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Ideas For Boosting Vietnam's GDP Growth

Possible Measures To Support Economic Growth in 2020 and Beyond

- The Government could guarantee loans made by banks to SMEs
- Infrastructure spending would support employment and boost future growth
- Some garment firms need help converting to make Personal Protective Equipment
- The Government can promote Vietnam's nascent Clinical Research Outsourcing industry
- Unfreezing the real estate industry will help meet pent-up demand and boost growth
- The MPI can take steps to boost future, high-value FDI inflows

Vietnam's Government has managed to "flatten the COVID curve" (meaning that the daily number of active COVID-19 cases has been flat/declining for weeks), and the country is starting to lift the public health measures that helped achieve that positive result. However, those same measures have had a significant impact on Vietnam's economy, and the Government has announced a variety of fiscal measures to mitigate the impact of COVID-19 on Vietnam's economy.

Those fiscal measures, which have been discussed at length in other articles, are more-or-less comparable to the measures that governments around the region have also enacted, including: cash payments to individuals and households over the next 2-3 months that are of a similar magnitude across the region, modest tax breaks, and varying degrees of electricity price cuts in some countries. In addition to these measures, we believe there are several other ways that Vietnam's government can drive economic growth in the short-, mid-, and longer-terms.

Funneling Credit to Small and Medium Enterprises (SME)

The State Bank of Vietnam (SBV) has also enlisted the cooperation of commercial banks to help support local businesses by extending loans with below-market lending rates. The economic impact of those concessionary loans will be borne by the banks themselves.

Thailand is also augmenting its fiscal measures by helping to channel credit to businesses, but the country's central bank is partly subsidizing the loans that the country's commercial banks will extend to small businesses. Thailand's central bank also launched a USD12 billion fund to buy investment grade corporate bonds issued by local corporations.

Vietnam's commercial banks have reportedly restructured USD44 billion of loans made to COVID-impacted businesses, and extended USD22 billion of new loans to such businesses at concessionary interest rates at the behest of the SBV. Despite these initiatives, many companies are reporting that they have been unable to access loans they need to fund their working capital and/or to pay salaries during this difficult time. Banks are apparently reluctant to lend to some of those businesses out of fear of not being repaid.

The difficulty small businesses face in accessing credit is not unique to Vietnam. The US government set up a special fund with its own money that is intended to be lent to small businesses that are impacted by COVID, but there have been media reports that less than one-in-ten firms that applied for these loans have actually been able to receive them. The issue has been that although the money behind these special loans comes from the US government (which will cover any losses and essentially expects to lose money), the loans are *administered* through commercial banks like JP Morgan, Bank of America, and others. The loan application process that is too difficult for many small businesses, which cannot afford to hire expensive lawyers and accountants. To date, only larger companies have managed to obtain loans under this scheme.

Germany has a different approach for lending to impacted SMEs than the US, and it is one Vietnam's Government may want to study. Unlike the scheme in the US, Germany's government is not lending its own money, but it is guaranteeing that the loans made from the country's commercial banks to COVID-impacted small businesses will be repaid. Such a loan guarantee scheme could work in Vietnam because it would minimize the Government's spending (i.e., the Government would only lose money if businesses fail to repay their loans). Additionally, the Government has a variety of ways at its disposal to reduce loan losses.

Infrastructure Development to Stimulate GDP And Boost Future Growth

The measures discussed above would help support Vietnam's economy by mitigating the negative impact of COVID on the country's economic growth and employment. However, these measures will not actually stimulate new economic activity.

The most obvious way for the Government to stimulate Vietnam's economy immediately is by ramping up infrastructure spending. This topic has been widely covered in the media and in our previous notes. There are several other ways to achieve economic growth that have yet to be widely discussed which we will introduce.

First, and perhaps most important, is the fact that the workers around the world who are likely to have their livelihoods disrupted by COVID-19 are relatively low-skilled workers. According to the latest employment statistics in the US, nearly 60% of hourly workers (i.e., those in relatively low-skill jobs) are out of work in the US.

One reason that we believe Vietnam's Government should take whatever measures are entailed to seriously accelerate its infrastructure development program is because these projects can absorb large numbers of relatively low-skilled workers. Nearly 30 million people have lost their jobs in the US since the COVID-19 outbreak emerged, so the US government is currently formulating a USD1 trillion infrastructure development program to help put many of those people back to work quickly.

The worldwide recession caused by the pandemic will be the most severe economic downturn since the great depression in the 1930s. At that time, the US government launched the Works Progress Administration (WPA), which employed over 8 million low-skilled workers (to put that number in context, the US population at that time was around 125 million). However, in addition to employing an enormous number of low-skilled workers, WPA infrastructure projects also massively increased America's electricity generation capacity, which in turn helped the US become the world's most powerful industrial country.

Similarly, China's government spent lavishly on infrastructure development after the 1997 Asian Financial Crisis (AFC), and after the 2008 Global Financial Crisis, which radically boosted the country's industrial capacity. Before the AFC, nearly all of China's high-value manufacturing was located around Shanghai and in other coastal provinces including Guangdong, but the massive improvement of the country's infrastructure enabled the growth of high-value added manufacturing in interior cities such as Wuhan.

These two examples lead to the second reason that we believe Vietnam should launch a major effort to build highways, ports, and public transportation: such infrastructure would also massively boost Vietnam's ability to attract FDI as well as the country's growth potential going forward. Over the past few years, disbursement of public funds has been low, due in part to Vietnam's complex and often conflicting laws, resulting in a level of gridlock. Provided the directive to spend on infrastructure comes from the highest level of government along with very clear KPIs for disbursement, we see no reason that ongoing and planned projects could not be accelerated and help jump start growth.

Industrial Policy to Support Employment

We are concerned about the possibility of mass unemployment in the garment industry. Vietnam's textile exports fell by about 9% yoy in Q1, and the Vietnam Textile and Apparel Association (VITAS) has forecast a 15% drop for the full year. We fear that forecast may be too optimistic. Garment sales in the US are currently down about 50% yoy and Vinatex has already said that it may have to furlough 50,000 workers, according to media reports.

Some firms are retooling from manufacturing clothes to manufacturing medical "Personal Protective Equipment (PPE)" such as face masks, but we believe the government could spend some of its own money in order to help a much wider range of garment firms produce PPE products. There will be massive demand for such products for years to come, especially since China currently exports about one-quarter of the world's face masks and consumers in the US and Europe have become increasingly wary of buying medical-related products made in that country.

Direct government assistance to help smaller garment firms make the conversion from garments to PPE could be a very effective way for the government to save a large number of jobs while boosting GDP growth.

In our understanding, the export of medical products such as "N95" face masks entails the manufacturer obtaining certification from the US Food and Drug Administration (FDA) or the European Union's CE mark. The government could fund a small team of foreign experts that could consult with any garment firm wanting to upgrade from making clothes to manufacturing PPE by offering both technical expertise and advice on the administrative aspects of exporting such products to the US and EU.

The concept of governments encouraging the development of specific industries or companies is called "Industrial Policy", but economists typically frown on Industrial Policy in emerging markets, largely because India's Industrial Policy between 1950 and 1990 produced disastrous results. There are even some critics of Japan's modest attempts to promote some firms over others in the 1960s (e.g., the Japanese government's preference that Toyota succeed at the expense of Honda at that time).

That said, the severe worldwide COVID-19 recession is prompting governments around the world to do many things that they would not ordinarily consider. For example, the US government is directly bailing out parts of the country's airline and travel industry (something that Vietnam's policy makers may need to consider in the future).

Industrial Policy to Promote Vietnam's Medical-Related Businesses

In addition to PPE, a wide range of other medical products and services will also be in high demand for years to come, so it would be superb if Vietnam were able to attract FDI into high-value niches such as the manufacture of medical devices.

It would also be ideal if local firms emerged that can produce high-value medical products such as medical instruments. That said, we do not believe there is much the Government could do to foster the development of a local medical device industry because the complexity of such products is too high to be effectively targeted by an Industrial Policy, which tend to work better when focused on lower-value added industries.

That said, the Government could take steps to foster the development of other medical-oriented businesses with a lower degree of complexity, such as the "Clinical Research Outsourcing (CRO)" industry. CRO firms organize the medical trials of new drugs and handle the onerous administrative processes entailed with applying to the FDA on behalf of pharmaceutical companies, which have outsourced about three-quarters of their medical research activities to such firms.

The CRO industry has been relocating to emerging market countries (and especially to China) for several years, largely to cut costs. The demand for CRO services will clearly grow at a much faster pace in the years ahead after the COVID epidemic. For those reasons, we think it could make sense for Vietnam's Government and the Ministry of Health to take the steps entailed in fostering the development of a local CRO industry to service foreign pharmaceutical companies. At present, there are already a few CRO firms in Vietnam, and we could imagine the development of an industry "cluster" in a location like Hue, which already has a well-regarded university and a reputable academic legacy.

Unfreezing Vietnam's Real Estate Development Market

The property market is another topic that has already been covered in the local media, but we would add a few points to augment what has been widely discussed:

- Some real estate development projects in Vietnam are being held up by challenging legacy issues, but VinaCapital believes that the development of many other projects that are not encumbered by such intractable issues should be allowed to progress right away. The framework that we propose to unfreeze Vietnam's real estate development market is akin to the so-called "Good Bank, Bad Bank" approach that regulators around the world usually take to bail out their banking systems when there is an NPL crisis.

- Before the COVID-19 outbreak, the pent-up demand of middle-class home buyers, coupled with the dearth of new projects, led to a situation in which newly launched units were typically receiving multiple bids on each unit for sale. In our opinion, that is a clear signal that more units need to be developed and launched for sale.

- Further to that last point, residential real estate prices in Vietnam's major cities have only dropped about 5-10% this year, which is considerably less than many cities around the world. This also reinforces our view that there is significant undersupply of housing for emerging middle-class consumers in Vietnam.

The quickest way the Government can boost Vietnam's GDP growth in 2020 is by approving planned real estate developments. A plethora of relatively small-scale projects could commence construction almost immediately upon receiving necessary approvals. Infrastructure development has more potential to boost Vietnam's GDP growth for years to come, but large-scale infrastructure projects would take longer to ramp up than the development of an apartment building, for example.

Attracting High Quality FDI

According to a survey from Harris Polling that was conducted earlier this month, over 70% of Americans think that US firms should scale back their manufacturing in China. There have also been an increasing number of articles in publications such as *The Economist* and *Foreign Policy*, as well as comments from notable investors like Mark Mobius, and from organizations like JETRO and AT Kearny all predicting that Vietnam is set to benefit from an acceleration in the movement of manufacturing out of China.

For these reasons, we believe that a wave of FDI inflows is inevitable after the COVID-19 medical issue is resolved (about one year from now). However, the MPI can start taking steps now to promote high quality FDI inflows for years to come. For example, MPI can document and promote the measures that have been taken to successfully manage the outbreak. The Government's early and aggressive public health measures, as well as the innovative measures deployed including Vietnam's unique "scoring system" approach to evaluate the risks of various businesses to the virus further reinforce the countries attractiveness as an FDI location, thanks to the Government's approach.