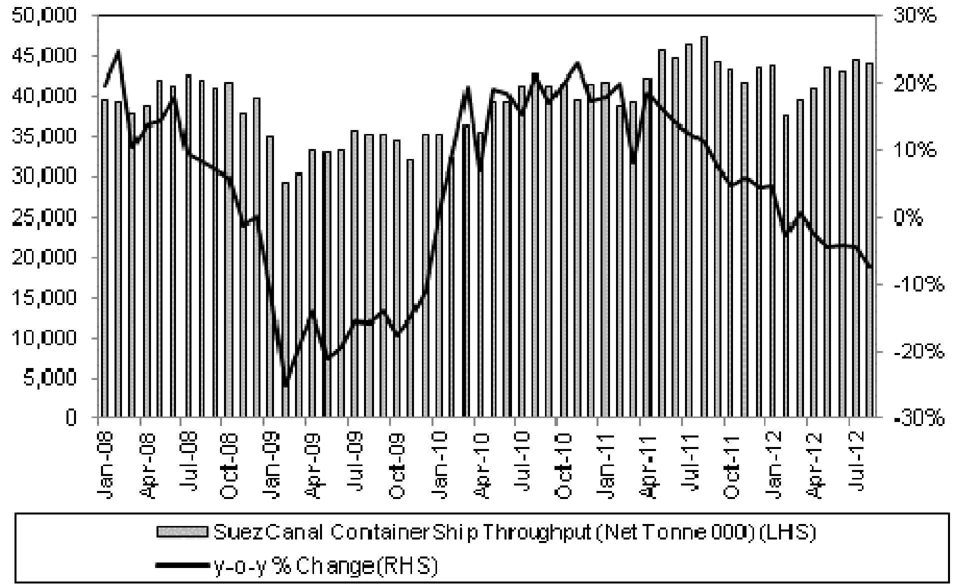
Bunker Fuels: Trans-Pacific Route Rebound Amid High Prices

Our global average forecast for bunker fuel (the average of the 180 and 380 grades global price) now stands at US$101.00/bbl, which is up slightly on the 2011 average of US$98.10. Shipping companies had been hard hit by the rise in bunker costs in 2011, where the cost of bunker fuel globally – calculated based on an unweighted average of Bunker fuel 180 and 380 for each of the three regions we cover – rose by 38.0% on 2010 levels. This, coupled with the excess capacity in the global shipping fleet across the traditional shipping sectors (container and dry and liquid bulk shipping), meant operators have suffered, with many reporting consecutive quarterly losses.

Global shipping data for 2012 indicates a growing disparity between two of the primary global shipping routes, with trans-Pacific trade growing 0.8% y-o-y, while Asia-Europe trade has fallen 1%. This is in line with our view that there will be a slow economic recovery in the US, while the eurozone crisis continues to ripple through European economies. Traffic through the Suez Canal has also been in decline since early 2011, with an acceleration in the rate of decline in growth in recent months, despite rising volumes. Indeed, August 2012 saw an 8% y-o-y decline in throughput growth.

Volumes Rising Despite Higher Costs

Suez Canal Container Ship Throughput (Net Tonne 000), and y-o-y % change



Source: Suez Canal Port Authority

As was the case during the last bunker fuel price peak in 2008, carriers are looking to alternative fuel sources – with liquefied natural gas (LNG) now being considered as a possible shipping fuel. **Det Norske Veritas** (DNV), a ship classification bureau, estimates that 19-45% of ships will be powered using LNG by 2030. Meanwhile **Maersk Line** wants to test biofuels and **NYK Line** is trialling a solar power-assisted car carrier. We believe that the most likely alternative to bunker fuel will ultimately be LNG. However, this remains a long-term prospect and high fuel costs will place pressure on carriers and shippers alike.

Our forecast for a decline in bunker fuel costs will offer shipping companies some relief and take the pressure off their bottom lines in the coming years, although prices will remain high by historical standards. As such, we believe that companies will continue to slow steam in an effort to conserve fuel and cut expenditure.

Political Outlook

Domestic Politics

Vietnam's Geopolitical Importance Rising, As US Tilts To Asia

BMI View: *Vietnam's geopolitical significance will rise over the coming decade, as the US courts it as a potential ally to counterbalance China. Although Hanoi is wary of Beijing's rise, it will avoid a formal alliance with Washington, instead charting a careful middle course between China and the US, to maximise its strategic independence.*

Vietnam's geopolitical significance will rise over the coming years, as the US courts it as a potential ally to counterbalance China. Although Vietnam and China are both nominally Communist one-party states, there is a degree of tension between them over ownership of the South China Sea and Hanoi does not wish to see Vietnam fall under the Chinese sphere of influence. Furthermore, Vietnam was the last sovereign state to be attacked by China, when the two sides fought a border war in 1979. Thus, Vietnam has in recent years been strengthening ties with the US, as well as India and Japan, as a means of offsetting China's power. For its part, the US has generally been happy to cultivate Vietnam as a new ally.

US Defense Secretary Leon Panetta visited the Vietnamese port of Cam Ranh Bay on June 3 2012, becoming the senior-most American official to set foot there since the Vietnam War. During that conflict, Cam Ranh Bay served as a major logistics hub for the US military. After the war ended with the defeat of the US-backed South Vietnam in 1975, Cam Ranh Bay became a major naval base for the Soviet Union, but its importance waned in the late 1980s, and in 2002 Russia finally withdrew its military presence there after the Vietnamese raised rental costs. Since then, there has been occasional speculation that the US Navy might reach some sort of regular visitation agreement for Cam Ranh Bay, but nothing has come of this, and American ships have instead called at other Vietnamese ports. More broadly, US-Vietnamese relations have been steadily improving since the two sides restored diplomatic relations (severed after the defeat of South Vietnam) in 1995 and signed a bilateral trade agreement in 2000.

Vietnam's Geopolitical Importance

Vietnam's location and population confer upon it an important role in Asian geopolitics. Three factors stand out:

- **Long coastline on the South China Sea:** Vietnam has a very long coastline, spanning almost all of the western stretch of the disputed South China Sea. (China regards most of the sea as its own and has become more assertive in its claims since 2010, whereas Vietnam, the Philippines and several other states claim the sea in part.) This means that Hanoi cannot help but have an interest in the affairs of the South China Sea, whose importance stems from the fact that it is a major shipping route; the significant oil and gas reserves there; and its considerable fish supplies. If Vietnam were to ally with China, then this would significantly enhance Beijing's control of the

South China Sea. As it happens, Vietnam's suspicion of China means that Beijing has a formidable competitor for control of the Sea. Even if Vietnam does not ally with the US, Hanoi's stance denies Beijing complete supremacy over the Sea, and this benefits other countries with claims on its waters, most notably the Philippines. Meanwhile, Japan, South Korea and Taiwan also do not wish to see Chinese dominance of the South China Sea, because this could theoretically interfere with their shipping.

- **Mainland South East Asia influence:** Vietnam also has a high degree of political and economic influence in Laos, where it competes with China and Thailand for loyalty and business opportunities. Vietnam's influence in Cambodia is less clear cut, because although the Phnom Penh leadership is on amicable terms with Hanoi, there is widespread distrust of Vietnamese intentions among ordinary Cambodians. Nevertheless, with Vietnam generally warming to the US, Thailand having officially been designated a US 'Major Non-NATO Ally' in 2003, and Myanmar moving towards rapprochement with the West, it is evident that mainland South East Asia's three most populous countries are seeking to counterbalance Chinese influence in the Asia-Pacific region.

- **Vast economic potential and large population:** Vietnam's geopolitical importance has also been boosted by its rapid economic growth, especially over the past decade, which has made the country a major emerging market and an attractive investment destination. In fact, some Japanese, South Korean and Western multinationals are said to favour Vietnam as an alternative to China, partly as a hedge against political risk in China (although there is considerable political risk in Vietnam, too), but also because Vietnam offers competitive labour costs. Vietnam's economic prospects are augmented by its large and youthful population (88mn and still rising), and the country also has the 11th-largest armed forces in the world, with 455,000 personnel. As Vietnam's economy and population grow, the country has the potential to emerge as a middle-ranked power in its own right, making it all the more attractive as a partner to countries seeking influence in South East Asia (ie, China, the US, Japan and India).

Vietnam In The Regional Context

As the second decade of the 21st century progresses, we envisage the US and China increasing their competition for influence in Asia (*see October 21, 2011, 'Sino-US Power Struggle To Intensify Over The Coming Decade'*). The US has publicly confirmed that it is shifting its attention towards the Asia-Pacific region after a decade of wars in Afghanistan and Iraq, and while Washington denies that it is seeking to counterbalance China, we believe that this is its *de facto* objective. Defense Secretary Panetta stated in early June that the US would maintain six out of its 11 aircraft carriers in the Pacific in the long term and would rebalance its global naval deployments so that 60% of its other warships would be operating in the region by 2020, compared to 50% at present. However, rather than build vast new bases in friendly countries, which might prove politically controversial, the US intends to carry out more rotational deployments. To this end, Vietnam stands out as an attractive destination to US military planners, although Singapore and the Philippines are more likely hosts for the US Navy in the near future.

The US is by no means alone in seeking to boost ties with Vietnam. India and Japan have in recent years reached out to Vietnam, politically and economically, for the same reasons as America. This has led to considerable speculation that an informal New Delhi-Tokyo-Hanoi 'strategic triangle' is emerging, backed by Washington, for the purposes of preventing Chinese domination of the Asia-Pacific region. However, a formal alliance does not appear to be forthcoming, since it could be interpreted to be anti-Chinese.

Obstacles To Deeper Vietnam-US Relations

Despite evident areas of mutual interests, the level of cooperation between the US and Vietnam is nowhere near as strong as between the US and its well-established regional allies, such as the Philippines and Thailand. Going forward, there are several obstacles to Vietnam and the US forging a more concrete partnership:

- **Vietnam does not wish to alienate China:** Although Vietnam is wary of China's rising power, it does not wish to alienate Beijing by formally allying with the US, for this would be seen as a provocative and obviously anti-Chinese step. China is a major trading partner of Vietnam and a source of foreign direct investment.

- **Vietnam favours strategic independence:** Having defeated the US in the early 1970s, Vietnam does not wish to become a US satellite state in Asia. Although memories of the Vietnam War are fading, there remains a degree of ideological opposition among the countries' leaders to forming an excessively close partnership with the US.

- **US and Vietnamese political differences:** There is considerable wariness towards Vietnam among some US legislators, owing to Vietnam's lack of democracy, its tough stance towards dissidents, and its curtailment of religious freedoms. This will occasionally stall the improvement in Hanoi-Washington relations.

Key Domestic Risks To Vietnam's Geopolitical Position

Looking to the remainder of this decade, there are two major risks that could weaken Vietnam as a geopolitical player. The first is a 'hard landing' or financial crisis in the Vietnamese economy as a result of runaway inflationary pressure and high trade and fiscal deficits. The resulting readjustment period could conceivably force Vietnamese leaders to turn their attention inwards. The second risk is an unstable political transition to democratic rule, of the kind seen in Indonesia from 1998-2004. This, too, would force the Vietnamese government to focus on domestic rather than international issues. However, neither interruption would be expected to diminish Vietnam's long-term importance in South East Asia.

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 (CPV) will face growing calls for democratisation, as was the case in other major South East Asian countries. While our core scenario envisages the CPV transforming itself into a technocratic administration, it faces major economic challenges which 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 which believes that a deceleration or even reversal of reform policies would benefit macroeconomic stability.

Ethnic And Regional Tensions: Vietnam is relatively homogeneous, 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 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 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, and criticism of a Chinese-financed bauxite mining project in the central highlands.

That said, the regimes in Beijing and Hanoi share the same ideological base and political system, and contacts between their respective politburos have decreased 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 moving 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 where 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 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.

Macroeconomic Outlook

Real GDP Growth Set To Pick Up In 2013

BMI View: *Vietnam's real GDP growth is expected to remain subdued at 5.3% in 2012, in line with our view that external demand will continue to cool over the coming months. However, the State Bank of Vietnam (SBV)'s decision to introduce its second policy rate cut in June will have a significant impact on gross fixed capital formation growth in 2013. Accordingly, we have revised our real GDP growth forecast upward from 6.5% to 7.0% for 2013.*

The State Bank of Vietnam (SBV) introduced its second rate cut in June, slashing its policy rate over the weekend by another 100 basis points (bps) from 11.00% to 10.00%. Although we have previously cautioned that downside risks to growth remain and that this could trigger further rate cuts by the central bank, the latest move was largely unexpected. From our perspective, we this as a sign that the central bank is becoming increasingly concerned that real GDP growth will miss the government's target of 5.5-6.0% this year. Indeed, the rate cut came just days after economic data published by the General Statistics Office (GSO) showed that the economy expanded by 4.7% year-on-year (y-o-y) in Q212, missing the government's full-year target by a wide margin. By comparison, the latest growth numbers is in line with our view that real GDP growth will remain subdued at 5.2% in 2012, compared to 6.7% in 2011.

Private Consumption To Be Hit By Bankruptcies

According to estimates published by the Ministry of Planning and Investments (MPI), more than 18,000 small and medium sized enterprises in Vietnam have filed for bankruptcy or suspended operations in the first four months of the year. We see this as a healthy adjustment for the economy over the medium term as inefficient companies that have previously managed to survive due to low lending rates and poor risk management practices in the commercial banking sector, were allowed to fail and exit the industry. Stronger oversight over the banking sector should result in better capital allocation across the economy over the longer term. Nonetheless, we expect the recent surge in bankruptcies to lead to an increase in the unemployment rate. This should in turn result in a slowdown in private consumption growth over the coming months. Until we begin to see an improvement in the outlook for the manufacturing sector, which continues to struggle with declining export orders, we believe that households will continue to cut back on spending.

Rate Cut A Boost To Real GDP Growth In 2013

With average lending rates elevated at around 13.00% as commercial banks tighten credit controls in response to a surge in bankruptcies and non-performing loans (NPL), we see the latest rate cut as an urgent response by the SBV to ease credit conditions and reignite economic growth. Concerns that aggressive monetary easing could undermine the SBV's previous efforts towards fighting inflation have also been tamed by the steady decline in headline consumer price inflation (CPI) in recent months. Headline CPI has fallen from its peak of 23% y-o-y in August 2011 to just 6.9% in June, in line our view that we could see headline CPI heading lower towards 4.2% by the end of the year. Looking ahead, we expect the recent rate cuts by the SBV – the central bank has implemented 500bps worth of rate cuts this year – to have a significant impact on gross fixed capital formation (GFCF) growth in 2013. Accordingly, we have revised up our 2013 real GDP growth forecast for Vietnam from 6.5% to 6.9%.

Increased Public Spending To Provide Limited Support

The Vietnamese government has approved a proposal by the MPI to advance VND30trn (US$1.4bn) in capital expenditure originally allocated for 2013 to help accelerate progress on public investment projects in 2012. According to the proposal, approximately US$0.7bn will be sourced from the state budget while the remaining half will be financed by new sovereign bond issues. We believe that the planned increase in public spending will help to support overall headline growth in 2012. However, given that government spending only makes up a small 6.6% share of Vietnam's GDP, we expect the impact on overall headline growth will be relatively limited.

Surprise Trade Surplus

Vietnam reported a surprise trade surplus of US$100mn in July, supporting our view that aggressive initiatives undertaken by the government to address the country's trade deficits in 2011 will begin to pay off. The latest reading reinforces our view that cooling domestic demand will help to keep trade imports subdued in 2012. Although we do not envisage a strong pickup in exports due to growing evidence of a lacklustre recovery in global demand, we expect the trade deficit to narrow significantly as demand for imports continues to cool over the coming months.

Vietnam's monthly trade balance averaged at a mild US$21mn deficit in the first seven months of the year, well below the average deficits of US$738mn and US$1.0bn in 2011 and 2010, respectively. Looking at the breakdown of exports, we are seeing encouraging evidence that Vietnam is becoming less reliant on refined crude imports (dominantly petroleum imports) and could soon become a net exporter of crude oil over the coming years. Not only has this been driven by cooling domestic demand for refined crude, we are also seeing a steady increase in the production of crude oil for export. As the accompanying chart shows, exports of crude oil reached US$960mn in July, surpassing the peak of US$875mn recorded in April 2011.

In light of the stronger-than-expected trade figures in recent months, which are supportive of our view that Vietnam's macroeconomic fundamentals will continue to improve going forward, we expect the trade deficit to narrow to 5.5% of GDP in 2012 (compared to our forecast of 6.4% previously). Over the longer term, we believe that continued efforts by the government to restructure the economy will help to boost investor confidence and long term economic growth.

Table: Vietnam – Economic Activity, 2011-2016						
	2011	**2012**	**2013**	**2014**	**2015**	**2016**
Nominal GDP, VNDbn [2]	2,487,746.4	2,835,012.3	3,179,481.9	3,597,041.4	4,052,241.5	4,568,752.7
Nominal GDP, US$bn [2]	120.5	134.8	152.9	174.9	199.3	227.3
Real GDP growth, % change y-o-y [2]	5.9	5.3	7.0	7.2	7.3	7.4
GDP per capita, US$ [2]	1,357	1,502	1,686	1,910	2,156	2,436
Population, mn [3]	88.8	89.7	90.7	91.6	92.4	93.3
Industrial production index, % y-o-y, ave [1,4]	10.9	8.0	12.0	14.0	13.0	12.0
Unemployment, % of labour force, eop [4]	4.5	5.0	4.8	4.7	4.6	4.5

Notes: [e] BMI estimates. [f] BMI forecasts. [1] at 1994 prices. Sources: [2] Asian Development Bank, General Statistics Office; [3] World Bank/UN/BMI; [4] General Statistics Office.

Company Profiles

Vietnam Airlines

Strengths	▪ Vietnam Airlines Cargo is the main air cargo provider in Vietnam. ▪ The recent green light given to the purchase of Jetstar Pacific will only strengthen the company's domestic position.
Weaknesses	▪ Unlike its peers, Vietnam Airlines Cargo does not have a freighter fleet and is reliant on using the bellyholds of its parent company's planes.
Opportunities	▪ The air carrier is well placed to benefit from Vietnam's growing role in the trade sector. The country has flooded money into the development of the country's port sector, but BMI believes aviation also stands to benefit. ▪ Vietnam Airlines is to reportedly run flights between the UK and Vietnam, which could result in cargo being transported in the bellyholds of aircraft in the future.
Threats	▪ While the sector has recovered well, the outlook for global air freight remains volatile, especially with oil prices at their current high levels.

Overview

Vietnam Airlines Cargo's parent **Vietnam Airlines** began operations in 1956 serving the domestic market. In 1993, it was established as Vietnam's national carrier.

The cargo carrier's operations are concentrated in Asia, catering for the domestic market. The airline operates its cargo business by transporting goods in the belly holds of its passenger planes.

Strategy

Operating out of hubs in Hanoi and Ho Chi Minh City, Vietnam Airlines Cargo has developed a network of both domestic and international routes. Within Vietnam the carrier lands at 18 domestic airports. It is heavily focused on Asia, with three freight flights to neighbouring Thailand and routes servicing China, Hong Kong, Japan, South Korea, Taiwan, Philippines, Malaysia and Indonesia. The air freight carrier is therefore able to cater for all five of Vietnam's top five import partners (China, Japan, Korea, Thailand and Singapore).

Vietnam Airlines Cargo's expansion into China offers a launch pad for further services to other Chinese airports. It has also developed routes to Australia, with freight connections to Melbourne and Sydney.

Allied to Vietnam Airlines Cargo's cargo links to three destinations in Europe (Paris, Frankfurt and Moscow), parent company Vietnam Airlines began operating a direct air route to the UK in the last months of 2011. The service flies to Gatwick Airport, with cargo space available in the bellyholds of planes going to and from London.

Financial Results

2011

Not available at the time of writing.

Latest Activity

SkyTeam alliance Adds Saudi Flag Carrier

SkyTeam, the global airline alliance, welcomed Saudi Arabia flag carrier **Saudia** at the end of May 2012 as the 16th member of the network, providing potential openings for Vietnam Airlines in terms of freight opportunities. Saudia adds a total of 51 new destinations to SkyTeam's global network, Vietnam Airlines said, including Islamabad, Pakistan; Colombo, Sri Lanka; and Alexandria, Egypt.

Michael Wisbrun, SkyTeam's managing director, explained: 'Saudia's membership adds value to the alliance by opening up the considerable Saudi Arabian market to our customers. We are responding to passenger demand for increased travel choice within the Middle East by adding a significant player from the region. This allows us to offer more destinations, while continuing our focus on enhancing products and services for our global customers.'

On June 18 2012, Bloomberg reported that Pham Ngoc Minh, chief executive of Vietnam Airlines Corporation, had announced that the company is seeking an international financial adviser for its upcoming privatisation process, with interested parties urged to submit their application between June 25 and July 24.

Vinatrans

Strengths	▪ Vinatrans is a diversified logistics company, offering a wide variety of services.
Weaknesses	▪ The company is exposed to the weaknesses inherent in state-owned companies, such as inefficiency and underfunding.
Opportunities	▪ BMI has identified intra-Asia trade as a market to watch, as consumer demand in the traditional markets of the US and Europe remains sluggish.
	▪ Vietnam is part of the ASEAN 5. As such, it should see an uptick in trade as a result of the group's free trade agreement (FTA) with China.
Threats	▪ Rising fuel prices pose a threat to logistics companies' profit margins.
	▪ The rate of economic growth in Vietnam has far outpaced the country's infrastructure. Road, railways and ports are all badly in need of upgrades.

Overview

Vinatrans is a state-owned, Vietnamese freight forwarding company, providing door-to-door logistics worldwide and a number of related services. These include air freight and sea freight forwarding (including customs clearance, cargo surveying, insurance, air consolidation for inbound and export cargos, and exhibition or project handling), shipping (including chartering, husbandry, crewing, and brokerage services) as well as warehousing and cold storage provision.

The company is 100% owned by the Vietnamese Ministry of Trade and acts as an agent for several foreign organisations including **BAX Global**, **Hapag-Lloyd Container**, **Zim Israel Navigation Company** and **Panalpina**. The firm's warehousing and storage facilities in Vietnam include: a 2,500 square metre (m^2) Container Freight Station (CFS) for sea and air cargo; a joint venture (JV) cold storage facility of 2,800m^2, run by Vinatrans and **Konoike Transport Company** of Japan; 40,000m^2 of covered warehousing; and 50,000m^2 of open storage.

Strategy

BMI has been following the trend of increasing investment in the Vietnamese port sector as the country establishes itself as a centre of production, particularly for the textile industry. We caution, however, that as many factories are situated inland, investment in the supply chain as a whole, including road, air, rail and storage, are needed to deal with increasing demand. Having declined by 10% y-o-y in 2009, Vietnamese exports returned to growth in 2010.

According to the Civil Aviation Authority of Vietnam, air freight to and from the country increased by 37% y-o-y to reach 340,000 tonnes in 2010. As such, we see growth opportunities for Vinatrans in the sector. We note that several air cargo carriers have already spotted the potential in the market. Chinese carrier **Jade Cargo** has recently opened the first air freight link between Vietnam and Amsterdam. In 2009 **Lufthansa Cargo**, the air freight subsidiary of **Deutsche Lufthansa**, launched a weekly direct service between Frankfurt and Hanoi, which it is considering doubling in the future to keep up with demand.

Financial Results

Vinatrans reported consolidated earnings for the second quarter and first half of 2010. In Q210, the company made a net profit of VND5.06bn on revenues of VND109.42bn, versus VND3.42bn and VND62.99bn respectively in the same period of 2009. The company made a net profit of VND9.94bn in H110, down 14.16% on a year earlier. Net revenues, however, rose 44.05% y-o-y to VND189.08bn during the period. Six-month earnings per share (EPS) were VND1,816, compared with VND2,117 in the same period in 2009. The company was targeting pre-tax profit of VND23bn on revenues of VND300bn for 2010, and a dividend payout equivalent to VND1,500 per share for the year.

Latest Activity

Vietnam Freight Forwarders Association Fears Logistics Companies Too Small

According to the Vietnam Freight Forwarders Association (Viffas), Vietnam now has more than 1,000 enterprises which provide logistics services, most of which (about 600-700 enterprises) are located in Ho Chi Minh City. Commenting on the capabilities of the enterprises, Mai Xuan Thieu, head of the Vietnam Logistics Institute, said the majority have a modest capital of VND1-1.5bn.

As a result, most Vietnamese logistics firms act as agents for multinational groups. Thieu believes many are incapable of providing enough transport services in Vietnamese territory with competitive costs. Currently, Vietnamese companies can only meet 25% of total domestic demand. **BMI** believes this is a cause for concern, given that we expect the country's trade volumes to continue growing.

Vietnam National Shipping Lines (Vinalines)

Strengths	▪ Diversified fleet operating in dry bulk, container and oil transport. ▪ Largest commercial shipping line in Vietnam.
Weaknesses	▪ Vietnam does not play a role on the major Asia-Europe routes, despite developing as a direct port of call on these routes. ▪ The US$3.6bn Van Phong International Port project, primarily constructed by state-owned Vinalines, was suspended in June 2011 following a reassessment of the geological conditions at the project site. ▪ Vietnamese shipping company Vinalines is currently US$2.1bn in debt, reported Reuters in June 2012.
Opportunities	▪ Vietnam is expanding its role in the global box market and it is fast becoming a mainstay port of call on Asia-Europe services. ▪ Potential to increase its intra-Asia role, shown by the expansion work at Cai Mep, and well placed to be chosen as a partner on these services by major lines.
Threats	▪ While Vietnam has invested heavily in its port network, the logistics supply chain could be let down by the landside freight network, which will have a negative impact on operators. ▪ In 2011 Vinalines posted its first ever loss in 15 years of operations, with further losses expected. ▪ Overcapacity is a threat over the medium term, unless money is pumped into port facilities and infrastructure. ▪ Vietnamese police issued an arrest warrant for the former chairman due to the scandal rocking the debt-mired company. Duong Chi Dung has been accused of deliberately mismanaging Vinalines during his tenure. ▪ Vinalines has been stung by the poor performance of the three container terminals it has joint venture interests in.

Overview

Vinalines is Vietnam's largest commercial shipping line. Established in 1996, it caters for domestic trade in Vietnam and also offers intra-Asia services.

The company also has a port operating division that is the largest in Vietnam, controlling and managing ports in Quang Ninh, Hai Phong, Da Nang, Ho Chi Minh and Can Tho.

Strategy

Vinalines' 14 shipping companies operate a diverse fleet, dominated by dry bulk vessels but also boasting container ships, oil and product oil vessels.

According to the company's website, Vinalines' fleet consisted of 128 vessels. The line is looking to expand, with a plan centred on increasing the proportion of specialised vessels such as box ships or oil tankers.

In order to achieve this, the line was seeking to spend US$2bn on ordering new ships from Vietnamese yards seeking state funding for the plan. Vinalines has in fact ended up expanding its fleet quicker than intended, with the shipping line taking on 36 vessels from the debt laden Vietnamese shipbuilder **Vinashin** in July 2010. Vinaline's chairman, Duong Chi Dung, said at the time that up to two-thirds of the acquired vessels could not be used as they failed to meet technical requirements. He estimated that the company would need to spend US$26mn to repair the vessels and purchase insurance cover. Dung added that the company expected some financial aid from the government for the project.

Vinalines services the trade needs of Vietnam's domestic shipping market, but also has exposure to the intra-Asia trade lane after joining forces with **NYK** in December 2010 to launch a Thailand-Vietnam-Singapore (TVS) service. Vinalines provides a 1,100 twenty-foot equivalent unit (TEU) vessel for the service.

BMI believes that Vinalines' presence on the intra-Asia trade route will increase, with major lines looking to expand into the route and the company well placed to enter partnerships with them. Vinalines is also increasing its contacts in the container sector, partnering with a number of the majors on container terminal projects in Vietnam.

According to Port Strategy, Vietnam is of increasing interest in East Asia, due to the fact that it is focusing on becoming better connected with both short and long haul destinations. Providing the bedrock to this strategy are the new terminals constructed in the Cai Mep area.

Financial Results

2012

Vinalines announced a VND1,439bn (US$69.2mn) loss during the first half of 2012, which is around double the losses incurred for the corresponding period a year previous. The loss was attributed to a 'perfect storm of liquidity and jobs woes', according to Vinalines director Nguyen Canh Viet, reported by Vietnam Investment Review.

2011

Vinalines recorded a VND62.15bn (US$3mn) profit for 2011, despite posting a loss of VND660bn (US$32mn) in H111 – the first time this has ever occurred in the company's 15 years of operations. The results came as a surprise to analysts who were expecting the company to suffer from the sinking of the bulker *Vinalines Queen*. In 2011, Vinalines shipped 36.8mn tonnes of cargo, which was a 1% annual increase on 2010.

Latest Activity

Authorities Take Former Vinalines Chairman Into Custody

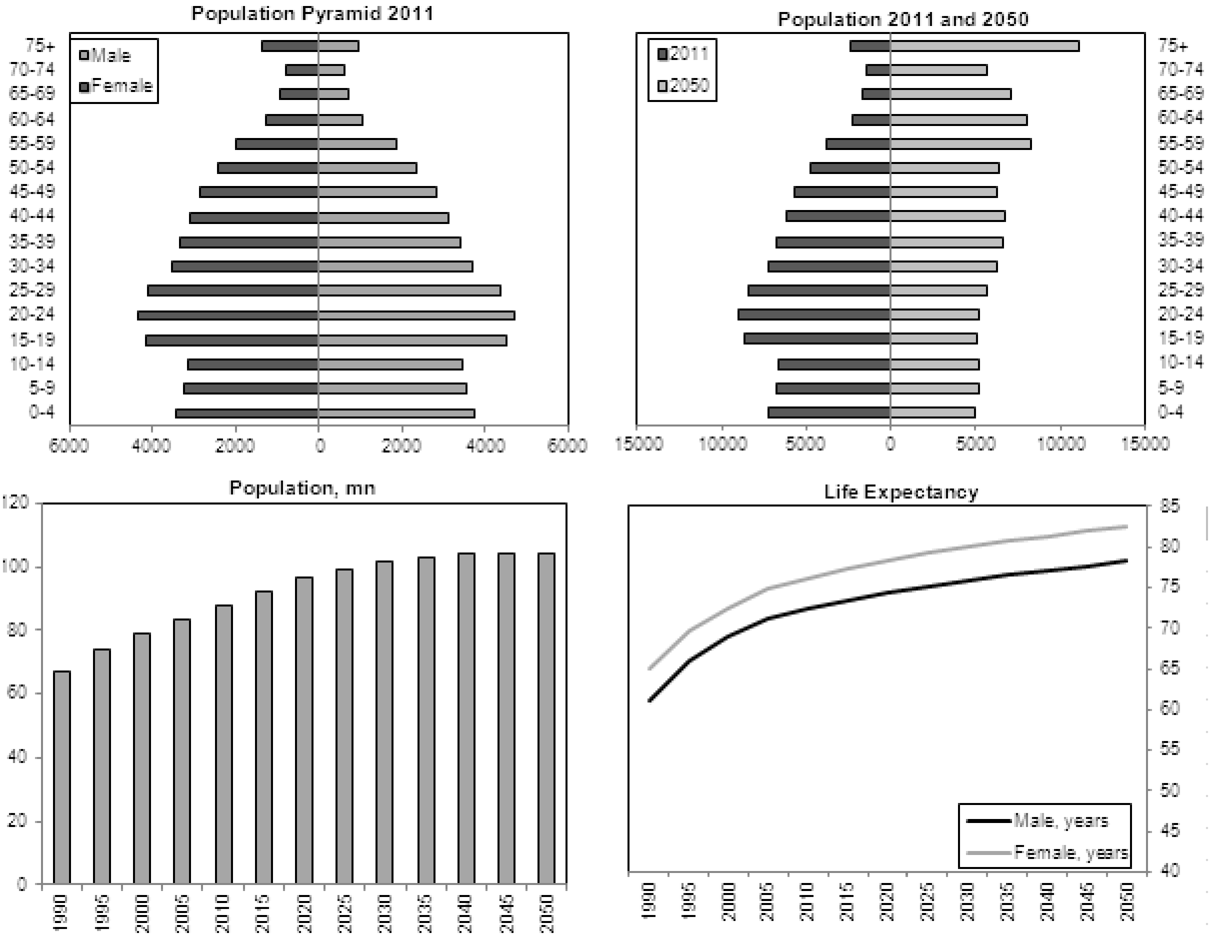
Duong Chi Dung, the former chairman of Vietnamese shipping company Vietnam National Shipping Lines (Vinalines), was taken into custody with the help of Interpol. The company has been facing an enquiry over corruption and debts, Vietnamese authorities stated on September 5. Dung has been accused of purposely mismanaging Vinalines' from 2005 to February 2012. A warrant was issued by Interpol against Dung in May 2012 and he was finally arrested on September 4 2012, according to the police ministry. However, the arrest location is not yet disclosed.

The company's former chairman was jailed in another Southeast Asian country and now has been brought back to Vietnam, according to the state media. Additionally, the company's six other executives have been taken into custody in a case that marks a large test of the government's graft-fighting credentials and whether the communist-run country will enter deep into an economic malaise.

Vietnam Demographic Outlook

Demographic analysis is a key pillar of **BMI**'s macroeconomic and industry forecasting model. Not only is the total population of a country a key variable in consumer demand, but an understanding of the demographic profile is key to understanding issues ranging from future population trends to productivity growth and government spending requirements.

The accompanying charts detail Vietnam's population pyramid for 2011, the change in the structure of the population between 2011 and 2050 and the total population between 1990 and 2050, as well as life expectancy. The tables show key datapoints from all of these charts, in addition to important metrics including the dependency ratio and the urban/rural split.



Source: World Bank, UN, BMI

Table: Vietnam's Population By Age Group, 1990-2020 ('000)

	1990	1995	2000	2005	2010	2012f	2015f	2020f
Total	67,102	74,008	78,758	83,161	87,848	89,730	92,443	96,355
0-4 years	9,340	9,212	7,002	6,776	7,186	7,186	7,026	6,529
5-9 years	8,685	9,193	9,124	6,921	6,703	6,885	7,143	6,982
10-14 years	7,504	8,604	9,142	9,038	6,844	6,539	6,668	7,104
15-19 years	7,127	7,408	8,535	9,064	8,963	8,161	6,806	6,628
20-24 years	6,492	7,003	7,305	8,420	8,954	9,115	8,892	6,745
25-29 years	5,893	6,361	6,879	7,167	8,284	8,602	8,862	8,803
30-34 years	4,884	5,779	6,250	6,765	7,058	7,475	8,202	8,779
35-39 years	3,965	4,794	5,688	6,163	6,677	6,770	6,991	8,131
40-44 years	2,420	3,884	4,710	5,614	6,086	6,304	6,609	6,925
45-49 years	2,039	2,358	3,802	4,653	5,548	5,761	6,012	6,536
50-54 years	1,933	1,968	2,287	3,739	4,580	4,936	5,449	5,914
55-59 years	1,946	1,843	1,887	2,201	3,617	4,001	4,446	5,305
60-64 years	1,544	1,822	1,737	1,767	2,076	2,573	3,455	4,268
65-69 years	1,283	1,391	1,659	1,582	1,621	1,649	1,927	3,233
70-74 years	919	1,084	1,194	1,439	1,389	1,384	1,438	1,729
75+ years	1,127	1,305	1,559	1,852	2,264	2,388	2,516	2,743

f = BMI forecast. Source: World Bank, UN, BMI

Table: Vietnam's Population By Age Group, 1990-2020 (% of total)

	1990	1995	2000	2005	2010	2012f	2015f	2020f
0-4 years	13.92	12.45	8.89	8.15	8.18	8.01	7.60	6.78
5-9 years	12.94	12.42	11.58	8.32	7.63	7.67	7.73	7.25
10-14 years	11.18	11.63	11.61	10.87	7.79	7.29	7.21	7.37
15-19 years	10.62	10.01	10.84	10.90	10.20	9.10	7.36	6.88
20-24 years	9.68	9.46	9.27	10.13	10.19	10.16	9.62	7.00
25-29 years	8.78	8.60	8.73	8.62	9.43	9.59	9.59	9.14
30-34 years	7.28	7.81	7.94	8.14	8.03	8.33	8.87	9.11
35-39 years	5.91	6.48	7.22	7.41	7.60	7.55	7.56	8.44
40-44 years	3.61	5.25	5.98	6.75	6.93	7.03	7.15	7.19
45-49 years	3.04	3.19	4.83	5.59	6.32	6.42	6.50	6.78
50-54 years	2.88	2.66	2.90	4.50	5.21	5.50	5.89	6.14
55-59 years	2.90	2.49	2.40	2.65	4.12	4.46	4.81	5.51
60-64 years	2.30	2.46	2.21	2.12	2.36	2.87	3.74	4.43
65-69 years	1.91	1.88	2.11	1.90	1.85	1.84	2.08	3.36
70-74 years	1.37	1.46	1.52	1.73	1.58	1.54	1.56	1.79
75+ years	1.68	1.76	1.98	2.23	2.58	2.66	2.72	2.85

f = BMI forecast. Source: World Bank, UN, BMI

Table: Vietnam's Key Population Ratios, 1990-2020

	1990	1995	2000	2005	2010	2012f	2015f	2020f
Dependent ratio, % of total working age [1]	75.5	71.2	60.5	49.7	42.1	40.9	40.6	41.6
Dependent population, total, '000 [2]	28,859	30,790	29,679	27,609	26,006	26,031	26,717	28,321
Active population, % of total [3]	57.0	58.4	62.3	66.8	70.4	71.0	71.1	70.6
Active population, total, '000 [4]	38,243	43,218	49,079	55,552	61,842	63,699	65,725	68,034
Youth population, % of total working age [5]	66.8	62.5	51.5	40.9	33.5	32.4	31.7	30.3
Youth population, total, '000 [6]	25,529	27,009	25,268	22,735	20,732	20,610	20,837	20,615
Pensionable population, % of total working age [7]	8.7	8.7	9.0	8.8	8.5	8.5	8.9	11.3
Pensionable population, '000 [8]	3,330	3,780	4,411	4,874	5,274	5,421	5,881	7,706

f = BMI forecast; [1] 0>15 plus 65+, as % of total working age population; [2] 0>15 plus 65+; [3] 15-64, as % of total population; [4] 15-64; [5] 0>15, % of total working age population; [6] 0>15; [7] 65+, % of total working age population; [8] 65+. Source: World Bank, UN, BMI

Table: Vietnam's Rural And Urban Population, 1990-2020

	1990	1995	2000	2005	2010	2012f	2015f	2020f
Urban population, % of total	20.3	22.2	24.3	26.4	28.7	29.7	31.2	33.9
Rural population, % of total	79.7	77.8	75.7	73.6	71.3	70.3	68.8	66.1
Urban population, '000	13,438.6	16,201.6	18,865.4	21,940.1	25,212.5	26,649.9	28,842.1	32,664.4
Rural population, '000	52,761.4	56,778.4	58,770.0	61,166.2	62,635.9	63,080.4	63,600.5	63,690.7

f = BMI forecast. Source: World Bank, UN, BMI

BMI Methodology

How We Generate Our Industry Forecasts

BMI's industry forecasts are generated using the best-practice techniques of time-series modelling. The precise form of time-series model we use varies from industry to industry, in each case being determined, as per standard practice, by the prevailing features of the industry data being examined. For example, data for some industries may be particularly prone to seasonality, i.e. seasonal trends. In other industries, there may be pronounced non-linearity, whereby large recessions, for example, may occur more frequently than cyclical booms.

Our approach varies from industry to industry. Common to our analysis of every industry, is the use of vector autoregressions. Vector autoregressions allow us to forecast a variable using more than the variable's own history as explanatory information. For example, when forecasting oil prices, we can include information about oil consumption, supply and capacity.

When forecasting for some of our industry sub-component variables, however, using a variable's own history is often the most desirable method of analysis. Such single-variable analysis is called univariate modelling. We use the most common and versatile form of univariate models: the autoregressive moving average model (ARMA).

In some cases, ARMA techniques are inappropriate because there is insufficient historic data or data quality is poor. In such cases, we use either traditional decomposition methods or smoothing methods as a basis for analysis and forecasting.

It must be remembered that human intervention plays a necessary and desirable part of all our industry forecasting techniques. Intimate knowledge of the data and industry ensures we spot structural breaks, anomalous data, turning points and seasonal features where a purely mechanical forecasting process would not.

Transport Industry

There are a number of principal criteria that drive our forecasts for each transport variable:

GDP Growth
As transport activity is heavily influenced by real GDP growth, this factor is examined to ascertain its relationship with overall trade volumes. Projected GDP growth is calculated using **BMI**'s own macroeconomic and demographic forecasts.

Real Trade Volumes
The sum of imports and exports plays a particularly important role in developing countries with a small

domestic industrial sector. In particular, the focus is on goods, as services do not employ transport. The volumes are forecast based on the following criteria:

- Trends manifested through historical data;
- The impact of future step changes to the economy (such as future membership of the EU or some other regional body).

Port Traffic

Port traffic levels act as a ‘second opinion’ on trade volumes. However, this check needs to be used with caution as trade values and volumes do not always move over time in the same way.

Market Share

The market share of each mode (road, rail, inland waterway, coastal shipping) for future years is based upon:

- Trends in historical modal split data;
- Evidence of government policy favouring one or more modes over others;
- Government and or private sector investment plans in specific modes.

Sources

Sources used in transport reports include local transport ministries, officially released company results and figures, established think tanks and institutes and donor agencies such as the World Bank and the Asian Development Bank.