

DROUGHT 2016: A BRIEF LOOK AT THE POTENTIAL IMPACT ON VIETNAM’S ECONOMY

Short-term hit to economy, longer term solutions needed

The El Niño phenomenon has affected countries around the world, and Vietnam has been particularly hard-hit. The Central Highlands and Mekong River Delta, the key regions for Vietnam’s agricultural sector, have suffered from a drought since the beginning of the year. In central Vietnam, water levels have fallen by 35-60% below annual averages, while 188 out of 599 water reservoirs have run dry – four times the level of 2015. Nearly two-thirds (62%) of Vietnam’s 63 provinces have been impacted by the drought, and 14 have declared states of emergency. As a consequence of the drought, the Mekong Delta is experiencing increasing salinisation, caused by sea water intruding further upstream, destroying crops and contaminating the land.

The severe conditions afflicting the country are not simply the result of Mother Nature, however. Dams built upstream starting in the mid-1990s, have exacerbated an already dire situation. Six hydroelectric plants in China have held back water and rich alluvial sediment, which is critical in maintaining the balance of the Mekong ecosystem and preventing salt water intrusion. Things are only set to become worse: Laos has commenced construction of one dam, with several more in the planning stages, while Cambodia has three such projects under consideration. In contrast, Vietnam has no plans to construct dams on the Mekong mainstream, although it has hydropower projects on rivers in the Highlands.

Impact on Agriculture

While urbanisation is gaining pace, some 60% of Vietnamese still reside in rural areas. Agriculture (including aquaculture) accounts for approximately 16% of Vietnam’s GDP and 12% of exports, so the effects of the drought will be felt far and wide. To date, damage to the agriculture sector is estimated at USD600 million, causing a decline in output of 2.2% and partially accounting for the sub-par 5.5% GDP growth recorded in the first quarter of 2016.

Rice, which accounts for 15% of total agricultural exports, has borne the brunt of crop damage. For the year, rice production forecasts are down 1.5% while export forecasts are 11% lowerⁱ. Nevertheless, Vietnam continues to be one of the world’s top exporters of the staple. Coffee, of which Vietnam is the world’s largest producer of the robusta variety, has also been greatly affected; it is estimated that coffee bean output will decline by 30%ⁱⁱ. Tens of thousands of hectares of coffee trees have already diedⁱⁱⁱ. Cashew nut yields, the third-largest component of Vietnam’s agricultural exports, dropped 20% during the year’s first crop^{iv}.

The Mekong accounts for approximately 25% of the world’s freshwater catch^v. The shrimp industry in Vietnam comprises about USD3 billion of



Source: United Nations Vietnam



Source: Waterglobal

the country's exports; today many of the shrimp farms in the south have been affected by the salt water intrusion -- the volume of farmed shrimp between December 2015 and March 2016 is just 50% compared to the same period a year earlier, according to the Ministry of Agriculture and Rural Development^{vi}.

Market & Portfolio Implications

The near-term implications of the drought are obvious: there will be smaller quantities of fruits, vegetables, seafood and other related products available for export. With food and foodstuffs making up 40% of the Consumer Price Index, rising prices will pressure inflation, which is already up 1.4% year-to-date. Companies operating in related sectors, including seafood, fertilizer, and rice production and processing, as well as hydropower, will likely see their trade affected.

With the rainy season forecast to start in June and based on current conditions, VinaCapital believes the economic damage resulting from the drought is short term. Further, any government assistance package for farmers and others is likely to have little effect on the fiscal deficit.

We have limited exposure to companies that are likely to be hit heaviest by the drought and related issues, as most of our large holdings are consumer related and not commodity driven. As such, we believe the overall impact is minor.

Conclusions

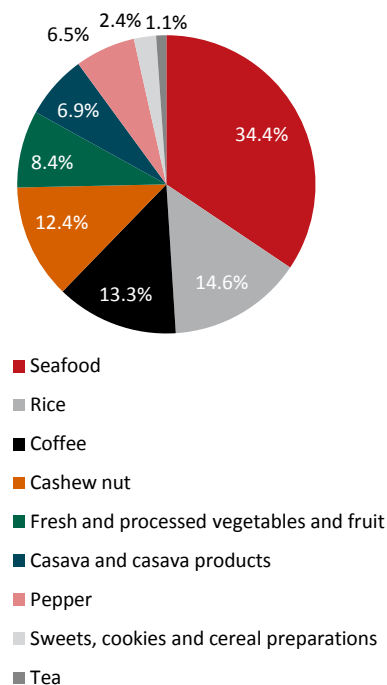
The damage from the drought is likely temporary, but many of the issues related to it are not. All of the affected countries need to work together to develop a sustainable Mekong River strategy that enables the production of electricity while safeguarding the livelihoods of the millions of people who depend on the river, whether via the existing Mekong River Commission or a different entity.

Vietnam's sometimes complicated relationship with its northern neighbour makes a political solution difficult to achieve in the short term. As the country that ultimately controls the Mekong tap, China can use water to exert political and economic pressure on downstream countries, although any *obvious* move to that end is unlikely given the potential for international condemnation.

What Vietnam *can* do is lessen its overall dependence on China, which is its largest overall trading partner. Recent entry into free trade agreements with the EU and Korea, and of course the yet-to-be ratified Trans-Pacific Partnership, should enable Vietnam to broaden trade relationships and reduce its reliance on China.

The geopolitical issues are complex, likely to take some time to resolve and the outcomes uncertain. What is certain, however, is continued extreme weather patterns, and the Vietnamese government must re-examine longstanding agricultural and environment practices and policies so that it can better prepare for and endure these changes in the years and decades ahead. That can take form in a number of ways including more sustainable agriculture, disaster preparedness and water conservation. Vietnam's rainy season is set to begin in a few weeks, and the short-term damage will largely be erased, albeit too late for the country's farmers, but we can only hope that the lessons from what some have billed as the worst drought in a century won't be forgotten.

Products as % of total ag exports



Source: General Statistics Office

ⁱ "Vietnam's H1 2016 rice exports may edge up despite output fall," *Reuters*, 15 April 2016

ⁱⁱ "Drought Hurts Coffee Production in Vietnam," *Wall Street Journal*, 6 May 2016

ⁱⁱⁱ "Historic drought cuts Vietnam's coffee exports by 25 percent," *VN Express*, 26 April 2016

^{iv} "Long drought hits crops in Vietnam," *VietnamNet Bridge*, " 5 May 2016

^v "Drought Killing Vietnam Rice Crops Compounds Mekong Water Crisis," *Bloomberg*, 19 April 2016

^{vi} "Serious drought, high salinity threaten aquaculture in Mekong Delta," *Vietnam Breaking News*, 5 April 2016

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