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VIETNAM

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Aggressive Growth Policies Risk Overheating

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VIETNAM – MACROECONOMIC DATA AND FORECASTS

	2005	2006	2007	2008	2009e	2010f	2011f	2012f	2013f	2014f
Population, mn [5]	83.1	84.1	85.2	86.2	87.3	88.4	89.3	90.2	91.1	92.0
Nominal GDP, US$bn [6]	52.9	60.9	71.1	89.8	92.4	95.9	107.9	117.2	131.3	146.3
Nominal GDP, VNDbn [6]	839,211.3	974,266.2	1,144,014.6	1,478,695.0	1,645,481.0	1,869,502.9	2,103,348.3	2,344,535.7	2,625,877.9	2,926,496.6
GDP per capita, US$ [6]	637	724	835	1,042	1,058	1,085	1,208	1,300	1,442	1,591
Real GDP growth, % change y-o-y [6]	8.4	8.2	8.5	6.2	5.3	6.0	5.5	6.0	6.8	6.9
Industrial production index, % y-o-y, ave [1,7]	17.7	16.8	16.7	14.6	7.6	10.0	12.0	14.0	14.0	14.0
Unemployment, % of labour force, eop [7]	5.3	4.8	4.6	5.0	5.5	5.5	5.0	4.5	4.0	4.0
Budget balance, VNDbn [8]	-9,062.0	13,000.0	-35,827.0	22,925.0	-85,002.0	-132,611.0	-143,207.4	-153,946.0	-166,341.8	-177,755.5
Budget balance, % of GDP [8]	-1.1	1.3	-3.1	1.6	-5.2	-7.1	-6.8	-6.6	-6.3	-6.1
Consumer prices, % y-o-y, eop [2,7]	8.8	6.6	12.6	19.9	6.5	12.0	7.2	6.0	6.0	5.0
Consumer prices, % y-o-y, ave [2,7]	8.2	7.5	8.3	23.0	7.0	8.5	11.5	6.5	6.0	5.5
Central bank policy rate, % [9]	7.80	8.25	8.25	8.50	9.00	10.00	10.00	8.00	8.00	8.00
Lending rate, %, eop [10]	11.4	11.2	12.0	15.0	9.0	15.0	12.0	12.0	10.0	10.0
Real lending rate, %, eop [3,11]	2.6	4.6	-0.6	-4.9	2.5	3.0	4.8	6.0	4.0	5.0
Exchange rate VND/US$, eop [12]	15,913.00	16,051.00	16,018.00	17,480.00	18,469.00	19,500.00	20,000.00	20,000.00	19,500.00	19,000.00
Exchange rate VND/US$, ave [12]	15,851.56	15,987.37	16,075.77	16,431.20	17,781.00	19,200.00	19,750.00	19,750.00	19,250.00	18,750.00
Exchange rate VND/EUR, eop [12]	18,840.99	21,180.90	23,368.66	24,472.00	26,780.05	24,375.00	24,600.00	24,800.00	24,375.00	23,750.00
Goods exports, US$bn [13]	32.4	39.8	48.6	62.7	56.6	63.9	71.9	80.5	90.2	101.0
Goods imports, US$bn [13]	34.9	42.6	58.9	75.5	68.8	77.4	86.0	95.1	104.6	115.0
Balance of trade in goods, US$bn [13]	-2.4	-2.8	-10.4	-12.8	-12.2	-13.5	-14.2	-14.6	-14.4	-14.1
Balance of trade in goods and services, US$bn [4,13]	-2.7	-2.8	-11.3	-15.1	-13.7	-14.8	-15.6	-16.2	-16.3	-16.2
Current account, US$bn [13]	-0.6	-0.2	-7.0	-9.8	-9.2	-9.4	-9.7	-9.6	-9.0	-8.2
Current account, % of GDP [13]	-1.1	-0.3	-9.8	-10.9	-10.0	-9.8	-9.0	-8.2	-6.9	-5.6
Foreign reserves ex gold, US$bn [13]	9.1	13.4	23.5	23.9	15.0	17.5	20.1	22.9	25.9	29.3
Import cover, months g&s [13]	3.1	3.8	4.8	3.6	2.6	2.7	2.8	2.9	3.0	3.1
Total external debt stock, US$mn [14]	19,211.5	20,202.5	24,223.0	27,214.1	30,080.5	32,941.1	35,946.7	38,942.8	42,194.5	45,723.5
Total external debt stock, % of GDP [14]	36.3	33.2	34.1	30.3	32.6	34.4	33.3	33.2	32.1	31.2
Total external debt stock % of XGS [14]	52.5	45.0	44.4	39.4	48.5	46.9	45.5	43.9	42.5	41.0

Notes: e/f = BMI estimates/forecasts. 1 At 1994 prices; 2 Base year 2000; 3 Real rate strips out the effects of inflation; 4 Includes investment income flows up until 2004; Sources: 5 World Bank/BMI calculation/ BMI; 6 IMF (General Statistics Office); 7 General Statistics Office; 8 Asian Development Bank, Ministry of Finance; 9 State Bank of Vietnam; 10 IMF; 11 IMF/BMI; 12 BMI; 13 Asian Development Bank, State Bank of Vietnam; 14 World Bank.

Contents

Executive Summary

Aggressive Growth Policies Risk Overheating

- Vietnam's economy recorded an impressive 6.3% year-on-year real GDP growth in Q210 and July economic indicators suggest that domestic demand will be the main driver of growth in H210. We expect strong private consumption growth and infrastructure investments to remain robust in H210 and 2011. Over the long term, Vietnam's growing political influence in the Association of Southeast Asian Nations is also expected to open up opportunities for exports to the region, especially Cambodia and Laos. However, we are growing increasingly concerned over the threat of higher inflation as well as widening current account and budget deficits going forward. Our bearish outlook for a slowdown in the US and EU also compels us to pencil in relatively weak real GDP growth of 6.0% and 5.5% for 2010 and 2011 respectively.

- We expect Vietnam's political influence within the Association of Southeast Asian Nations (ASEAN) to grow significantly over the coming years, parallel to its ambition to become an economic powerhouse in South East Asia. Bilateral relations between Vietnam and its neighbouring countries, in particular Cambodia and Laos, will continue to play a huge part on the government's agenda. We see Vietnam's move to tighten its relationship with Cambodia and Laos as not only due to the two countries' increasing potential for economic growth, but also because Vietnam is in a perfect position to leverage on its relationship with these countries to boost its political influence in the bloc.

- The government's aggressive growth target for 2010 and 2011 are likely to come at the expense of higher inflation and persistent budget deficits. The State Bank Of Vietnam remains in an accommodative stance in spite of inflation remaining above 8.0%, underlining the central bank's weak credibility when it comes to inflation targeting. As such, we believe the risk of a sharp pick-up in consumer price inflation remains going forward. Shrinking foreign reserves are also raising risks that the government may face difficulties servicing debt denominated in foreign currencies, which led to a downgrade of its foreign currency debt by Fitch Ratings.

- With the construction of a number of large infrastructure projects under way, growth for the infrastructure industry is set to remain strong in 2010 and 2011. Over the longer term, the total value of the infrastructure industry is expected to grow steadily, rising from US$3.0bn in 2010 to US$6.4bn in 2014, according to our Infrastructure team's forecasts. We believe the government's stance towards encouraging public-private investments will also open up opportunities for foreign companies to invest in the country's growing need for infrastructure development. The government's support for infrastructure development in Laos also presents opportunities for companies to expand into the neighbouring country.

Chapter 1:
Political Outlook

SWOT Analysis

Strengths

- The Communist Party government appears committed to market-oriented reforms, although specific economic policies will undoubtedly be discussed at the 2011 National Congress. The one-party system is generally conducive to short-term political stability.
- Relations with the US are generally improving and Washington sees Hanoi as a potential geopolitical ally in South East Asia.

Weaknesses

- Corruption among government officials poses a major threat to the legitimacy of the ruling Communist Party.
- There is increasing (albeit still limited) public dissatisfaction with the leadership's tight control over political dissent.

Opportunities

- The government recognises the threat that corruption poses to its legitimacy and has acted to clamp down on graft among party officials.
- Vietnam has allowed legislators to become more vocal in criticising government policies. This is opening up opportunities for more checks and balances within the one-party system.

Threats

- The slowdown in growth in 2009 and 2010 is likely to weigh on public acceptance of the one-party system, and street demonstrations to protest economic conditions could develop into a full-on challenge of undemocractic rule.
- Although strong domestic control will ensure little change to Vietnam's political scene in the next few years, over the longer term, the one-party-state will likely be unsustainable.
- Relations with China have deteriorated over the past year due to Beijing's more assertive stance over disputed islands in the South China Sea and domestic criticism of large Chinese investment into a bauxite mining project in the central highlands, which could potentially cause widescale environmental damage.

BMI Political Risk Ratings

Vietnam's short-term political risk rating of 78.1 reflects a largely stable political system, kept in place largely by the ruling Communist Party of Vietnam's monopoly on power. While public expressions of discontent have so far been limited, slower growth and high inflation pose a threat to stability in the near term. However, we see one-party rule as inherently unsustainable in the longer term and thus accord Vietnam a rating of 52.8 in our long-term political risk ratings, due mainly to a score of 27.6 in the 'characteristics of polity' sub-rating.

	S-T Political	Rank	Trend
Singapore	97.3	1	=
Hong Kong	86.7	2	=
China	83.5	3	=
Taiwan	81.9	4	=
Laos	80.4	5	=
Malaysia	80.2	6	=
South Korea	79.6	7	=
Vietnam	**78.1**	**8**	**=**
Indonesia	74.2	9	=
Sri Lanka	72.3	10	=
India	70.2	11	=
Philippines	67.9	12	=
Thailand	65.4	13	=
Bangladesh	65.0	14	=
Cambodia	62.7	15	=
Pakistan	42.5	16	=

Regional ave 74.2 / Global ave 66.7 / Emerging markets ave 64.0

	L-T Political	Rank	Trend
South Korea	81.2	1	=
Singapore	71.6	2	=
India	70.5	3	=
Taiwan	70.4	4	=
Malaysia	69.2	5	=
Hong Kong	67.9	6	=
China	63.4	7	=
Sri Lanka	59.7	8	=
Philippines	57.0	9	=
Indonesia	55.0	10	=
Thailand	54.8	11	=
Vietnam	**52.8**	**12**	**=**
Cambodia	51.9	13	=
Bangladesh	51.4	14	=
Pakistan	47.9	15	=
Laos	43.5	16	=

Regional ave 60.5 / Global ave 63.2 / Emerging markets ave 59.4

Domestic Politics

Growing Political Influence To Reap Economic Benefits

BMI VIEW

Vietnam looks set to extend its political influence within the Association of Southeast Asian Nations, in line with its growing economic footprint in the region. We believe the Vietnamese government will continue to leverage on its close relationship with neighbouring countries, such as Cambodia and Laos, as a base for Vietnam's political influence in the regional bloc.

We believe Vietnam's political influence within the Association of Southeast Asian Nations (ASEAN) will continue to grow in the coming years, parallel to its ambition to become an economic powerhouse in South East Asia. Since achieving membership of the ASEAN in 1995, the Vietnamese government has managed to successfully anchor the country's political presence. Indeed, Vietnam's role in organising and hosting several important ASEAN events, as well as its influence in ASEAN's decision-making process, clearly demonstrates the country's rising influence. We expect Vietnam to take full advantage of its political position in the region to promote its exports industry.

ASEAN's Growing Demand

As the accompanying chart (*see following page*) shows, the US and EU remain the largest export destinations for Vietnamese exports (as of 2008). The US and EU's share of total Vietnamese exports stood at 18.9% and 17.2% respectively, while ASEAN came in third at 16.3%. We see the Vietnamese government's aim to extend its influence in ASEAN as a strategic move to secure its political position ahead of ASEAN's growing importance for Vietnam's exports. Indeed, looking at historical export figures, ASEAN's potential to overtake the US and EU as the largest export destination for Vietnam is evident. Given that we expect deleveraging in the US and EU to continue and consumption to remain weak going into 2011, we believe South East Asia has the potential to catch up with the US and EU in terms of share of Vietnamese exports.

Leading ASEAN Into 2015

To put Vietnam's growing political influence in perspective, just three years after admission into ASEAN, Vietnam hosted the sixth ASEAN Summit in Hanoi in December 1998. Vietnam then successfully took over the chair of the ASEAN Standing Committee and led other ASEAN members to adopt the Hanoi Statement, which focused on narrowing the development gap at the 34th ASEAN Foreign Ministers' Meeting in July 2001.

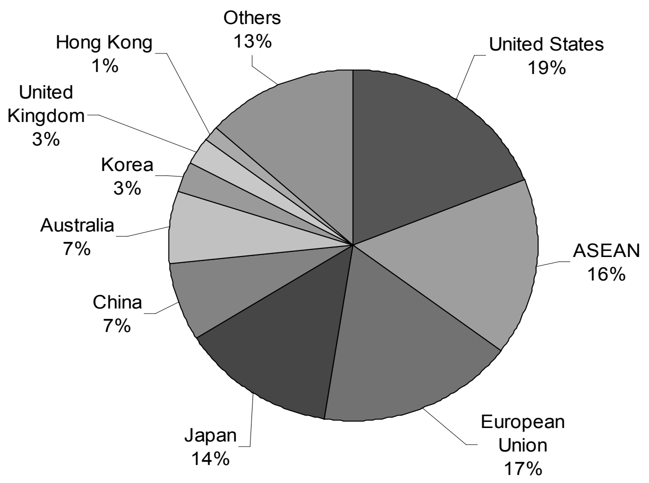
TABLE: VIETNAM POLITICAL OVERVIEW

System of Government	Single-party socialist republic
Head of State	President Nguyen Minh Triet (serving first five-year term)
Head of Government	Prime Minister Nguyen Tan Dung (serving first five-year term)
Last Election	Parliamentary – May 2007
	Communist Party Congress – April 2006
Composition Of Current Government	Communist Party of Vietnam (CPV)
Key Figures	The 14-person Communist Party politburo, elected by the 160-person party central committee at the national party congress, acts as the de facto highest decision-making body and comprises the top leadership of the CPV. Its most important members are: Party General Secretary Nong Duc Manh; State President Nguyen Minh Triet; Prime Minister Nguyen Tan Dung and General Minister of Public Security Le Hong Anh
Other Key Posts	Deputy Prime Minister – Nguyen Sinh Hung; Foreign Minister – Pham Gia Khiem; Minister of Planning and Investment – Vo Hong Phuc; Vice President – Truong My Hoa; Central Bank Governor – Nguyen Van Giau
Main Political Parties (number of seats in parliament)	Communist Party of Vietnam (CPV): Founded in Hong Kong in 1930, the CPV has been in power in North Vietnam since independence in 1954 and in South Vietnam since the end of the American war in 1975. Divisions exist within the party between a younger, more reform-minded faction originating from Southern Vietnam and an older generation, originating from Northern Vietnam and more aligned to traditionally communist ideology.
Next Election	Presidential and parliamentary – May 2012
	CPV Congress – Spring 2011
Ongoing Disputes	Ongoing dispute with China, Malaysia, the Philippines and Taiwan over Spratly Islands in South China Sea
Key Relations/ Treaties	ASEAN and WTO member, temporary seat (2008-2009) on the UN Security Council
BMI Short-Term Political Risk Rating	78.1
BMI Structural Political Risk Rating	52.8

Source: BMI

This year, Vietnam has taken over the chair of ASEAN for the second time, with the aim of coordinating measures to implement an ASEAN Community by 2015. The choice of Vietnam as a host for the 16th ASEAN Summit in Hanoi in April 2010 and the 43rd ASEAN Foreign Ministers' Meeting in July further underlines Vietnam's growing influence in the region.

ASEAN Poised To Dominate
Share Of Total Exports To Selected Countries 2008, %



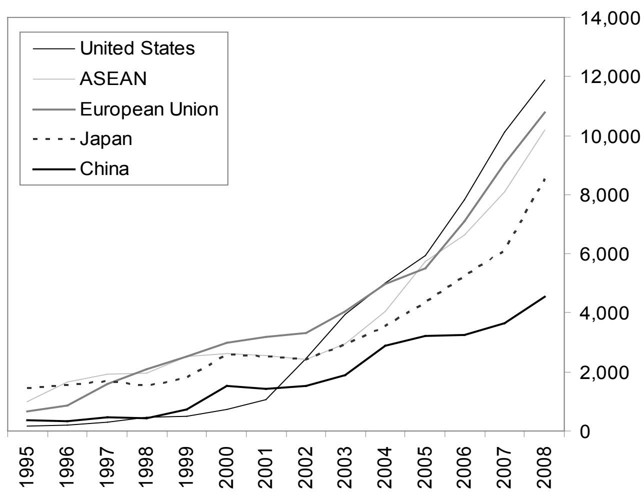
Source: GSO, BMI

Strengthening Relations With Laos and Cambodia

We believe relations between Vietnam and its neighbouring countries, in particular Cambodia and Laos, will continue to play a huge part on the government's agenda to increase Vietnam's political influence within ASEAN. Foreign relations with Cambodia have traditionally been threatened by historical tensions, in particular the invasion of Cambodia by Vietnamese troops in the 1970s. However, since becoming a member of ASEAN, Vietnam has actively promoted the admission of Cambodia and Laos into ASEAN, which has helped to promote closer cooperation between the countries. The government's involvement in providing funding and technical assistance on a range of development projects in Cambodia and Laos reinforces our view that the government may be interested in leveraging its relationship with neighbouring countries as a base for Vietnam's political influence in the coming years.

Cambodian King Norodom Sihamoni and Vietnamese State President Nguyen Minh Triet voiced their enthusiasm towards improving bilateral relations when the two leaders met on June 23, suggesting increased scope for economic cooperation in the coming years. The two countries then went on to sign an agreement on July 23 to establish a new border gate along the Tan Bien district in the Vietnamese south-western province of Tay Ninh and Romeas Haek district in the Cambodian province of Svay Rieng. This is one of the 11 border gates that have been in operation to facilitate the transportation of people and goods, highlighting improving relations and increasing cross-border trade between the countries. At the same time, the Vietnamese government is also driving efforts to strengthen its relationship with Laos. According to local media reports, Vietnam is currently one of the leading foreign investors in Laos, with 219 projects amounting to US$2.4bn worth of investment as of May 2010.

Catching Up With The US And EU
Exports To Selected Countries, US$mn



Source: GSO, BMI

We believe the Vietnamese government will continue to strengthen foreign relations with Laos and Cambodia by assisting in development projects and encouraging economic cooperation between the countries. We are projecting private consumption growth to average 6.1% in Cambodia and real GDP growth to average 6.6% in Laos from 2010 to 2019. However, we see Vietnam's move to improve relations with Cambodia and Laos as not only due to their increasing potential for economic growth, but also because Vietnam is in a perfect position to leverage on its relationship with these countries to boost its own political influence in ASEAN.

Long-Term Political Outlook

Key Political Challenges Over The Coming Decade

BMI VIEW

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

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

Challenges And Threats To Stability

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

Divisions Within the Communist Party: High inflation and devaluation have opened schisms within the CPV leadership between proponents of continued economic reform and a more conservative wing that believes a deceleration or even reversal of reform policies would benefit macroeconomic stability. This debate could come to the fore at the CPV's 11th National Congress in January 2011, which is to evaluate government policy over the past five years and determine policy and targets for 2011-2020.

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

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

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

Relations With China: Relations with China have become increasingly strained in recent years as Beijing has expanded its economic, political and military influence southwards. The main point of contention is the conflicting territorial claims for the Paracel and Spratly Islands in the South China Sea. Vietnam's relations with China have also been strained by the large bilateral trade deficit it runs with its northern neighbour, which amounts to more than 10% of GDP, as well as criticism of 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 served to decrease tension between them. Nonetheless, we believe Vietnam will seek increasingly close relations with the US – and potentially India and Japan – in the defence sphere as a hedge against China's rising power in the region.

Vietnam's long-term political risk rating of 52.8/100 is weighed down by a score of 27.6 in the 'characteristics of polity' sub-component. 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 only the ruling party has a realistic chance of winning them. Looking even further beyond the horizon, the experiences of South Korea, Taiwan and Japan have shown that even dominant-party systems eventually give way to opposition rule. However, in Vietnam's case, this may be more than a decade away.

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

Chapter 2:
Economic Outlook

SWOT Analysis

Strengths

- Vietnam has been one of the fastest-growing economies in Asia in recent years, with GDP growth averaging 7.6% annually between 2000 and 2009.
- The economic boom has lifted many Vietnamese out of poverty, with the official poverty rate in the country falling from 58% in 1993 to 20% in 2004.

Weaknesses

- Vietnam still suffers from substantial trade, current account and fiscal deficits, leaving the economy vulnerable as the global economy continues to suffer in 2010. The fiscal picture is clouded by considerable 'off the books' spending.
- The heavily managed and weak dong currency reduces incentives to improve quality of exports and also serves to keep import costs high, thus contributing to inflationary pressures.

Opportunities

- WTO membership has given Vietnam access to both foreign markets and capital, while making Vietnamese enterprises stronger through increased competition.
- The government will, in spite of the current macroeconomic woes, continue to move forward with market reforms, including privatisation of state-owned enterprises, and liberalising the banking sector.
- Urbanisation will continue to be a long-term growth driver. The UN forecasts the urban population to rise from 29% of the population to more than 50% by the early 2040s.

Threats

- Inflation and deficit concerns have caused some investors to re-assess their hitherto upbeat view of Vietnam. If the government focuses too much on stimulating growth and fails to root out inflationary pressure, it risks prolonging macroeconomic instability, which could lead to a potential crisis.
- Prolonged macroeconomic instability could prompt the authorities to put reforms on hold as they struggle to stabilise the economy.

BMI Economic Risk Ratings

Vietnam's short-term economic risk rating of 44.4 reflects mainly a deterioration of external conditions and the fiscal situation as the government attempts to supplant a sharp reduction in external demand with fiscal stimulus. Vietnam's chronic fiscal and current account deficits also weigh down our long-term economic risk ratings, where the fiscal and external components score 35.0 and 33.3 (out of 100) respectively. However, this is partly offset by a robust score of 75.0 in the growth component, reflecting a strong potential for rapid economic expansion, bringing the overall long-term rating to 53.7.

	S-T Economy	Rank	Trend
China	90.4	1	=
Singapore	83.1	2	+
Taiwan	82.7	3	+
Hong Kong	76.7	4	=
South Korea	73.8	5	=
Malaysia	72.1	6	-
Thailand	69.4	7	=
Indonesia	65.2	8	=
India	61.5	9	-
Philippines	60.6	10	+
Laos	58.1	11	=
Bangladesh	57.7	12	=
Sri Lanka	47.7	13	+
Cambodia	45.0	14	=
Vietnam	**44.4**	**15**	**=**
Pakistan	43.8	16	=

Regional ave 64.5 / Global ave 52.4 / Emerging markets ave 51.1

	L-T Economy	Rank	Trend
Singapore	78.5	1	+
Taiwan	75.7	2	=
China	75.7	3	=
Hong Kong	74.8	4	=
Malaysia	73.8	5	=
South Korea	71.5	6	=
Thailand	67.0	7	=
Bangladesh	64.9	8	=
India	60.9	9	-
Philippines	55.8	10	=
Indonesia	54.4	11	=
Vietnam	**53.7**	**12**	**+**
Sri Lanka	49.4	13	=
Laos	47.9	14	=
Cambodia	46.6	15	=
Pakistan	40.0	16	=

Regional ave 61.9 / Global ave 53.2 / Emerging markets ave 50.9

Economic Activity

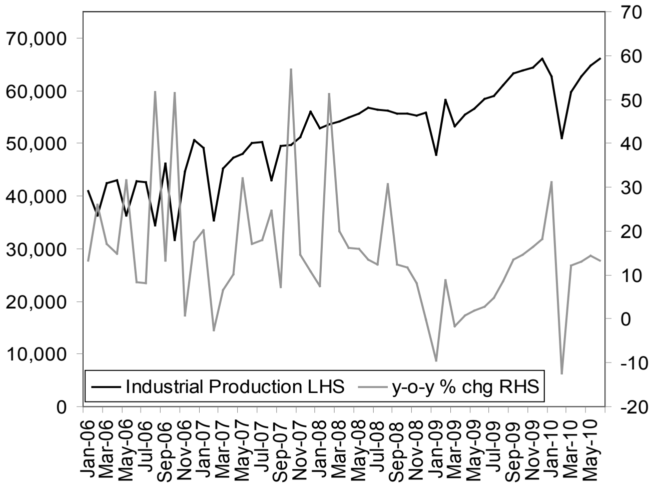
Private Consumption And Infrastructure Investment Cushion External Weakness

BMI VIEW

Economic indicators in July provided an optimistic outlook for Vietnam's growth in H210. We believe private consumption and investment in infrastructure development will continue to be the main drivers of economic growth going forward. However, we see external demand weakness leading to a widening of the trade deficit, which will be a drag on growth. Therefore, we are maintaining our real GDP growth forecast of 6.0% and 5.5% for 2010 and 2011 respectively.

Picking Up The Pace

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

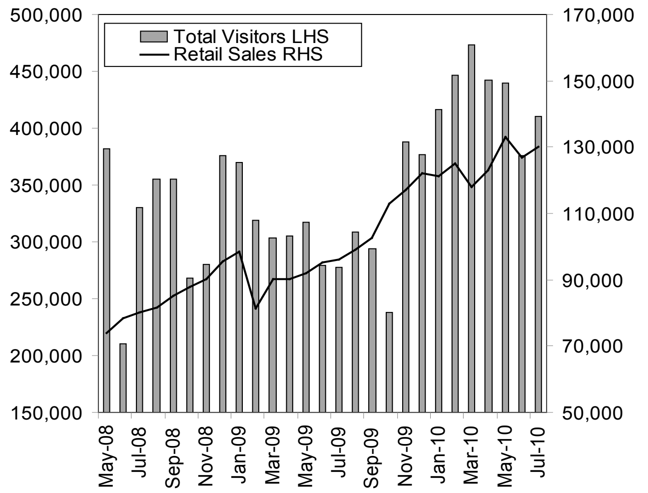


Source: General Statistics Office, BMI

Vietnam recorded an impressive real GDP growth of 6.3% year-on-year (y-o-y) in Q210 as the economy heads towards the government's growth target of 6.5% for 2010. Economic indicators in July also reinforced the government's aggressive target after industrial production came in at a better-than-expected 16.0% y-o-y in July. To a certain extent, the encouraging numbers helped to alleviate concerns that weakening external demand from the US and EU would be a drag on the economy. Industrial production accelerated after slowing down for three consecutive months, falling from 5.0% month-on-month (m-o-m) in April to 3.3% and 2.2% in May and June respectively. This prompted the Vietnamese government and the State Bank Of Vietnam to exert pressure on commercial banks to lower lending rates in June. However, we expect loan growth to remain weak on a historical basis in H210 due to the threat of higher inflation, which forces commercial banks to keep lending rates high at around 12-14%. Therefore, we do not see business investments contributing significantly to industrial production growth going forward. Instead, we see private consumption and government-supported infrastructure investment as the main drivers of economic growth in H210.

Poised For A Strong Bounce

Tourist Arrivals (LHS) & Retail Sales VNDbn (RHS)



Source: General Statistics Office, BMI

Retail Sales And Tourist Arrivals Point To Strong Domestic Demand

Retail sales came in at 35.3% y-o-y in July, reflecting the strong

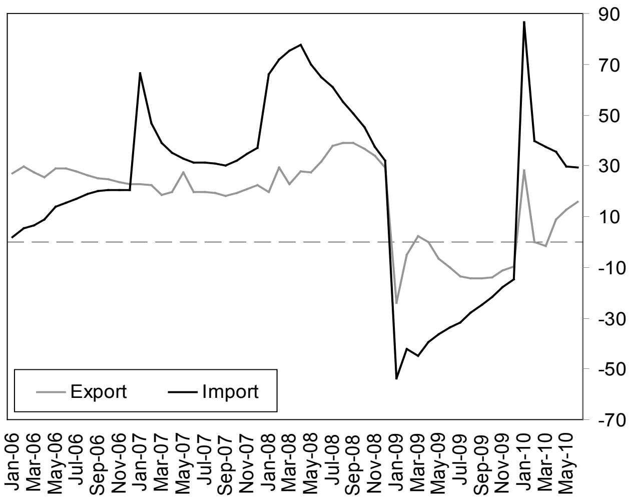
TABLE: ECONOMIC ACTIVITY

	2007	2008	2009e	2010f	2011f	2012f	2013f	2014f
Nominal GDP, VNDbn [2]	1,144,014.6	1,478,695.0	1,645,481.0	1,869,502.9	2,103,348.3	2,344,535.7	2,625,877.9	2,926,496.6
Nominal GDP, US$bn [2]	71.1	89.8	92.4	95.9	107.9	117.2	131.3	146.3
Real GDP growth, % change y-o-y [2]	8.5	6.2	5.3	6.0	5.5	6.0	6.8	6.9
GDP per capita, US$ [2]	835	1,042	1,058	1,085	1,208	1,300	1,442	1,591
Population, mn [3]	85.2	86.2	87.3	88.4	89.3	90.2	91.1	92.0
Industrial production index, % y-o-y, ave [1,4]	16.7	14.6	7.6	10.0	12.0	14.0	14.0	14.0
Unemployment, % of labour force, eop [4]	4.6	5.0	5.5	5.5	5.0	4.5	4.0	4.0

Notes: e/f = BMI estimates/forecasts. 1 At 1994 prices; Sources: 2 IMF (General Statistics Office); 3 World Bank/BMI calculation/BMI; 4 General Statistics Office.

momentum in consumer demand. We see retail sales as a relatively good indicator of consumer demand as private spending makes up 85.8% of the indicator. Given that retail sales tend to accelerate in the second half of the year largely due to the holiday season, we believe private consumption will play a more significant role in providing support for economic growth in H210. We note that the retail sector is heavily dependent on tourist arrivals. As the accompanying chart shows, the correlation between tourist arrivals and private consumption is strong.

A Cause For Concern
Export & Import Growth, % chg y-o-y



Source: General Statistics Office, BMI

Tourist arrivals rose 47.5% y-o-y in July, in line with strengthening retail sales figures. The tourism industry's pace of growth also highlighted the industry's growing potential as a source of economic growth for Vietnam going forward. The government announced in July that it has set a target for Ho Chi Minh City to host 4mn foreign visitors by 2015, raising the tourism industry's revenues from an expected US$2.1bn in 2010 to US$3.15bn by 2015 (*see Investment Climate section*). We believe the government's tax policies aimed at promoting investment in the tourism sector will continue to provide support for the industry's growth in H210.

Infrastructure Development To Support Construction Industry And Jobs Growth

We have previous highlighted that infrastructure projects that are already initiated, such as the construction of a number of ports, roads and thermal power plants, will continue to provide support for the construction sector in H210 and 2011 (*see our online service, July 2, 'Aggressive Government Policies Risk Overheating'*). We believe growth on this front will help to support demand for building materials such as cement and steel, which Vietnam produces domestically, thus having positive spillover effects. Indeed, looking at the breakdown of industrial production data in July, cement production increased by 27.4% y-o-y, while steel production remained stable at 1.5% y-o-y.

External Demand Weakness Supports Our Forecast

In line with our view that strong private consumption will drive domestic demand in H210, we expect the trade deficit to widen in 2010. The construction sector's need to import large quantities of materials and capital goods for ongoing infrastructure projects will also keep imports elevated over the coming month. Furthermore, with Vietnam's exports remaining concentrated on the US and EU, the country's trade deficit looks set to widen significantly based on our view of a slowdown in the US and EU in H210. The widening trade deficit will no doubt be a drag on Vietnam's economic growth in H210. Therefore, we are maintaining our real GDP growth forecast for 2010 at 6.0%, slightly lower than the government's target of 6.5%.

Investment Climate

Infrastructure Development Key To Sustaining Growth

BMI VIEW

We believe that Vietnam's economic growth in the coming years will be heavily dependent on the success of its infrastructure developments, and we are generally bullish on this front. That said, power shortages and congested roads could limit the country's economic growth if investments fail to meet the demanding needs of the country's growing population and expanding businesses going forward. We are projecting real GDP growth to rise from 6.0% in 2010 to 6.9% in 2014.

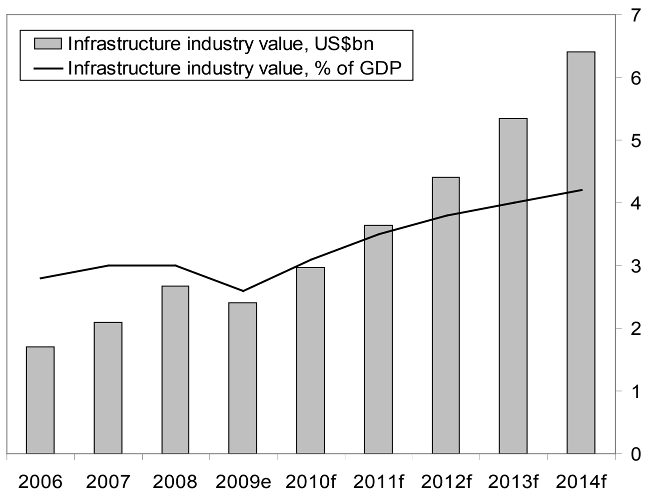
Laying The Foundations For Growth

We are optimistic towards the outlook for Vietnam's economic growth – a view that is supported by the expected completion of major infrastructure projects over the next two to three years, which will provide support for the country's next phase of economic development towards 2016. Progress on the financing aspect of future infrastructure projects has been encouraging, as the Export-Import Bank of the US and the Vietnam Development Bank recently signed a credit deal worth US$500mn in June to boost infrastructure development in Vietnam. We have previously highlighted the positive developments regarding Vietnam's move towards private-public partnership schemes and cooperation with the US over investment opportunities between the two countries (*see our online service, June 15, 'Investors Alert To Infrastructure Opportunities'*). In our view, Vietnam's move towards increasing cooperation with private companies is a positive sign towards reducing the government's fiscal deficit while supporting infrastructure development.

Projects To Get Under Way

The total value of the infrastructure industry is expected to grow steadily over the next few years, rising from an expected US$3.0bn in 2010 to US$6.4bn in 2014 according to our Infrastructure team's forecasts. Vietnam's Ministry of Planning and Investments has released a list of 60 urban infrastructure projects to be implemented before 2016 amounting to US$12bn in investment. The projects range from new water and sanitation infrastructure to new roads and traffic systems, and will take place in 15 provinces around the country. A portion of these projects will be funded by official development assistance (ODA) from Europe, Japan and the Asian Development Bank, while the rest will come from public-private partnerships.

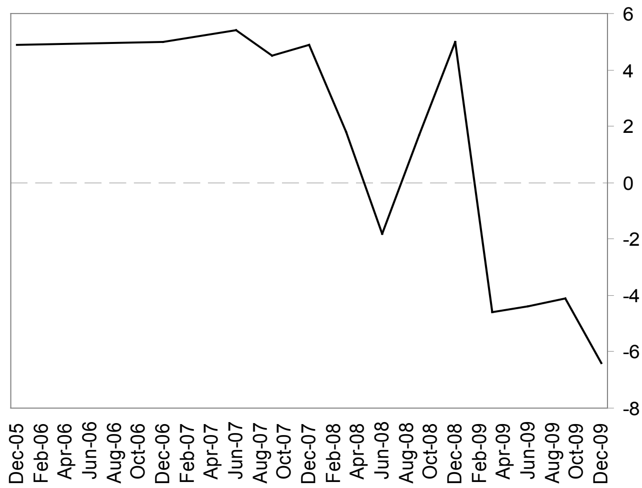
Infrastructure Boom
Infrastructure Industry Forecasts



Source: BMI

Looking forward, the government's announcement of projects including plans to build eight nuclear power plants in the country by 2030 (*see 'Questions Loom Over Ambitious Nuclear Programme', June 24*) suggest that it is keen to take steps to secure energy needs for Vietnam's long-term growth. However, **BMI**'s Power team believes that the nuclear project is overly ambitious, given the fact that Vietnam currently has no operating nuclear capacity and is yet to put in place the appropriate operating environment for developing civilian nuclear operations. Nonetheless, we see this as an encouraging sign that the government is making long-term plans to support Vietnam's economic boom. Furthermore, the Vietnamese National Assembly's decision to reject plans for the construction of a north-south high-speed railway is also a positive move, in our view (*see 'Vietnam National Assembly Rejects High-Speed Rail Proposal', June 22*). The decision to reject the proposal suggests to us that the government remains prudent in the allocation of investment funds. Indeed, the ability of the government to channel resources effectively towards productive investments remains one of **BMI**'s key factors in determining an economy's medium-term prospects. One of the main reasons over our relatively bearish view on China's real GDP growth is that a significant portion of investment in recent years has been concentrated in areas that are likely to yield negative returns.

A Cause For Concern
Fiscal Budget Balance As Proportion Of GDP, %



ADB, Ministry Of Finance

The Government's Agenda Towards 2016

The Communist Party of Vietnam's National Congress, to be held in January 2011, is set to review the country's economic performance over the past five years and set a roadmap for Vietnam's next phase of development towards 2016. We believe the National Congress will mainly focus on the country's goal towards achieving developed country status as well as reducing government debt and establishing free trade agreements to open up markets for the country's exports. Vietnam's spectacular growth in recent years, despite the financial crisis has largely been due to aggressive government spending and policies towards encouraging credit growth. However, this is placing increasing pressure on the government budget balance which, as of September 2009, reached a deficit of 4.1% of real GDP (*see chart above*). As such, we believe the government will increasingly be forced to rely on alternative sources of growth going forward. In fact, we are already witnessing signs that the government is taking steps towards that direction.

Finding Alternative Sources Of Growth

From our standpoint, government policies are increasingly targeted at gradually replacing the economy's dependence on government spending with a more sustainable model of growth, mainly through exports and tourism, which will require substantial infrastructure investment. Indeed, the Vietnamese government announced in July that it has set a target for Ho Chi Minh City to host 4mn foreign visitors by 2015, raising the tourism industry's revenues from an expected US$2.1bn in 2010 to US$3.15bn by 2015. Deputy Chairwoman of the municipal People's Committee, Nguyen Thi Hong, reiterated the government's intentions when she mentioned that tourism is one of the nine service sectors to which the city is giving priority and that the government will speed up tourism infrastructure projects and help local travel companies become more competitive. In our view, infrastructure investments that are currently aimed at improving electricity supply and transport will be key in providing support for these policies.

Risks To Growth Lie To The Downside

We remain optimistic on Vietnam's long-term economic growth, projecting real GDP growth to rise from 6.0% in 2010 to 6.9% in 2014. However, we note that the success of government initiatives to promote alternative sources of growth will be heavily dependent on Vietnam's infrastructure developments over the coming years. Despite witnessing relatively strong real GDP growth of 5.3% in 2009, chronic power shortages and congested roads are evidence that the economy faces risks of overheating as well as operational bottlenecks for businesses. In particular, businesses that are heavily reliant on a stable supply of electricity and smooth logistics may struggle to maintain efficient and stay competitive in the coming years. Most importantly, we are increasingly concerned that the government's failure to make infrastructure investments in time due to its growing debt could greatly limit the economy's potential for growth going forward. We believe infrastructure development in Vietnam remains pertinent in raising the country's productivity and keeping inflationary pressures in check going forward.

Monetary Policy

CPI Risks Remain Despite Downward Revision

BMI VIEW

We are revising our forecast for average consumer price inflation from 10.2% to 8.5% in 2010 following a lower-than expected July reading. However, we reiterate our view that expansionary policies pursued by the Vietnamese government pose risks in the form of overheating and will keep price pressures elevated over the coming quarters.

Figures released by the General Statistics Office Of Vietnam showed that consumer price inflation (CPI) continues to slow. Headline consumer price inflation rose 8.2% y-o-y in July, compared with 8.7% in June and 9.1% in May, largely due to a drop in transport costs. In light of the slowdown in CPI in Q210, we are revising our forecast for average consumer price inflation from 10.2% to 8.5% in 2010. Our new forecast continues to pencil in rising monthly inflation rates, as we expect CPI to pick up in H210 due to the government's expansionary policies aimed at achieving its real GDP growth target of 6.5% for 2010.

Transport Costs May Head Lower

Looking at the individual components of the CPI index, we note that the slowdown in consumer prices in July is mainly due to a significant fall in transport costs following the recent decline in crude oil prices. Brent Crude prices fell 13.9% from US$89.9/

TABLE: MONETARY POLICY

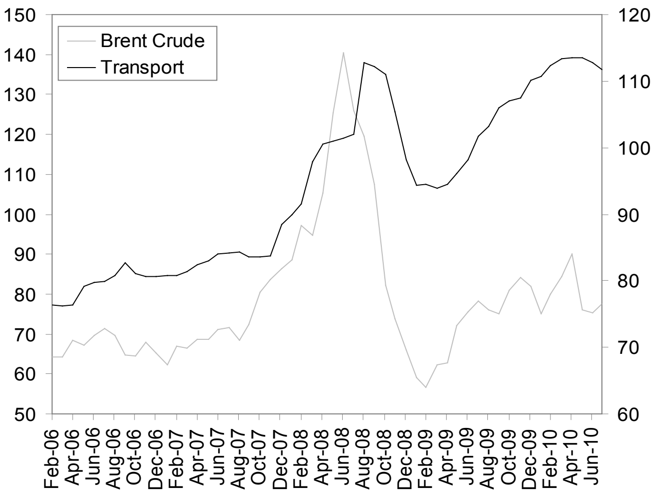
	2007	2008	2009e	2010f	2011f	2012f	2013f	2014f
Consumer prices, % y-o-y, eop [1,3]	12.6	19.9	6.5	12.0	7.2	6.0	6.0	5.0
Consumer prices, % y-o-y, ave [1,3]	8.3	23.0	7.0	8.5	11.5	6.5	6.0	5.5
M2, VNDbn [4]	1,348,200.0	1,939,600.0	2,496,265.0	3,120,332.0	3,838,008.0	4,605,609.0	5,526,731.0	6,632,077.0
M2, % y-o-y [4]	46.1	43.9	28.7	25.0	23.0	20.0	20.0	20.0
Central Bank policy rate, % [5]	8.25	8.50	9.00	10.00	10.00	8.00	8.00	8.00
Lending rate, %, eop [6]	12.0	15.0	9.0	15.0	12.0	12.0	10.0	10.0
Lending rate, %, ave [6]	12.0	15.0	9.0	15.0	12.0	12.0	10.0	10.0
Real lending rate, %, eop [2,7]	-0.6	-4.9	2.5	3.0	4.8	6.0	4.0	5.0
Real lending rate, %, ave [2,7]	3.7	-8.0	2.0	4.8	0.5	5.5	4.0	4.5

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

bbl in April to US$77.4/bbl in July. As the chart below shows, there is a strong correlation between Brent Crude prices and the transport index historically. With the transport index carrying an 8.87% weighting in the headline CPI index, a further decline in crude prices and transport costs could further soften CPI going forward. Our outlook for global demand to weaken in H210 also means that commodity prices could remain depressed over the coming months.

Cheaper Crude Drags Transport Costs Lower

Brent Crude, $US (LHS) & Transport Index (RHS)



GSO, BMI

Inflationary Pressures Remain Elevated

In a previous report, we highlighted our view that the Vietnamese government's expansionary policies and accommodative monetary policy pose risks of overheating and CPI in H210 (*see our online service, July 2, 'Aggressive Government Policies Risk Overheating'*). The government is targeting real GDP growth of 6.5% for 2010 and 7.5% in 2011; we believe its expansionary policies will continue to drive inflationary pressures in H210 and 2011.

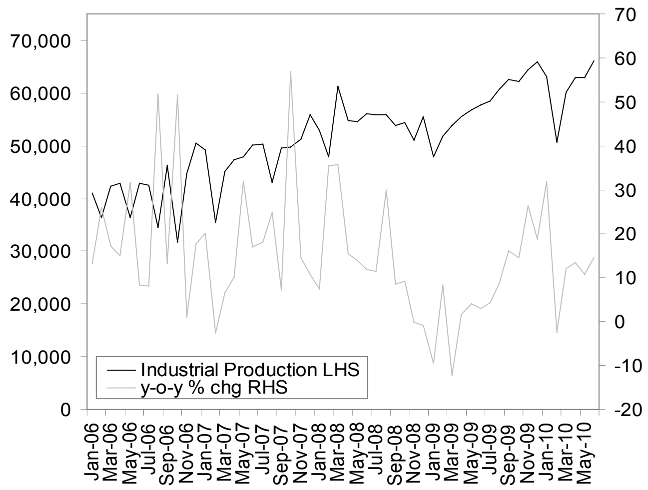
As the chart on the right shows, industrial production rose 14.6% y-o-y in June compared with 10.8% in May, suggesting that capacity utilisation could continue to increase in the coming months. Furthermore, the Vietnamese government has been pressuring commercial banks to lower lending rates from around 14.0% to 12.0% to support economic growth (*see 'Ambitious Growth Target Supports Inflation View', July 16*). We believe this will have a positive impact on industrial production in the coming months. Therefore, our forecast for CPI to average 8.5% in 2010 remains above consensus as we expect CPI to accelerate in H210.

Food Prices May Spike, Forcing Rate Hike

Given Vietnam's history of high inflation, we are worried that the State Bank of Vietnam (SBV) will be forced to hike rates aggressively if prices reverse and begin to tick up again. This was the case back in August 2008 when food prices rose 44.2% y-o-y and CPI rose 28.3% y-o-y. In response, the SBV hiked its policy rate by 525 basis points from 8.75% in May 2008 over the course of two months to 14.0% in June 2008. The fact that the SBV remains in an accommodative stance in spite of inflation remaining above 8.0% underlines the central bank's weak credibility when it comes to inflation targeting. As such, we believe the risk of a sharp pick-up in CPI remains going forward.

Industrial Production Picking Up

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



GSO, BMI

Fiscal Policy

Deficits To Widen Due To Imbalanced Policies

BMI VIEW

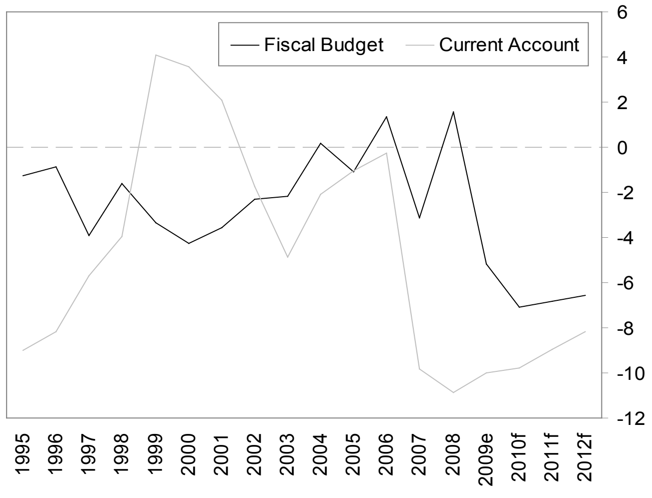
The recent downgrade of Vietnam's foreign currency sovereign debt rating by Fitch chimes with our long-held view that the government's pro-growth policies will lead to persistently wide deficits and deteriorating confidence in the Vietnamese dong. Our sovereign risk rating score for Vietnam comes in at 47.0 (E+), highlighting our view that the country's creditworthiness remains one of the worst in South East Asia.

Vietnam's foreign currency debt rating was downgraded by **Fitch Ratings** from BB- to B+ on July 29, in line with our long-held view that the country's external creditworthiness remains in a weak position due to its sizeable twin deficits. We are projecting the budget deficit to grow from 5.2% of GDP in 2009 to 7.1% of GDP in 2010 and the current account deficit to remain high at 9.8% of GDP in 2010.

Shrinking Foreign Reserves And Twin Deficits

The government's pro-growth policies are likely to come at the expense of higher inflation and persistent budget deficits, in our view. We have already seen a nominal fiscal shortfall worth 3.6% of GDP in Q210. Moreover, while inflation is currently trending downwards, we continue to see upside pressure building in H210 (*see Monetary Policy section*). For these reasons, while the government is targeting real GDP growth of 6.5% in 2010 and 7.5% in 2011, we are more conservative, pencilling in economic expansion of 6.0% and 5.5% this year and next.

Growth At The Expense Of Balooning Deficits
Fiscal Budget Balance, % Of GDP & Current Account Balance, % Of GDP



Source: Ministry Of Finance, BMI

Loose policies will keep pressure on external trade dynamics. Vietnam's trade deficit widened from US$0.8bn in May to US$1.2bn as imports grew while exports remained stable. Imports rose 5.9% m-o-m from US$6.8bn in May to US$7.2bn in June, while exports actually fell 1.7% from US$6.1bn to US$6.0bn in June. We expect import growth in H210 to remain strong due to higher imports of capital goods and materials amid ongoing demand from infrastructure projects. However, we believe weakening global demand in H210 will lead to a slowdown in exports, which means we see the current account deficit remaining high at 9.8% of GDP for 2010.

TABLE: FISCAL POLICY

	2007	2008	2009e	2010f	2011f	2012f	2013f	2014f
Fiscal revenue, VNDbn [2]	315,915.0	434,761.0	442,340.0	493,012.0	558,290.4	632,931.5	718,441.1	816,601.2
Revenue, % of GDP [2]	27.6	29.4	26.9	26.4	26.5	27.0	27.4	27.9
Fiscal expenditure, VNDbn [2]	341,417.0	411,836.0	527,342.0	590,623.0	661,497.8	740,877.5	829,782.8	929,356.8
Expenditure, % of GDP [2]	29.8	27.9	32.0	31.6	31.4	31.6	31.6	31.8
Fiscal expenditure, VNDbn [2]	229,257.0	292,374.0	347,381.0	389,066.7	435,754.7	488,045.3	546,610.7	612,204.0
Current expenditure, % of total expenditure [2]	67.1	71.0	65.9	65.9	65.9	65.9	65.9	65.9
Current expenditure, % of GDP [2]	20.0	19.8	21.1	20.8	20.7	20.8	20.8	20.9
Capital expenditure, VNDbn [2]	112,160.0	119,462.0	179,961.0	201,556.3	225,743.1	252,832.2	283,172.1	317,152.8
Capital expenditure, % of total expenditure [2]	32.9	29.0	34.1	34.1	34.1	34.1	34.1	34.1
Capital expenditure, % of GDP [2]	9.8	8.1	10.9	10.8	10.7	10.8	10.8	10.8
Budget balance, VNDbn [2]	-35,827.0	22,925.0	-85,002.0	-132,611.0	-143,207.4	-153,946.0	-166,341.8	-177,755.5
Budget balance, % of GDP [2]	-3.1	1.6	-5.2	-7.1	-6.8	-6.6	-6.3	-6.1
Primary balance VNDbn [1,2]	-23,167.0	39,655.0	-61,624.0	-103,388.6	-106,679.3	-108,285.9	-109,266.6	-106,411.6
Primary balance % of GDP [1,2]	-2.0	2.7	-3.7	-5.5	-5.1	-4.6	-4.2	-3.6

Notes: e/f = BMI estimates/forecasts. 1 Fiscal balance stripping out interest payments on government debt; Sources: 2 ADB, Ministry of Finance.

The government's pro-growth policies are creating an increasingly unstable economy, which we believe will put further pressure on foreign reserves. Foreign reserves fell to seven weeks of imports in March, according to the IMF. This is after State Bank of Vietnam Deputy Governor Nguyen Van Binh announced reserves of US$16bn in December 2009, which at that time amounted to more than three months' worth of imports. The shrinking reserves are raising risks that the government may face difficulties servicing debt denominated in foreign currencies. As such, we believe this has heightened risks that the government may be forced to devalue the Vietnamese dong for the second time this year.

Given the above factors, Fitch's recent downgrade comes as no surprise to us. Indeed, Vietnam comes in near the foot of our regional sovereign risk rating table (*see our online service, June 16, 'Near-Term Concerns, But Structurally Solid'*) with a score of 47.0. Until we see the authorities pursue a more credible monetary and fiscal strategy, investor concerns are likely to stay elevated.

Chapter 3:
10-Year Forecast

The Vietnamese Economy To 2019

Rebalancing Needed To Maintain High Growth

BMI VIEW

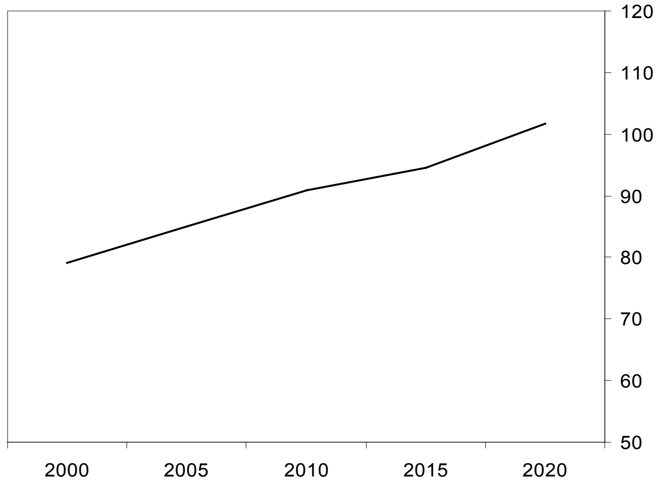
We remain positive about Vietnam's growth prospects over the next 10 years, in spite of the adjustment of our average GDP growth projection over 2013-2019 from 8.0% to 6.9%. This is because we expect a shift in government policy to accommodate the effects of a less conducive global environment and a need to avoid overheating tendencies such as high inflation and a large trade deficit, which have characterised the Vietnamese economy in recent years.

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

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

Vietnam To Enter The 100mn Club

Population



Source: UN World Population Prospects, 2006 Revision

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

TABLE: VIETNAM LONG-TERM MACROECONOMIC FORECASTS

	2012f	2013f	2014f	2015f	2016f	2017f	2018f	2019f
Nominal GDP, US$bn [2]	117.2	131.3	146.3	162.3	180.1	199.9	222.0	246.6
Real GDP growth, % change y-o-y [2]	6.0	6.8	6.9	6.9	7.0	7.0	7.0	7.1
Population, mn [3]	90.2	91.1	92.0	92.8	93.7	94.6	95.4	96.3
GDP per capita, US$ [2]	1,300	1,442	1,591	1,749	1,922	2,114	2,326	2,561
Consumer prices, % y-o-y, ave [1,4]	6.5	6.0	5.5	5.0	5.0	5.0	5.0	5.0
Current account, % of GDP [5]	-8.2	-6.9	-5.6	-4.4	-3.1	-1.9	-0.7	0.5
Exchange rate VND/US$, ave [6]	19,750.00	19,250.00	18,750.00	18,250.00	17,750.00	17,250.00	16,750.00	16,250.00

Notes: f = BMI forecasts. 1 Base year 2000; Sources: 2 IMF (General Statistics Office); 3 World Bank/BMI calculation/BMI; 4 General Statistics Office; 5 Asian Development Bank, State Bank of Vietnam; 6 BMI.

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

Indeed, the near-exclusive focus of the government on meeting highly set growth targets through accommodative fiscal and monetary policy has led to serious macroeconomic imbalances in the form of high inflation and ballooning trade and fiscal deficits over 2007-2009. We believe steps will be taken at the 11th National Congress of the CPV in January 2011 to adjust government policy over 2011-2016 towards achieving more sustainable growth, by allowing checks on overheating tendencies such as currency appreciation and inflation-targeting monetary policy. This would inevitably come at the cost of lower growth in the medium term and we expect the government to start targeting annual real GDP growth of 7.0-7.5% over 2011-2016, instead of 8.0-8.5% as previously.

We do not foresee this constituting a turning point in the Vietnamese growth story – merely adjusting growth rates to lower, more sustainable trajectories. The main effect will be to decrease the share of net exports from a massive -16.5% of GDP (in nominal terms) in 2008 towards -11.8% in 2013 and -5.7% in 2019 as export growth starts outpacing import growth after private consumption and fixed gross capital formation settle at more sustainable levels. A decreasing trade deficit combined with continued growth – albeit at a slower pace – of remittances and foreign direct investment should mean that upside pressure on the dong should resume once the government has tightened its fiscal and monetary policy to curb the stimulus-driven increase in domestic demand in 2009. We thus expect the dong to start to appreciate beyond the initial depreciation that will be necessary in 2010. We are currently envisaging a 2.6% depreciation in 2011, to be followed by an average 2.8% appreciation over 2012-2019.

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

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

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

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

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

Chapter 4:
Business Environment

SWOT Analysis

Strengths

- Vietnam has a large, skilled and low-cost workforce, which has made the country attractive to foreign investors.
- Vietnam's location – its proximity to China and South East Asia as well as its good sea links – makes it a good base for foreign companies to export to the rest of Asia and beyond.

Weaknesses

- Vietnam's infrastructure is still weak. Roads, railways and ports are inadequate to cope with the country's economic growth and links with the outside world.
- Vietnam remains one of the world's most corrupt countries. Its score in Transparency International's 2009 Corruption Perceptions Index was 2.7, placing it in 22nd place in the Asia Pacific region.

Opportunities

- Vietnam is increasingly attracting investment from key Asian economies such as Japan, South Korea and Taiwan. This offers the possibility of the transfer of high-tech skills and know-how.
- Vietnam is pressing ahead with the privatisation of state-owned enterprises and the liberalisation of the banking sector. This should offer foreign investors new entry points.

Threats

- Ongoing trade disputes with the US and the general threat of American protectionism, which will remain a concern.
- Labour unrest remains a lingering threat. A failure by the authorities to boost skills levels could leave Vietnam a second-rate economy for an indefinite period.

BMI Business Environment Risk Ratings

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

	Business Environment	Rank	Trend
Singapore	80.8	1	=
Hong Kong	78.6	2	-
Malaysia	63.4	3	=
Taiwan	62.7	4	=
Thailand	62.2	5	=
South Korea	60.6	6	=
China	51.8	7	=
Philippines	49.9	8	=
Vietnam	**45.2**	**9**	**=**
India	44.1	10	=
Sri Lanka	42.7	11	=
Indonesia	40.2	12	=
Pakistan	36.7	13	=
Cambodia	35.5	14	=
Bangladesh	30.9	15	-
Laos	26.4	16	=

Regional ave 50.8/ Global ave 46.6 / Emerging markets ave 42.0

Business Environment Outlook

Introduction

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

Latest Developments

- Vietnam's Ministry of Information and Communications has approved a proposal by the country's mobile operators to cut tariffs by up to 15%, reports VietNamNet Bridge. The country's three leading telecoms operators – **Viettel**, **MobiFone** and **Vinaphone** – proposed in early July that cutting charges by up to 20% could result in the reduction of average call cost from VND1,200 (US$0.06) to VND960 (US$0.05) per minute. The approval is likely to help mobile operators expand their subscriber base. **BMI** estimated that mobile subscribers in Vietnam amounted to 110.80mn in 2009 and anticipates this number to grow by an impressive 147.6% by 2014 to 274.37mn.

- Kuwait-based logistics company **Agility** has relocated its operations to a new modern facility in Ho Chi Minh City, which is located near the Tan Son Nhat International Airport. The new office will cover an area of 550m² and will serve as the company's headquarters for Vietnam and Indochina operations. The logistics company currently operates three offices in Vietnam – Danang, Hanoi and Vung Tau – with a staff of more than 120. It can be seen as part of the company's strategy to enhance its presence in rapidly growing emerging markets in South East Asia.

- Japanese automaker **Honda Motor** will invest around US$70mn to boost motorcycle production in Vietnam to 2mn units per annum by H211, from a current annual capacity of 1.5mn units. It is planning to double capacity at one of its two motorcycle plants in Vietnam to cater

TABLE: BMI BUSINESS AND OPERATION RISK RATINGS

	Infrastructure Rating	Institutions Rating	Market Orientation Rating	Business Environment
Afghanistan	26.6	24.7	20.5	23.9
Australia	75.0	78.2	70.1	74.4
Bangladesh	41.6	21.8	29.3	30.9
Bhutan	23.0	48.5	24.4	32.0
Cambodia	31.4	24.2	50.9	35.5
China	56.3	52.4	46.6	51.8
Hong Kong	70.0	80.7	85.2	78.6
India	47.4	42.0	42.9	44.1
Indonesia	37.1	31.2	52.3	40.2
Japan	78.3	80.1	55.9	71.4
Laos	36.8	22.6	19.8	26.4
Malaysia	55.3	66.9	67.9	63.4
Maldives	40.3	52.5	30.7	41.2
Nepal	28.1	32.6	23.2	27.9
New Zealand	77.4	91.0	77.1	81.8
Pakistan	35.5	32.9	41.7	36.7
Philippines	50.7	39.0	60.0	49.9
Singapore	79.1	83.9	79.4	80.8
South Korea	71.2	52.7	53.5	60.6
Sri Lanka	45.7	42.6	40.0	42.7
Taiwan	60.6	67.0	60.4	62.7
Thailand	59.5	59.3	67.8	62.2
Vietnam	**47.8**	**36.7**	**51.0**	**45.2**

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

to the rising demand in the country. The world's fourth largest market for two-wheelers behind China, India and Indonesia, Vietnam boasts 3mn worth of unit sales that are largely Japanese-branded. The company believes that there is potential in Vietnam where, despite the market's size, ownership is relatively low at one in four people.

- **Damco**, the logistics division of Denmark-based shipping group **AP Moller Maersk**, has launched a cross-border trucking service that the company believes will allow it to capture a share of growing trilateral trade volumes between Vietnam, Cambodia and Laos by providing a faster and more cost-efficient alternative to existing sea and air freight services. **BMI** believes that intra-Asian trade will become a progressively more important source of revenue for international freight transport operators over the next few years. Between 2000 and 2008, trilateral trade between the three countries increased by an average of 25% y-o-y, totalling US$10.03bn in 2008.

- The UK's **Technostar Management** and Russia's **Telloil** are to begin construction of the Vung Ro oil refinery in Phu Yen province in June. The project is expected to take three years to complete. The developers plan to raise the Vung Ro refinery's capacity to 6mn tonnes per year from the 4mn tonnes that was originally envisaged, which has raised the investment requirement from US$1.7bn to nearly US$3bn. The refinery, Vietnam's first wholly foreign-invested oil refinery project, will produce liquefied petroleum gas, jet fuel, gasoline, diesel, polypropylene, benzene and sulphur.

Institutions

Legal Framework

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

Most of the legal documents in force relating to business were issued in the early 1990s under market-led reform programmes. However, Vietnam rewrote almost all of its laws and regulations

TABLE: BMI LEGAL FRAMEWORK RATING

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

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

affecting commercial activity and judicial procedures between 2002-2006. Despite some progress in protecting intellectual property rights (IPRs), the overall legal system in Vietnam is regarded as excessively cumbersome.

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

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

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

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

Property Rights

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

Intellectual Property Rights

The enforcement of IPRs is wholly inadequate, with widespread pirating of products, particularly software, music and videos. The requirements of WTO accession mean that the government will have to beef up IPR protection substantially. In July 2006, a new Intellectual Property Law came into effect, designed to clarify the responsibility of government agencies charged with protecting IPRs, though doubts remain over the effectiveness of its implementation. The police service is generally slow to act on administrative orders where trademarks have been infringed. Often violators will seek to extract a payoff in compensation for ceasing the infringement. The US State Department has, therefore, despite improvements in the enforcement of IPRs in 2008, kept Vietnam on its 2009 Special 301 Report watch-list of countries with inadequate protection of IPRs.

Corruption

Investors see official corruption as one of the biggest hindrances to running a business in Vietnam. Joint ventures with state-owned enterprises are particularly prone to corruption and abuse, though surveys indicate that, while corruption affecting businesses is quite prevalent, the amounts involved are usually quite small. However, rapid economic growth provides opportunities for graft to grow more quickly than government systems evolve. Vietnam scored 2.7 out of 10 in Transparency International's 2009 Corruption Perceptions Index, placing it in joint 120th place among the 180 countries surveyed, alongside Armenia, Bolivia, Ethiopia, Kazakhstan and Mongolia.

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

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

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

The burden of red tape is amplified by the overlapping of government approvals. Vietnam ranks poorly in the length of time it takes to close a business. It can take about five years to close a business, compared with an average of 3.4 years in east Asia and Pacific, and 1.5 years in Organisation for Economic Co-operation and Development states.

Infrastructure

Physical Infrastructure

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

As an example of progress already made, more than 90% of rural households now have electricity, compared with just over 50% 10 years ago. Rapid industrialisation of the economy has, however, seen power demand increase by 15-17% per year, outpacing the expansion of capacity. Vietnam is estimated to have produced 69.7bn kilowatt hours of electricity in the first

TABLE: LABOUR FORCE QUALITY

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

Source: BMI/World Bank/ILO. Labour Market Rigidity score from Ease of Doing Business report, 1 = highest score

10 months of 2009, up 12.3% from a year earlier, according to the General Statistics Office. It has been estimated that Vietnam needs to build 124 new power plants during 2006-2010, adding a total capacity of roughly 36,000 megawatts, to satisfy demand. Several ongoing construction projects of power plants have been hit by delays – due to slow land clearance, delayed equipment supplies and poor contractor performance – and power blackouts and brownouts are therefore likely to remain a problem. Our techological infrastructure rating for Vietnam stands at 25.0, placing Vietnam in 85th place in our rankings.

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

Labour Force

Vietnam's large, well educated and inexpensive labour force remains one of the country's chief attractions to foreign investors. The labour pool is increasing by up to 1.5mn a year, while wage costs are still low compared with other countries in the region, although wage growth has picked up pace in recent years. The General Statistics Office estimated the number of employed at 45.0mn in 2008. The unemployment rate is expected to remain at 5-6% in 2010.

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

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

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

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

One of the main regulatory burdens is the social protection system, which imposes a compulsory social insurance contribution scheme in which employers must pay in 15% of the salary, with employees proving 5%. Regulations for hiring workers are significantly more onerous than the east Asia and Pacific average. Whereas the hiring cost is 17% of the salary in Vietnam, it is only 5% in Thailand, for example. The imposition of the Chinese Labour Contract Law on January 1 2008 has, however, made many foreign companies view Vietnamese labour market regulation more favourably. Employers are required by law to establish labour unions within six months of setting up, and these must be members of the Vietnam General Confederation of Labour. While most factories have trade unions, many of these do not operate in practice. Trade unions are more active in the public sector, and only one-third of foreign companies have collective agreements with their workforces.

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

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

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

Market Orientation

Foreign Investment Policy

Increased FDI is an integral part of Vietnam's ambitious economic expansion plans and, with ratings agencies pushing their grades higher, the country looks like a solid investment destination, especially for manufacturing. FDI pledges amounted to US$5.6bn in the year to April 20 2010, down 25.7% compared with the same period in 2009. Actual FDI disbursements were estimated at US$4.6bn in the same period.

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

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

The government has been introducing and amending legislation

TABLE: ASIA, ANNUAL FDI INFLOWS

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

Source: UNCTAD, BMI.

in an effort to remedy these perceived shortcomings.

Key legislation includes:

- The Law on Foreign Investment (1989), which has been amended several times to make FDI more attractive.
- Government decree 24 of 2000, which carries a pledge to avoid expropriation, and guarantees the right to repatriate profits. It also outlines the government's intention to treat private and state sectors equally.
- A revised bankruptcy law and a Law on Competition, both passed by the National Assembly in 2004, in a bid to improve the FDI climate. Fully owned foreign banks are now allowed to compete on an equal footing with domestic banks.

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

The main forms of foreign investment are:

- Joint venture agreements, under which foreign and domestic firms share capital and profits.
- Business cooperation contracts, which allow a foreign company to carry out business in cooperation with a Vietnamese firm through capital investment and revenue sharing, but without gaining right of establishment or ownership.
- Wholly foreign-owned enterprises are becoming more common, especially those involving industrial production for export.
- Build-operate-transfer (BOT) agreements are the least common form of FDI and have a reputation among foreign investors of causing regulatory and financing problems.

Foreign portfolio investment is permitted only in small quantities, with aggregate foreign ownership of listed companies capped at 49%. Foreign ownership of banks is capped at 10% per investor,

TABLE: TRADE AND INVESTMENT RATINGS

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

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

and 30% in aggregate. Moreover, many of the shares listed on the Ho Chi Minh City Stock Exchange are too illiquid to attract foreign investors. Investments in export processing zones (EPZs), industrial zones (IZs) and high-technology zones attract tax and other incentives, and offer a ready-made operational infrastructure that may be difficult to arrange outside.

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

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

Foreign Trade Regime

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

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

The Vietnam-Japan Economic Partnership Agreement (VJEPA) came into effect on July 1 2009 and has already aided an increase in garment exports to Japan. Moreover, the completion of a fee trade agreement (FTA) with the EU should help to strengthen Vietnam's share in European markets. The Swedish government has, according to Swedish Ambassador to Hanoi Rolf Bergman, set up an FTA with Vietnam as one of its top three priorities during its presidency of the EU in H209, with the negotiation process expected to be completed by October 2010.

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

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

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

The legislation providing the framework for the trade regime is 1998's Law to Amend the Import and Export Tariffs Law. However, given the ASEAN and WTO requirements, the tariff

TABLE: VIETNAM TOP EXPORT DESTINATIONS

	2001	2002	2003	2004	2005	2006	2007	2008
Exports To World	15,025.10	16,707.30	20,144.90	26,485.00	32,447.10	39,826.20	48,561.40	60,816.00
Exports To United States	1,065.65	2,453.15	3,939.56	5,024.80	5,924.00	7,845.10	10,089.10	12,594.10
Exports To Japan	2,509.80	2,436.96	2,908.60	3,542.10	4,340.30	5,240.10	6,069.80	8,264.30
Exports To Australia	1,041.80	1,328.33	1,420.86	1,884.70	2,722.80	3,744.70	3,556.90	4,466.29
Exports To China,P.R.: Mainland	1,417.42	1,518.33	1,883.12	2,899.10	3,228.10	3,242.80	3,356.70	4,174.25
Exports To Germany	721.8	729.03	854.71	1,064.70	1,085.50	1,445.30	1,855.10	2,714.70
Sum of Top 5	6,756.47	8,465.80	11,006.85	14,415.40	17,300.70	21,518.00	24,927.60	32,213.64
% of Top 5	44.97	50.67	54.64	54.43	53.32	54.03	51.33	52.97

Source: IMF, Direction of Trade Statistics.

structure is in a constant state of flux. To reduce the rising costs of a range of products, Vietnam in October 2007 cut import tariffs by between 30% and 60% on many food and dairy products.

Tax Regime

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

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

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

Indirect Tax: Main VAT rate is 10%. A 5% rate is charged on some goods, including computers and accessories, construction, machinery, chemicals, coal and metallurgy products. The following attract a zero VAT rate: exported goods and software as well as services exported to firms in export processing zones. Registration is obligatory for businesses. VAT taxation is also subject to an ongoing revision by the National Assembly.

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

Operational Risk

Security Risk

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

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

Chapter 5:

Key Sectors

Telecommunications

Executive Summary

BMI's latest update on the telecommunications market in Vietnam announces the introduction of greater competition to the mobile and 3G sectors, as well as the fixed-line sector. The announcement of a ninth operator, **Vietnam Multimedia Corporation** (VTC) in June 2010, to the mobile sector by the Ministry of Information and Communications (MIC) is aimed at driving network expansions further into rural areas, where the provision of services is limited. VTC, which has been awarded a mobile virtual network operator (MVNO) licence, is to utilise the network of **EVN Telecom** to launch services by the end of 2010.

EVN Telecom commercially deployed its 3G services in June 2010, becoming the final operator to do so since licences were awarded in 2009. The operator is targeting the deployment of its service in Hanoi, Ho Chi Minh City, Hai Phong, Da Nang and Can Tho in its first phase. EVN Telecom has so far invested VND2trn (US$104mn) in the installation of around 2,500 base transceiver stations (BTS) in 63 provinces and cities nationwide, covering 46% of the country's population. Under the second phase, the company plans to install more than 5,000 BTS by the end of the year. EVN Telecom is hoping to sign up 1mn 3G subscribers within one year of launch. Furthermore, the launch of EVN Telecom's 3G service means that VTC may also launch 3G services.

In addition, the fixed-line sector announced the entrance of a ninth operator. Mobile operator **GTel** was award a fixed-line licence by the MIC. We believe that the operator could be eyeing the growing fixed-wireless market, as well as the provision of bundled services to grow both its subscriber base and market share. The operator is not the only one to cross over into another sector, with MVNO operator **Indochina Telecom** announcing in May 2010, it had been granted a permit to trial WiMAX technology by the MIC, according to VietNamNet Bridge. The company joins nine others – mostly mobile network operators – in being authorised to test the 4G mobile broadband technology, which **BMI** believes will help boost broadband service availability across the country.

The growing level of competition in the sector has also led to growing maturity across the telecoms market, which saw its score for telecoms market increase in the quarter. This was responsible for improving Vietnam's position in the Asia Pacific Telecoms Business Environment Ratings table. The country rose one spot from 16 th to 15 th , placing it slightly ahead of Bangladesh but behind Cambodia and Laos.

Industry Forecast

Internet: The latest data published by the Vietnam Internet Network Information Center (VNNIC) suggest that the total number of internet users rose by 9.3% in 2009 to reach 22.78mn. This was down from the 12.3% y-o-y rise in 2008.

We do not necessarily take slowing growth as a sign that the potential for new growth is waning. Instead, we believe that the current trend reflects two phenomena. On the one hand, internet user growth to date has been largely confined to urban centres. In major cities and town, the internet user penetration rate is already relatively high. On the other hand, penetration levels remain very low in rural parts of the country. This means that the ability to sustain higher growth rates in the future, will depend on the pace of internet infrastructure development in rural parts of the country.

We continue to predict that internet user growth will slow in each consecutive year of our forecast. Nevertheless, the rate of decline will be gradual. By the end of our five-year forecast, we now anticipate a market of just over 30mn internet users; this would be the equivalent to around 32.1% of the population.

Meanwhile, we have also retained our expectations for broadband subscriber growth going forward. VNNIC data indicate that the number of broadband subscribers rose by 44.8% in 2009, to reach 2.967mn. In 2008, Vietnam's broadband subscriber base expanded by 58%. We continue to predict a relatively robust broadband subscriber growth over the next five years. We expect the growth rate to average at around 37.6% per year.

By the end of 2010, we envisage a market of around 4.420mn broadband subscribers, equivalent to a penetration rate of 5%. By the end of our forecast in 2014, we now predict just over 14.5mn broadband customers and a penetration rate of around 15.4%. The strong broadband growth in the latter years of our forecast will be supported by a number of developments, including the considerable investment which is currently occurring in the broadband sector, largely relating to mobile broadband. Growth will also reflect the increased market competition, as well as the availability of new WiMAX-based services.

Fixed Line: With no new data available for the fixed-line market since the General Statistic Office reported a total of 19.7mn, we have retained our current forecasts. In the first quarter, the market continued to expand, up by 3.7% from the end of 2009, when there were 19mn fixed-lines.

BMI believes that much of the new fixed-line growth has been driven by the expansion of fixed-wireless services that are offered by incumbent operator **VNPT** and by military-backed **Viettel**. Over the next five years, we expect investment in CDMA-based fixed-line services to continue, especially in rural parts of the country where there is considerable room for fixed-line infrastructure development. Although the proliferation of fixed-wireless services in rural districts is likely to result in a slight loss of market share for VNPT, we expect the incumbent operator to generally retain its dominance within the market.

Our five-year fixed-line forecast remains unchanged for Vietnam and sees growth of close to 20% during 2010 as whole. We estimate that, by the end of the year, the number of Vietnamese fixed-line connections will have risen to close to 23mn; the equivalent to a penetration rate of 25.5%. Long term, however, we continue to envisage a slowing rate of growth over the next five years. Although fixed-wireless services will continue to be rolled out in rural parts of the country, they will have to compete with mobile services. An increase in mobile substitution, together with the proliferation of VoIP services in the latter years of our forecast, will result in much weaker demand for fixed-line services.

Mobile: The latest figures are for March 2010, with a total of 117.9mn, representing an increase of 6.4% since 2009, when there were 110.8mn subscribers. Despite penetration rates in excess of 125%, the market continues to expand as a result of aggressive price competition and the expansion of operators' networks to rural areas. While there are seven active mobile operators in the market, a further two are expected to launch commercial services either during 2010 or 2011. This should bring greater price competition to the sector thereby encouraging further take-up of services. Already, as a result, this has led to multiple SIM ownership, which accounts for the high penetration rates in the country.

The MIC is seeking to remove inactive subscribers clogging up much-needed spectrum on networks and also free up prefix numbers; however, earlier attempts in 2009 and early 2010 have resulted in failure. The regulator has not indicated whether it will try and enforce the regulation once more.

BMI has retained its mobile forecast for the end of 2010, to reach 164.7mn. This would represent a penetration rate of 185%, and by the end of our forecast in 2014, we estimate will rise further to 292%.

Meanwhile, figures for 3G market conflict between operators and the regulator. According to Viettel, which claimed around 1.5mn subscribers, around 95% of the population do not have a 3G mobile handset, while access to 3G USB modems over laptops also remains low. In addition to this, prices for 3G remain

TABLE: TELECOMS SECTOR – INTERNET – HISTORICAL DATA AND FORECASTS

	2007	2008	2009	2010f	2011f	2012f	2013f	2014f
No. of internet users ('000)	18,551	20,834	22,780	24,352	25,753	27,109	28,546	30,157
No. of internet users/100 inhabitants	21.7	24.0	25.9	27.3	28.5	29.6	30.7	32.1
No. of broadband internet subscribers ('000)	1,294	2,049	2,967	4,420	6,415	8,748	11,450	14,509
No. of broadband internet subscribers/100 inhabitants	1.5	2.4	3.4	5.0	7.1	9.5	12.3	15.4

f = forecast. Source: VNNIC, BMI

TABLE: TELECOMS SECTOR – FIXED-LINE – HISTORICAL DATA AND FORECASTS

	2007	2008	2009	2010f	2011f	2012f	2013f	2014f
No. of main telephone lines in service ('000)	11,440	13,180	19,001	22,719	24,756	26,416	27,338	27,689
No. of main telephone lines/100 inhabitants	13.4	15.2	21.6	25.5	27.4	28.8	29.4	29.5

f = forecast. Source: International Telecommunication Union (ITU), BMI high, which act as a further prevention toward the take-up of 3G services. This makes believing that operators could already have 3G bases of over 7mn difficult to believe.

The last 3G licensed operator, EVN Telecom has now launched services, and the operator is aiming for around 1mn subscribers. This should bring much needed competition to the marketplace, while all four operators have said they will invest a total of VND33trn into network expansion over the three years ended 2012. Given the limited availability of data, **BMI** has retained its current forecast until figures are made available. We anticipate that the market will achieve 23,000 3G subscribers at the end of the year, representing 14% of the total market, and that as of 2014, it will account for 26.6%.

ARPU: Forecasting the average revenue per user (ARPU) is difficult as a result of the limited amount of historical data published by Vietnam's mobile operators and its state-owned news media. We have calculated the ARPU, which is expressed in US dollars, as a market average for the sector as a whole.

BMI estimates that blended ARPUs reached US$5.52 as of 2009, representing a decline of 8% in the year, and only slightly higher than in the previous year, which fell by 7.7%. Mobile ARPU reached US$6 in 2008, compared to US$6.5 in 2007 and US$7 in 2006.

The decline in ARPU relates to a dominant prepaid market, while the economic downturn has also contributed to a negative downturn in blended ARPUs. Furthermore, intense competition among the operators has led to the introduction of price plan cuts also impacting ARPUs.

We envisage that Vietnam's average blended ARPU will fall by 9.4% in 2010 and by 10.2% in 2011. By the end of 2014, we predict that Vietnam's average blended ARPU will have fallen to around US$3.6. The rate of decline which is expected to affect the country's mobile ARPU over the next five years would not be as high if the sector was not so dependent on prepaid customers, and if there were clearer signs of strong growth in demand for mobile data services.

Shipping

Executive Summary

In the second half of 2010, there were further signs of catch-up investment in Vietnam's ports. In June, a contract was signed between the **Gemalink Joint Stock Company** and the Republic of Korea alliance **Dealim-SAMWHA** to develop the Gemalink Cai Mep Container Terminal. Based in the southern Ba Ria-Vung Tau province, the Cai Mep area is the loading location for around 70% of Vietnam's container volume. Work on the terminal was scheduled to start in August, with phase one of operations scheduled to start in 2013. The facility will have an annual capacity of 1.2mn 20-foot equivalent units (TEUs). Phase two is scheduled for completion in 2014 and will double the terminal's capacity to 2.4mn TEUs. The Gemalink Cai Mep Container Terminal is part of a much larger investment programme in Vietnam's ports. A US$4.5bn government investment plan has been confirmed, and this has been followed by foreign companies, such as the Gemalink Joint Stock Company and Dealim-SAMWHA, looking to get a foothold in the country.

In October 2009, Japan's largest shipping company, **Mitsui OSK Line** (MOL), announced that it planned to set up a terminal operation company to build and manage a new container terminal at Cai Mep. **BMI** believes that expanding the county's port infrastructure has become necessary as there has been a huge growth in Vietnamese exports to the West. It is worth noting, however, that Vietnam has some way to go in developing its ports if it is to move away from being a country chiefly served by feeder services. Vietnam is ranked some way behind its neighbours in both the World Economic Forum's Global Competitiveness Report 2009-2010, where it is ranked 99th out of 133 countries in terms of its ports infrastructure, and in the World Bank's Logistics Performance Index, where it comes in 53rd place, while its neighbours Singapore and Malaysia are placed second and 29th respectively.

The local ports and shipping industry is set to benefit from economic growth. **BMI** believes that in the run-up to the National Congress of the Communist Party of Vietnam, due to be held in January 2011, the authorities will be particularly concerned to keep the economy and foreign trade growing. With evidence of a consumer boom emerging, we recently boosted our GDP growth forecast for this year to 6.0% (up from 4.4% earlier). Over the next five years, we are predicting that growth will come out at a vigorous annual average of 6.2%.

BMI is projecting an increase in volume at the Port of Ho Chi Minh City (also known as SNP, Saigon New Port), up by 6.2%, after the 5.2% contraction during the slump last year. At Da Nang Port (DNP) we see this year's volume gaining by 2.3%. Container throughput will also be in positive territory at both ports, up by 3.5% at SNP, and by 6.2% at DNP (where container volumes are much smaller).

In real terms, Vietnam's total trade (imports + exports) fell by 14.5% last year, reflecting the impact of the global recession. **BMI** is predicting a recovery this year with 5.4% growth, followed by a slightly stronger pick-up in 2011, with 6.2% growth. Over the next five years, we calculate that total foreign trade will expand at an annual average rate of 6.5%, just ahead of the growth of the economy as a whole (+6.2%). Over this period, exports will grow at an average per annum rate of 7.3%, ahead of imports at 5.9%. We expect Vietnam to continue to run a balance of trade deficit throughout our five-year forecast period running to 2014.

There are a range of downside risks to our shipping and port forecasts. Overheating is one of them, with the possibility of the trade deficit and inflation both rising too sharply and then having to face a sharp correction. However, for the moment strong inflows of foreign direct investment are helping as a counterweight on the foreign payments front, and also playing a role in improving the country's stretched infrastructure. Power shortages are another related risk. On the political front, the government may find itself hard pressed to calm nationalist, anti-Chinese sentiment, as well as demands for political liberalisation. Ahead of the National Congress, the authorities may be a little jumpy.

Market Overview

Port of Da Nang: Da Nang Port is the largest sea port in the central region of Vietnam. The port is situated on the mouth of Han River (Da Nang), which flows into the South China Sea. As well as profiting from coastal and interior shipping routes, its location makes it as an important spot on the East-West economic corridor, an economic corridor that links Vietnam, Burma, Thailand and Laos.

The port is located within the natural harbour of Danang Bay, which measures 12km² and has a depth of 10-17m. It has a natural breakwater, allowing year-round vessel handling and anchorage. The port is situated at a latitude of 16° 4' 56" north and a longitude of 108° 13' 37" east.

Da Nang Port is split into two areas: Tien Sa terminal and Song Han terminal. The port is primarily a general cargo handling facility, though it currently handles a small volume of container cargo. The port is operated by the state-controlled Port Authority of Danang (PAD).

Shipping: The port is able to receive ships with a maximum draught of 12m with a capacity of up to 45,000 deadweight tonnes (DWT) at its Tien Sa terminal, allowing it to accommodate Panamax vessels, which have a design draught of 12m. The terminal is also able to accommodate ro-ro vessels with a maximum capacity of 2,000 TEUs. Work is currently in progress to equip the terminal with an additional two berths, which should have a berthing depth of 13-14m, allowing it to accommodate the Post-Panamax series of vessel that is currently in development that will have a design draught of 13.6m.

Congestion: The port is currently operating significantly below its reported handling capacity of more than 5mn tonnes per year and there are no reported instances of congestion at the port.

Tonnage throughput has increased steadily in the past decade,

TABLE: MAJOR PORT DATA, 2007-2014

	2009e	2010f	2011f	2012f	2013f	2014f
Port of Ho Chi Minh City (Saigon New) throughput, tonnes '000*	19,140	20,330	21,844	23,581	25,564	27,692
Port of Ho Chi Minh City (Saigon New) throughput, tonnes, % y-o-y*	-5.15	6.22	7.45	7.96	8.41	8.32
Port of Ho Chi Minh City (Saigon New) container throughput, TEU	2,432,000	2,518,053	2,627,587	2,753,293	2,896,746	3,050,637
Port of Ho Chi Minh City (Saigon New) container throughput, TEU, % y-o-y	20.51	3.54	4.35	4.78	5.21	5.31
Port of Da Nang throughput, tonnes '000*	2,556	2,615	2,688	2,771	2,865	2,967
Port of Da Nang throughput, tonnes, % y-o-y*	-6.78	2.31	2.76	3.08	3.41	3.54
Port of Da Nang container throughput, TEU*	51,832	55,019	58,919	63,394	68,501	73,979
Port of Da Nang container throughput, TEU, % y-o-y*	-16.24	6.15	7.09	7.60	8.06	8.00

**2009 figure is an estimate. Source: VPA, BMI. e/f = BMI estimates/forecasts. Forecasts assume existence of spare capacity and the corrrespondence of national trade trends at local port level.*

from 2.074mn tonnes in 2002 to 2.742mn tonnes in 2008. Growth in y-o-y terms has been relatively consistent, increasing by 5.0% in 2003 and 6.0% in 2004 before decreasing by 2.3% y-o-y in 2005. Growth returned in 2006, reaching 4.9%, and increased by 15.4% in 2007. Growth in 2008 was significantly lower at just 0.2%, owing to the onset of the economic crisis, which has affected trade volumes in the Asia Pacific region. In 2009, the resulting recession led to a 6.8% drop in tonnage to 2.556mn tonnes and a 16.2% drop in boxes handled to 51,832 TEUs.

Terminals, Storage And Equipment: Da Nang Port offers two general cargo terminals, which are equipped to handle general cargo as well as limited volumes of container cargo.

Tien Sa Terminal: Tien Sa terminal is the largest terminal within the port complex and has a total quay length of 965m, offering five berths. The terminal has a berthing depth of 12m and is able to accommodate vessels with a capacity of up to 45,000DWT, as well as ro-ro and container ships with a capacity of 2,000TEUs. Throughput capacity at the terminal is around 4.5mn tonnes per year.

Song Han Terminal: Song Han is the smaller of the two terminals and offers five berths with a combined quay length of 528m. The terminal has a berthing depth of 7m and is able to receive vessels with a capacity of 5,000DWT. Throughput capacity at the terminal is more than 1mn tonnes per year.

Storage: The port offers storage yards, measuring 183,772m², and has a warehouse storage space of 29,204m². These are split between three areas: Tien Sa terminal, Song Han terminal and Tho Quang freight warehouse station.

Equipment: The port is equipped with two quay gantry cranes, two rubber-tyred gantry cranes, two Liebherr cranes and 23 mobile cranes with capacity of between 10 and 80 tonnes.

Expansions And Developments: Da Nang Port Authority has announced its intention to invest US$70mn in expanding the port's facilities between 2007 and 2010. Major projects include the construction of two new berths with a quay length of 500m and a berthing depth of 13-14m at Ten Sa terminal. The berths will include about 100,000m² of yard and warehouse space. The proposals also include the promotion of outside investment, aimed at funding the construction of a new terminal in the Tho Quang area of the port.

Multi-Modal Links: Da Nang Port enjoys good links with nearby rail, road and air networks. The port is located close to the Danang International Airport and Danang national railway station. Danang city is linked to Vietnam's northern and southern provinces by the national highway system.

Industry Forecast

The Vietnamese macroeconomic environment is broadly favourable to the local ports and shipping industry. **BMI** believes that in the run-up to the National Congress of the Communist Party of Vietnam, due to be held in January 2011, the authorities will be particularly concerned to keep the economy and foreign trade growing. With evidence of a consumer boom emerging, we recently boosted our GDP growth forecast for this year to 6.0% (up from 4.4% earlier). Over the next five years, we are predicting that growth will come out at a vigorous annual average of 6.2%. There are of course a range of risks. Overheating is one of them, with the possibility of the trade deficit and inflation both rising too sharply.

However, for the moment strong inflows of foreign direct investment are helping as a counterweight on the foreign payments front, and also playing a role in improving the country's stretched

TABLE: TRADE OVERVIEW, 2007-2014

	2007e	2008e	2009e	2010f	2011f	2012f	2013f	2014f
Imports, real growth, % y-o-y	28.32	11.92	-14.00	4.00	6.00	6.50	6.50	6.50
Exports, real growth, % y-o-y	15.58	10.85	-15.00	7.00	6.50	7.00	8.00	8.00
Total Trade, real growth, % y-o-y	22.11	11.42	-14.46	5.37	6.23	6.73	7.20	7.20
Imports, US$bn	66.0	85.2	71.7	74.2	81.5	91.2	104.6	119.2
Import growth, % y-o-y	38.52	29.14	-15.82	3.37	9.89	11.98	14.59	13.99
Exports, US$bn	54.71	70.33	58.56	62.16	68.61	77.17	89.62	103.54
Export growth, % y-o-y	21.97	28.57	-16.74	6.15	10.37	12.48	16.13	15.53
Total trade, US$bn	120.7	155.5	130.3	136.3	150.1	168.4	194.2	222.7
Total trade growth, % y-o-y	30.49	28.88	-16.23	4.62	10.11	12.20	15.30	14.70

Source: National statistical authority, BMI. e/f = BMI estimates/forecasts infrastructure. Power shortages are another related risk. On the political front, the government may find itself hard pressed to calm nationalist, anti-Chinese sentiment, as well as demands for political liberalisation. Ahead of the National Congress, the authorities may be a little jumpy.

Total Tonnage: BMI is projecting an increase in volume at the Port of Ho Chi Minh City, up by 6.2% to 20.33mn tonnes, after the 5.2% contraction during the slump last year. Going forward we believe growth will be vigorous, with the annual average over the 2010-2014 period coming out at 7.7%, comfortably above the general growth rate of the Vietnamese economy. At DNP, we see this year's volume gaining by 2.3% to 2.62mn tonnes. Average growth of volume at DNP across the forecast period will be 7.4%, also above the general GDP growth rate.

Container Throughput: SNP is expected to see 3.5% container handling growth to 2.518mn TEUs this year, following strong growth of 20.5% experienced in 2009. The DNP will see growth of 6.2% to 55,019 TEUs – in other words, moderate growth from a very low base. Going forward, SNP will experience medium term average annual box handling growth of 4.6%, while for DNP the figure will be a somewhat higher 7.4%.

Trade: In real terms, Vietnam's total trade (imports + exports) fell by 14.5% last year, reflecting the impact of the global recession. **BMI** is predicting a recovery this year with 5.4% growth, followed by a slightly stronger pick-up in 2011, with 6.2% growth. Over the next five years, we calculate that total foreign trade will expand at an annual average rate of 6.5%, just ahead of the growth of the economy as a whole (+6.2%). Over this period, exports will grow at an average per annum rate of 7.3%, ahead of imports at 5.9%. In nominal terms, this year exports will gain 6.2% to US$62.16bn, while imports will grow 3.4% to US$74.2bn. We expect Vietnam to continue to run a balance of trade deficit throughout our five-year forecast period running to 2014. In the immediate short term, the deficit will widen as the growing economy sucks in more imports, despite the effects of two devaluations of the Vietnamese dong (in November 2009 and February 2010).

Vietnam's principal export commodities are crude oil and manufactured goods. The country's main imports are machinery and equipment.

Vietnam's main export partners are the US, Japan, Australia, China and Germany. The country's main sources for imports are China, Singapore, Japan, South Korea and Thailand. Vietnam's geographic position on the South China Sea allows the country access to the main transpacific and intra-Asian shipping routes, enabling the country to meet its trading needs.

Chapter 6:
BMI Global Assumptions

Global Outlook

US Slowdown In H210 Looking Likely

Our global growth projections envisage a slowdown in real GDP expansion from 3.4% in 2010 to 3.0% in 2011. Emerging markets will be the main contributor to growth, with the economies of the US, several Western European states and Japan all forecast to weaken going into 2011. There is increasing evidence that the US economy is headed for a slowdown in the second half of 2010, in line with our long-held core view. Core states in the eurozone have shown significant resilience so far this year and our 2010 forecast for the bloc has been bumped up slightly to 1.1% from 1.0% since our last Global Assumptions update in June.

We are continuing to forecast very loose monetary policy in developed states, with the Federal Reserve and European Central Bank remaining on hold until the end of 2011. With growth weak and inflationary risks tilted to the downside, any significant tightening of monetary policy will have to wait until 2012 at the earliest.

Bloomberg consensus forecasts for 2010 US growth come more in line with our projections – moving from 3.2% in June to 3.1% in July (closer to our 2.8% figure) – as recent data, including leading indicators, have been disappointing. Similarly, Bloomberg consensus estimates for Chinese growth in 2011 have fallen from 9.3% to 8.9%. Our forecast for Chinese real GDP growth is 7.5%.

TABLE: GLOBAL ASSUMPTIONS

		2009	2010f	2011f	2012f	2013f	2014f
Real GDP Growth (%)							
	USA	-2.4	2.8	1.8	2.2	2.3	2.3
	Eurozone	-4.1	1.1	1.4	1.9	1.9	1.8
	Japan	-5.2	1.9	0.9	1.1	1.2	1.2
	China	8.7	8.8	7.5	8.6	7.6	7.1
	World	-1.7	3.4	3.0	3.6	3.6	3.6
Consumer Inflation (avg)							
	USA	-0.4	1.6	0.5	1.2	1.7	2.0
	Eurozone	0.2	0.9	1.4	1.7	1.6	1.8
	Japan	-1.3	-0.5	-0.3	0.0	0.8	1.3
	China	-0.7	2.6	2.6	2.2	1.7	2.0
	World	1.8	3.0	3.1	3.3	3.3	3.3
Interest Rates (eop)							
	Fed Funds Rate	0.00	0.00	0.00	2.50	4.00	4.25
	ECB Refinancing Rate	1.00	1.00	1.00	2.00	3.00	4.00
	Japan Overnight Call Rate	0.10	0.10	0.10	0.20	0.30	0.30
Exchange Rates (avg)							
	US$/EUR	1.40	1.29	1.22	1.26	1.25	1.25
	JPY/US$	93.60	96.00	104.00	110.00	110.00	112.50
	CNY/US$	6.83	6.83	6.83	6.69	6.52	6.36
Oil Prices (avg)							
	OPEC Basket (US$/bbl)	60.10	83.00	85.00	90.00	90.00	90.00
	Brent Crude (US$/bbl)	67.00	85.00	87.00	92.00	92.00	92.00

Source: BMI

Developed States

Our developed states aggregate growth forecasts reflect our view that the US, eurozone and Japanese economies are likely to experience a slowdown in growth going into 2011. We are forecasting 2.0% growth for developed states in 2010, falling to 1.6% in 2011 (the latter figure has been revised down slightly from 1.7% in our previous set of estimates in June). Our eurozone real GDP growth forecast (*see previous page*) has been bumped up from 1.0% to 1.1% for 2010, primarily owing to upgrades to our Belgian outlook. The acceleration to 1.4% in 2011 mainly reflects our view that some states will exit outright contraction, which effectively means that the aggregate figure for the bloc will be higher owing to base effects rather than a significant and tangible improvement in activity. We remain concerned by the potential for a significant retrenchment in developed world consumption in H210 and 2011 as households rebuild their balance sheets, the labour market remains loose and the effects of government stimulus measures wear off.

Emerging Markets

Emerging markets (EM) on aggregate are forecast to grow by 5.7% in 2010, up from 5.6% in our previous update. In keeping with our view that the rebound will fade following a strong post-recession recovery, we have made no change to our 5.1% outlook for EM in 2011.

TABLE: GLOBAL & REGIONAL REAL GDP GROWTH

	2009	2010f	2011f	2012f
World	-1.7	3.4	3.0	3.6
Developed States	-3.4	2.0	1.6	2.0
Asia Ex-Japan	5.7	7.5	6.3	7.2
Latin America	-1.7	4.2	3.4	3.3
Emerging Europe	-5.1	3.9	4.3	4.7
Sub-Saharan Africa	2.4	5.5	5.8	6.2
Middle East & North Africa	1.8	4.0	3.9	4.1
Developed Market Exchange Rates				
Eurozone	US$/EUR, ave	1.40	1.29	1.22
Japan	JPY/US$, ave	93.60	96.00	104.00
Switzerland	CHF/US$, ave	1.09	1.05	1.04
United Kingdom	US$/GBP, ave	1.55	1.50	1.58
Emerging Market Exchange Rates				
China	CNY/US$, ave	6.83	6.83	6.83
South Korea	KRW/US$, ave	1212.54	1167.69	1183.84
India	INR/US$, ave	47.23	46.40	48.00
Brazil	BRL/US$, ave	2.00	1.82	1.93
Mexico	MXN/US$, ave	13.49	12.50	11.80
Russia	RUB/US$, ave	31.72	29.41	28.00
Turkey	TRY/US$, ave	1.55	1.48	1.42
South Africa	ZAR/US$, ave	8.38	7.47	7.25

Source: BMI

TABLE: CONSENSUS FORECASTS

		US	Eurozone	Japan	Brazil	China	Russia	India
2010	Bloomberg Consensus	3.1	1.1	3.4	6.6	10.0	4.0	N/A
	BMI	2.8	1.1	1.9	6.0	8.8	4.7	7.8
2011	Bloomberg Consensus	2.9	1.3	1.7	4.5	8.9	4.5	N/A
	BMI	1.8	1.4	0.9	3.6	7.5	4.4	7.8

Source: BMI

Our Latin America projection for 2010 has been pushed up to 4.2% from 4.0% previously, owing primarily to an increase in our Argentine growth forecast. Our aggregate forecasts for the Middle East & North Africa and Sub-Saharan Africa regional forecasts have moved up slightly, with the former coming in at 3.9% and 3.8% for 2010 and 2011, and the latter at 5.5% and 5.8% in those years, respectively.

Our forecasts for emerging Europe and emerging Asia also remain broadly unchanged. While our caution on China naturally leaves us wary of emerging Asia, we continue to forecast it being the highest-growth emerging market region, with real GDP expansion of 7.5% in 2010, slowing to 6.3% in 2011.

TABLE: EMERGING MARKETS AGGREGATE GROWTH

	2009	2010f	2011f	2012f
Emerging Markets Aggregate Growth	1.5	5.7	5.1	5.6
Latin America	**-1.7**	**4.2**	**3.4**	**3.3**
Argentina	1.0	4.3	2.3	2.0
Brazil	-0.2	6.0	3.6	3.9
Mexico	-6.5	4.4	3.2	2.7
Middle East & North Africa	**1.6**	**3.9**	**3.8**	**4.0**
Sub-Saharan Africa	**2.4**	**5.5**	**5.8**	**6.2**
South Africa	-1.8	3.0	4.1	4.1
Nigeria	6.9	7.5	7.4	7.6
Saudi Arabia	0.1	2.2	2.7	3.0
UAE	-2.9	4.8	3.6	4.1
Egypt	4.7	4.9	4.8	5.3
Emerging Asia	**5.7**	**7.5**	**6.3**	**7.2**
China	8.7	8.8	7.5	8.6
Hong Kong	-2.8	5.4	1.5	3.0
India*	7.4	7.8	7.8	8.5
Indonesia	4.5	5.2	5.3	5.7
Malaysia	-1.7	4.9	3.4	4.3
Singapore	-1.3	12.9	3.3	4.5
South Korea	0.2	5.5	3.2	3.7
Taiwan	-1.9	5.9	2.8	5.1
Thailand	-2.5	3.6	3.7	4.0
Emerging Europe	**-5.1**	**3.9**	**4.3**	**4.7**
Russia	-7.9	4.7	4.4	4.5
Turkey	-4.7	4.9	4.7	5.3
Czech Republic	-4.1	2.2	3.2	3.8
Hungary	-6.3	1.1	3.0	3.5
Poland	1.7	3.4	3.9	4.0

**Fiscal years ending March 31 (2009=2008/09)*

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