Asia: "Made in Vietnam"

Understanding the rise of Vietnam as an export powerhouse

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Key points

- Rising globalisation has greatly benefitted emerging Asia as supply chain migration from developed countries fuelled the region's tremendous export growth over the past decade
- Vietnam has been a standout winner in gaining export market share in labour-intensive and low margin segments where China has lost competitiveness
- The country's attractiveness as a supply chain location is credited to its successful integration in international trade, geographic advantage, and manufacturing competitiveness – including cheap labour, and favourable government policies for foreign investment
- Vietnam has successfully moved into the space created by China's continued economic evolution. However, Vietnam's relatively small size compared to China, means that it cannot replace China's "world's factory" title. Instead, as a close trading and production partner in China's expanded supply chain ecosystem, Vietnam looks set to continue to thrive
- COVID-19 disruptions, domestic policies, and geopolitical tensions could pose risks for Vietnam's continued rise as a manufacturing and export powerhouse

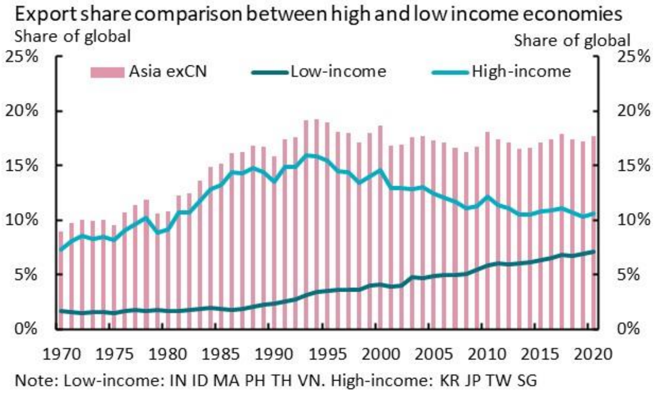
One of the most dramatic economic developments of recent decades has been the integration of emerging market countries (EM) in Asia – defined here as Asia ex-China – into global trade. Within the region, Vietnam ranks high on economic performance, fuelled by a powerful gain of manufacturing and export capability. Our previous research shows that Vietnam has been the standout winner of global export market share in recent years, particularly as China has successfully moved up the value-chain in global trade, increasingly vacating the lower-value-added, labour-intensive space as it becomes less competitive[1]. This paper investigates the reasons behind Vietnam's success and discusses the prospects for broadening its position in the regional and global production ecosystem.

Macro factors lead to supply chain shifts

Asia's exports, as a share of the world's total, rose to almost 20% at its peak in the mid-1990s (Exhibit 1).These gains occurred mostly prior to the 1990s, largely reflecting the rise of developed economies in the region – notably Japan, but also South Korea, Taiwan and Singapore. Since then, market share has stabilised, although a divergence in export performance between developed and emerging economies has emerged. This is due to increased globalisation of production process, leading to low-value-added assembly lines shifting to developing economies, whereas developed economies have focused on specialising high value-added products and components.

[1] Our previous paper – Yao, A. and Shen, S., "Unpacking Made in China", AXA IM Research, 15 July 2021 – examined China's role in the global trade and supply chain in significant detail.

Exhibit 1: Geographical dispersion of trade boom



Source: World Bank and AXA IM Research, as of September 2021

Apart from the supply chain transfer from developed to developing countries, our previous work has shown that low-margin production has also started to migrate out of China in recent years due to its maturing economy, growing labour costs and, more recently, trade tensions vis-à-vis the US. However, Vietnam has been a standout winner in this respect with its export value rising fivefold over the last decade – markedly outperforming the rest of the region. (Exhibit 2)

Exhibit 2: Vietnam sees the fastest export growth

Source: World Bank and AXA IM Research, as of September 2021

An important corollary of Vietnam's rise as a trade powerhouse is its ability to attract business relocation. Recent high-profile examples of supply chain shifts include Nike and Adidas, which moved their manufacturing bases from China. In addition, many technology firms, including Google, Microsoft, and Intel, have also transferred, or are in the process of shifting, parts of their manufacturing lines to Vietnam. Foxconn, for example, is building an iPad and MacBook assembly line in Vietnam's Bắc Giang province. In late 2018 and 2019, Samsung also shut two large phone assembly plants in China, and by now, more than half of its flagship handsets are assembled at Bắc Ninh and Thái Nguyên provinces of Vietnam.

Growing attraction as a manufacturing hub

There are several characteristics contributing to Vietnam's growing trade and manufacturing competitiveness. First, the successful integration into the Association of Southeast Asian Nations (ASEAN) was key to igniting its trade engine. In 1995, Vietnam joined ASEAN with the aim of accelerating its economic, social, and cultural development. The membership allowed it to enjoy zero tariffs when trading with other ASEAN members. In the years following, Vietnam also signed free trade agreements with other major economies including China, the European Union, the UK, and Japan (Exhibit 3), creating a fertile environment for trade relations to grow.

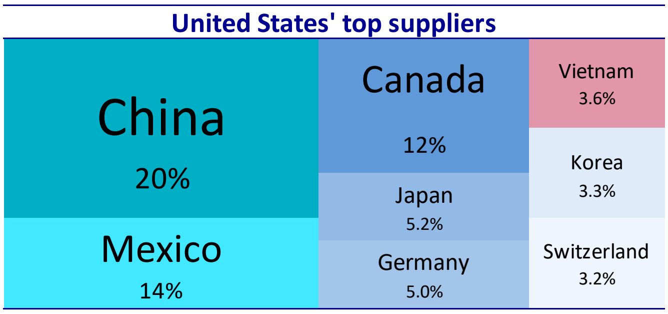
Exhibit 3: Trade agreements signed by Asian countries

	Free Trade Agreements						
	RCEP	CPTPP	China	EU	US	UK	JP
ID	☑		☑				☑
IN							☑
JP	☑	☑		☑		☑	
KR	☑		☑		☑	☑	
MA	☑	☑	☑				☑
PH	☑		☑				☑
SG	☑	☑	☑	☑	☑	☑	☑
TH	☑		☑				☑
TW							
VN	☑	☑	☑	☑		☑	☑

Source: Media sources and AXA IM Research, as of September 2021

Its geographic proximity to China – along the ancient Silk Road trade route – also made Vietnam a beneficiary of China's Belt and Road Initiative. Deep infrastructure cooperation between the two countries, with fast railway lines connecting China's manufacturing hub (Guangdong province) and Hanoi – Vietnam's capital – has helped to lay a critical foundation from which trade and commerce can flourish. Apart from land-connections, Vietnam's maritime position is also suited to export activities, with its long and deep coastlines favourable for seaports, and navigable rivers connecting major urban centres.

Exhibit 4: Vietnam benefits from trade-war



Source: UNComtrade and AXA IM Research, as of September 2021

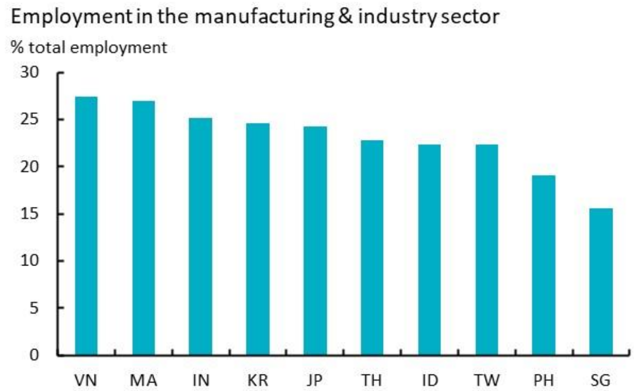
More recently, Vietnam has been amongst the biggest winners of the US-China trade war. Our research shows that Vietnam achieved the largest gains in export market share with the US in 2018 and 2019 when Chinese products lost competitiveness due to hefty tariffs. Chinese producers – of furniture, car tires, refrigerators and so on – also used Vietnam as a transhipment port for US-bound exports to circumvent custom levies. Vietnamese exports to the US surged by 29% in 2019, and by the end of last year, Vietnam became the sixth largest importer to the US market, up from 12th place in 2017 (Exhibit 4).

Exhibit 5: Vietnam experiences rapid rise in manufacturing value-add

Source: World Bank and AXA IM Research, as of September 2021

A rapid increase in manufacturing competitiveness has also contributed to Vietnam's rise as a regional export powerhouse. Manufacturing value-added increased by the most in the past decade, doubling, for example, India's gain (Exhibit 5). The country also employs the most manufacturing workers as a percentage of total work force in Asia (Exhibit 6). The Ministry of Industry and Trade has highlighted the need to prioritize manufacturing development, as well as promoting telecommunications and electronics, in its latest 'Industrial Development Strategy'.

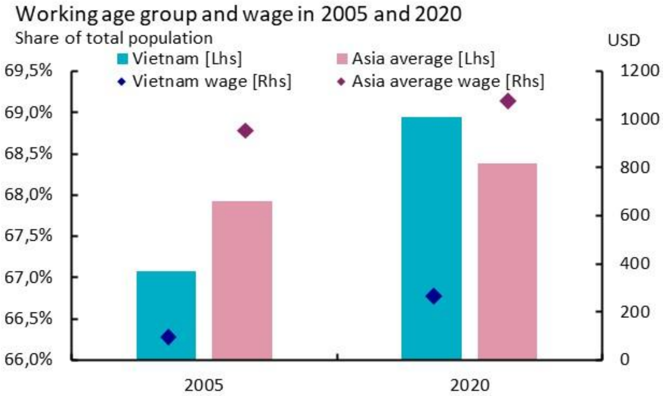
Exhibit 6: Vietnam has the highest manufacturing employment sector



Source: World Bank and AXA IM Research, as of September 2021

Manufacturing competitiveness has been underpinned by low labour expenses. A rapidly growing young population has helped to keep wage pressure low despite fast economic growth. Exhibit 7 shows that Vietnam's average wage is lower than those of neighbouring countries and various government policies are likely to keep wage pressure contained in the near future.[2] Anecdotal evidence suggests that manufacturing labour costs in Vietnam are only half that in major Chinese cities.

Exhibit 7: Labour market is competitive in Vietnam

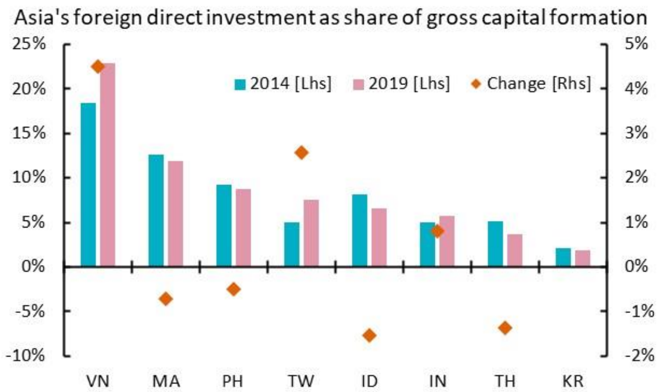


Source: CEIC and AXA IM Research, as of September 2021

Vietnam has also been very successful in attracting foreign direct investment (FDI), thanks to favourable government policies. Since embarking on its "reform and open-up" programme in the 1980s, Vietnam has moved towards an export-oriented growth model and prioritized foreign investment in fledgling industries. Special Economic Zones (SEZs) that gave priority to foreign investment played a key role in development since the first Industrial Park opened in Ho Chi Minh City. By 2020, the number of industrial parks in Vietnam had grown to 369, an increase of 180% from 2005.

The Vietnamese government offers a variety of tax benefits and streamlines regulations for foreign entities.[3] This has been reflected in an impressive gain in Vietnam's ranking in the World Bank's "ease of doing business" index – up 23 places to 70 from ten years ago. Exhibit 8 shows that Vietnam's FDI inflow[4] has experienced the fastest growth in the region.

Exhibit 8: Foreign direct investment inflow is key



Source: World Bank and AXA IM Research, as of September 2021

Aggregating the above discussions, Exhibit 9 shows a set of proprietary competitiveness scores calculated – based on ease of doing business, logistic quality, wage cost, GDP

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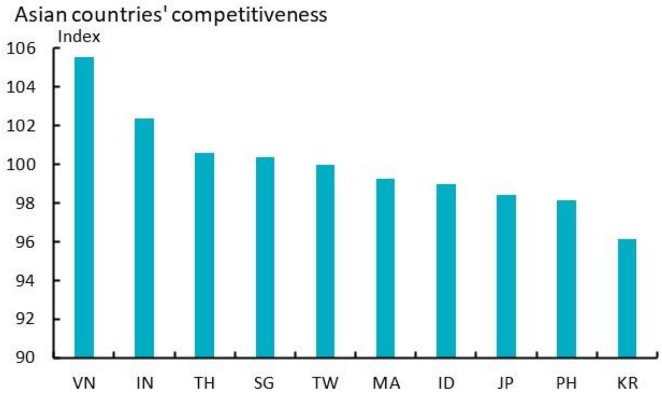
[2] The government is committed to only modestly increase annual minimum wages, which have rarely exceeded 4% in real terms in recent years. Meanwhile, industrial actions – the formation of unions, striking and participation in collective bargaining – will remain tightly controlled by the government authorities.

[3] Vietnam's success in drawing FDI is in part due to its socio-political stability, by which the government carried out comprehensive renovation of the regulatory system by simplifying procedures, improving transparency, and encouraging competition.

[4] Recent data from the Ministry of Planning and Investment suggests that, despite the COVID-19 disruptions, Vietnam's FDI inflows rose by 3.8% year-on-year to USD 10.5 billion in the first seven months of 2021, with processing and manufacturing taking the lead, taking up 47% of the total.

growth and changes in the share of exports and FDI. On this measure, Vietnam is the most competitive country in the region, which has underpinned its impressive export market share gains in recent years.

Exhibit 9: Vietnam stands as the most attractive spot



Source: AXA IM Research, as of September 2021

Partnership between Vietnam and China

While Vietnam has been a favoured destination for supply chain relocation, talks of it replacing China as the next "world's factory" are, in our view, misplaced. Vietnam's size creates obvious obstacles and bottlenecks that limit its capacity to accommodate production operations on a comparable scale to China.

Indeed, size matters when it comes to projecting Vietnam's role in the global supply chain. Compared to the world's second largest economy, Vietnam is much smaller – only 1/54th of China's GDP, and 1/14th of China's population and total manufacturing work force. Vietnam's manufacturing output is only 0.3% of the global total, whereas China amounts to 28%. Other key comparisons, including research and development (R&D) expenditure, rail line built, capital stock and power generating capacity all point to significant size difference between Vietnam and its giant neighbour (Exhibit 10).

In addition, our previous research has shown that Vietnam is highly dependent on China for supply of critical industrial material and components. As such, Vietnam has flourished as a close trading and production partner of China. Moreover, Vietnam has maintained friendly trading relations with other major developed economies. Overall, we expect Vietnam to continue to thrive by being an active part of a broader Asian supply-chain.

Exhibit 10: Vietnam is smaller than China in all aspects

Comparison of key statistics: Vietnam and China

Indicator	Vietnam	China
GDP USD bn	270	14700
Total population mn	97	1400
Manufacturing work force mn	15	210
Manufacturing VA USD bn	45	3900
Manufacturing output % total	0,3	28
R&D expenditure % GDP	0,5	2,4
Rail line route-km	2481	68141
Capital stock bn USD	410	39000
Power generating capacity mn kW	41	1540

Source: World Bank, CEIC and AXA IM Research, as of September 2021

Key risks and challenges

In the short term, the adverse impact from the COVID-19 pandemic will linger, weighing on Vietnam's manufacturing and export sector, restraining the pace of corporate capital expenditure, and hampering the relocation of global supply chains. Over the long term, we expect foreign businesses to resume the establishment of efficient global supply chains. However, investors may be conscious of Vietnam's relatively high corporate tax rates (up to 50% for certain industries), along with restrictions on foreign currency, language barriers[5], inadequate Intellectual Property Rights (IPR) protection and complicated business setup requirements. Vietnam will undoubtedly continue to reform these areas, but the risk is that the pace of change fails to meet lofty investor expectations.

Geopolitically, the surging trade surplus with the US has also put Vietnam in a precarious position. In December 2020, Vietnam was labelled a currency manipulator by the Trump administration, attracting US investigations on many of its key industries. While the Biden administration has removed the currency-manipulator label and terminated the probe, the US will most likely continue to keep a close eye on Vietnam's foreign exchange and trade policies. Over the longer-term one cannot rule out renewed trade conflicts if the US's policies turn protectionist again amidst widened bilateral imbalances.

Moreover, competing claims with China in the South China Sea could see a deterioration in relations between these two countries, creating tensions at the heart of the Asia supply-chain hub. In this sense, Vietnam's broadening connection with economies outside of its immediate sphere may provide some diversification from this risk. In either case, as a beneficiary from global trade and the diversification of global supply chains, Vietnam will continue to do better the longer trade tensions remain subdued.

*** Country codes used for the charts in this paper are as follow** –China (CN); Eurozone (EU); India (IN); Indonesia (ID); Japan (JP); Malaysia (MA), Philippines (PH); Singapore (SG); South Korea (KR); Taiwan (TW); Thailand (TH); United Kingdom (UK); United States (US); Vietnam (VN)

[5] Impacting filing, reporting and certificates which must only be in Vietnamese. In cases of foreign-owned company, financial reports must be audited by an independent Vietnamese auditing firm.

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