

FEATURE

# Vietnam

Economy continues robust growth in 2018

Lester Gunnion

Vietnam continues to ride the wave of foreign investment and low-cost manufacturing. Its robust trade ties are likely to support export-driven growth in the medium term. However, growing trade tensions between the United States and China, if escalated further, could slow global trade and put the brakes on Vietnam’s economic growth. There are other risks too—wages are rising quicker than productivity, and automation in manufacturing could possibly displace millions of workers over the next decade or two.

## Manufacturing drives Vietnam closer to “Asian tiger” status

Vietnam’s economy grew 7.1 percent year over year in the first half of 2018.<sup>1</sup> Manufacturing boomed in the first half of the year (12.9 percent), fueling the industry and construction segment of the economy (9.1 percent), while agriculture (3.9 percent) and services (6.9 percent) also recorded healthy growth rates.

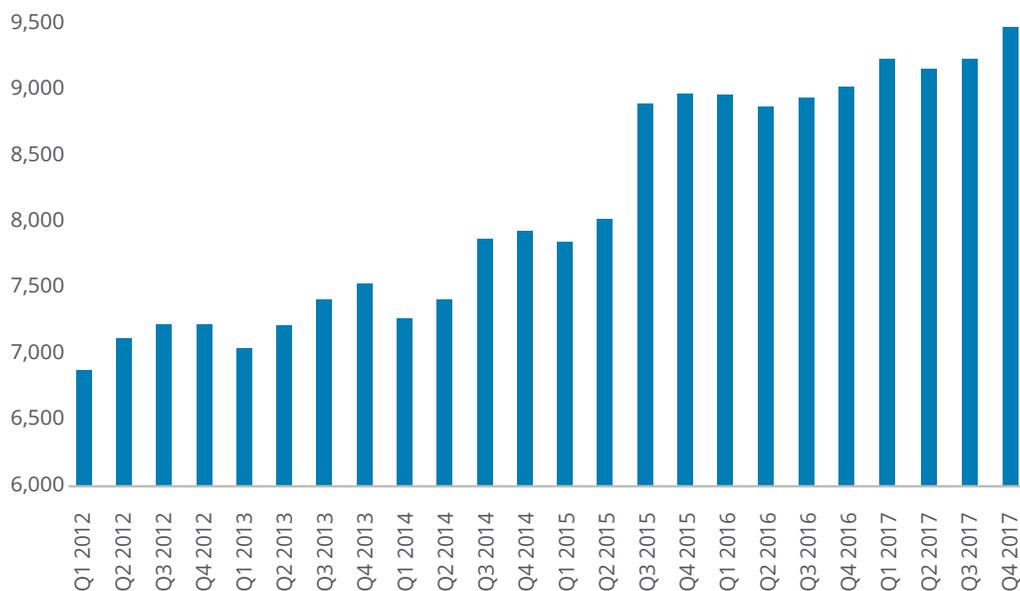
The Nikkei purchasing manager’s index for manufacturing in Vietnam touched a multiyear high in June 2018. Strong global demand resulted in manufacturing output accelerating for the third straight month in June. As a result, manufacturers have been hiring more workers.<sup>2</sup> Quick growth in manufacturing employment through 2017 is therefore likely to continue through 2018 (figure 1).

Vietnam’s promise as a low-cost manufacturing hub continues to hold strong. However, foreign

FIGURE 1

### The quick growth in manufacturing employment is likely to continue in 2018

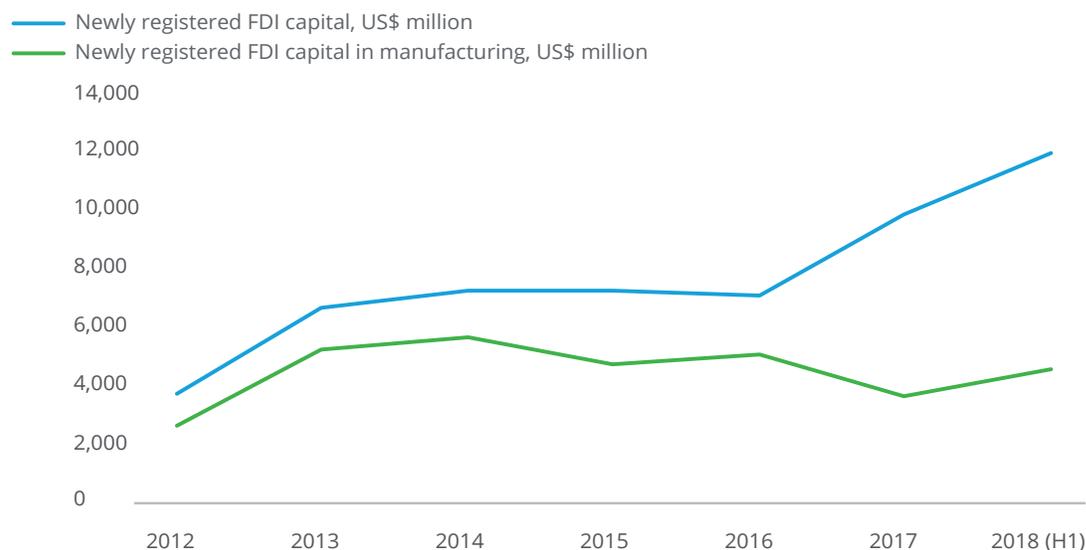
■ Employment in manufacturing, thousands



Source: General Statistics Office of Vietnam via Haver Analytics.

FIGURE 2

## Foreign capital diversified away from manufacturing in 2017 and H1 2018



Source: General Statistics Office of Vietnam/Ministry of Planning and Investment via Haver Analytics.

direct investment (FDI) seems to be diversifying away from the sector in recent times (figure 2). From 2012 to 2016, newly registered FDI in manufacturing accounted for 70 percent of all newly registered FDI in the economy. However, in 2017 and in the first half of 2018, manufacturing's share of new FDI dropped to about 35 percent as investors shifted capital to the real estate sector. The shift of investment capital to real estate, in Hanoi and Ho Chi Minh, is likely due to the easing of rules on foreign ownership of property in 2017; it is also a vote of confidence in favor of Vietnam's economic prospects.

Even though attractive real estate deals might be shifting investor focus, it is highly likely that key manufacturing sectors will continue to attract foreign investment given Vietnam's solid export performance. Total exports increased a robust 16 percent from a year ago in the first half of 2018. Key manufacturing verticals—phones, electronics, textiles, and footwear—accounted for 50 percent of all exports during the same period. Foreign investment into these sectors is therefore unlikely to dry up any

time soon especially as Vietnam continues to sign free trade agreements.

## Trade developments bring promise and threat

Vietnam has been ahead of the game when it comes to signing free trade deals—the country has signed 16 bilateral and multilateral free trade agreements.<sup>3</sup> Vietnam is a member of the Association of South East Asian Nations (ASEAN) and is an active participant in making ASEAN a single market through the ASEAN Economic Community. Beyond Southeast Asia, Vietnam has completed trade agreements with the United States, the European Union, Japan, South Korea, and the Eurasian Customs Union. It is also one of the 11 nations that are part of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

These strong trade ties could stand Vietnam's export-oriented economy in good stead by allowing it to tap into lucrative consumer markets while

also allowing foreign investment to flow into the local economy. For instance, the recent trade deal with the European Union—which is expected to be ratified in 2018—will eliminate import tariffs on 99 percent of all goods within a decade and therefore allow Vietnamese manufacturers access to the vast and wealthy European consumer market, while members of the European Union can tap into Vietnam and the ASEAN region. In fact, European investment in Vietnam has already accelerated, with 24 EU member countries having made investments worth a total of US\$ 21.5 billion as of 2017.<sup>4</sup>

However, trade tensions between the United States and China could pose a threat. An all-out trade war could slow global trade, and in turn, Vietnam’s economy. In the short term though, tariffs imposed on China might just benefit Vietnam. Low-cost manufacturers are likely to expedite plans to shift production from China, where wages are already considerably higher, to Vietnam.

## How long will low labor costs be an advantage to Vietnam?

Rising labor costs in China have indeed worked to Vietnam’s advantage as many manufacturers have already shifted entire production facilities across the border. This trend is likely to continue through the medium term. Made in China 2025—China’s intensive effort to climb the manufacturing value chain to higher value-added manufacturing—also likely contributes to low-cost manufacturers viewing Vietnam as a favorable base in the medium term.

However, low-cost, labor-intensive manufacturing can come with its set of problems. In Vietnam, one such problem is that labor productivity has not kept pace with rising wages (figure 3). Over the medium term, the gap between productivity growth and wage growth could drive up costs, making Vietnam a less competitive manufacturing base. Even though productivity has increased 36 percent from 2006 to 2017, Vietnam is still behind regional competitors—productivity in Vietnam is a third of

FIGURE 3

### Wages have grown faster than labor productivity



Source: General Statistics Office of Vietnam via Haver Analytics.

that in Thailand, while the average monthly wage in Vietnam is a little more than half of that in Thailand.<sup>5</sup> Indeed, Vietnam’s productivity in manufacturing is even behind that of Cambodia. And even as productivity increased 36 percent between 2006 and 2017, average real wages doubled during roughly the same period. Furthermore, the ratio of minimum wage to average labor productivity increased from 25 percent in 2004 to 50 percent in 2015.<sup>6</sup>

Automation is another potential problem—one that is likely to draw greater attention in the medium to long term. Industry 4.0 or the Fourth Industrial Revolution presents the risk of low-skill labor-intensive jobs being completely replaced by machines,<sup>7</sup> but this is unlikely to happen in the short term. In the case of Vietnam, increased mechanization could provide a much-needed boost to productivity without hurting job growth. However, the advanced stages of automation could put millions of workers at risk of losing their jobs. Indeed, Made in China 2025, while possibly pushing low-cost manufacturing to Vietnam in the short to medium term, may pose a threat in the long term. While the initial focus on higher value-added manufacturing in China might encourage low-cost manufacturers to shift to Vietnam, widespread automation across manufacturing in China could result in low-cost

manufacturing shifting *out* of Vietnam and *back* to China as labor-intensive techniques are supplanted by capital-intensive production at higher productivity, lower costs, and better quality.

According to the United Nations International Labor Organization, more than 56 percent of all employment in Vietnam, Cambodia, Indonesia, the Philippines, and Thailand are at high risk of dis-

placement due to automation over the next decade or two.<sup>8</sup> Vietnam could use this looming threat as an opportunity to upskill and reskill its workforce. However, to fund any broad-based education and training initiative in the medium term, Vietnam will likely need to keep making hay (and smartphones and garments) while the proverbial sun shines brightly.

## Endnotes

1. All statistics unless mentioned otherwise have been taken from General Statistics Office of Vietnam via Haver Analytics, accessed on July, 9, 2018.
2. Nikkei, “Nikkei Vietnam manufacturing PMI,” press release, July 2, 2018.
3. Sebastian Eckardt, Deepak Mishra, and Viet Tuan Dinh, “Vietnam’s manufacturing miracle: Lessons for developing countries,” Brookings, April 17, 2018.
4. Ralph Jennings, “Vietnam expects economic boom from EU trade deal,” Voice of America, June 29, 2018.
5. Vietnam Institute for Economic and Policy Research, *Vietnam annual economic report 2018*, 2018.
6. Ibid.
7. Deloitte Insights, *The Fourth Industrial Revolution is here—are you ready?*, 2018.
8. Jae-Hee Chang, Gary Rynhart, and Phu Huynh, “ASEAN in transformation: The future of jobs at risk of automation,” International Labor Organization, July 1, 2016.

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