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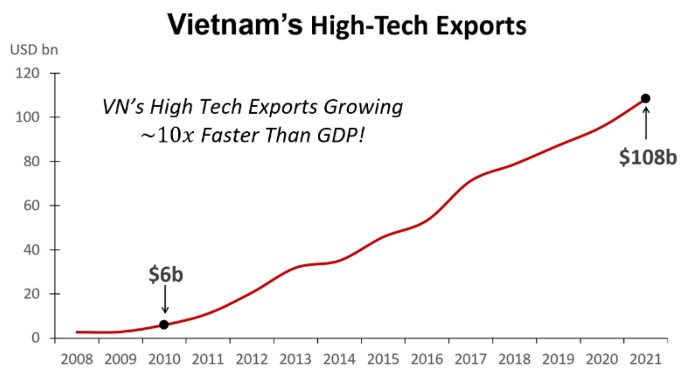
High-Tech FDI Is Driving Vietnam's Economic Evolution

In recent meetings with international investors, we have been asked if Vietnam can "de-couple" from a likely global/US economic slowdown next year as most of the world struggles with slowing GDP growth and surging inflation. In fact, Vietnam's economic growth has been accelerating as 2022 progresses. Consequently, the World Bank, IMF, and others have recently sharply revised up their Vietnam GDP growth forecasts, with an increasing number of economists now expecting it to exceed 8% this year. This has prompted investors to ask what's different in Vietnam and why.

One reason that Vietnam is an economic outlier is that foreign direct investment (FDI) is supporting the country's manufacturing sector, while also driving an increase in the complexity of products produced in Vietnam. That last point is important because an increase in the complexity of the products that a country is able to produce is the single most powerful growth driver for a developing country's economy, according to newly published research by economists at Harvard University.[1] The recent announcements by Samsung, Apple and others highlighted below make us confident that high-tech foreign investments will continue propelling Vietnam's economic growth for years to come.



Specifically, Samsung which is already Vietnam's single largest foreign investor, announced that it will start producing semiconductor parts in the country[2] and Apple announced that it will begin producing Apple Watches and MacBooks in Vietnam, [3] which will be the first time these products will be made outside of China. Apple has "big plans for Vietnam" according to insiders, who also noted that the Apple Watch is particularly complicated to manufacture because of the challenge of squeezing so many components into such a small case.

FDI is instrumental to "help developing economies move into higher value-added parts of the value chain", according to research by the London School of Economics (LSE) and the World Bank,[4] and high-tech FDI has had an enormous positive impact on Vietnam's economy. Intel and Samsung both ramped up production at their first Vietnam factories in 2010, and Vietnam's high-tech exports subsequently increased nearly 20-fold, as can be seen in the chart above, at a time that the country's economy essentially doubled. Furthermore, Vietnam achieved the biggest jump in Harvard's Economic Complexity Index (ECI) ranking over the last two decades, partly because the Samsung and Intel investments attracted a flurry of other high-tech investments from Apple, LG Electronics, Dell, and a plethora of Japanese firms.

The primary motivations for firms to set up high tech factories in Vietnam include Vietnam's high-skill, low wage work force and the country's geographic proximity to high-tech supply chains in Asia. Recent US-China trade tensions have accelerated the movement of manufacturing capacity from China to Vietnam, as evidenced by the fact that Vietnam's trade surplus with the US more than doubled from USD35 billion in 2018 to USD71 billion (or ~20%/GDP) in 2021, during which time its trade deficit with China also more than doubled to USD54 billion. We believe last week's announcement that the Biden administration will keep Trump's tariffs on Chinese imports in

[1]https://www.hks.harvard.edu/faculty-research/policy-topics/development-economic-growth/assessing-growth-which-countries-are
[2]https://asia.nikkei.com/Business/Tech/Semiconductors/Samsung-to-begin-making-semiconductor-parts-in-Vietnam-in-2023
[3]https://asia.nikkei.com/Business/Technology/Vietnam-to-make-Apple-Watch-and-MacBook-for-first-time-ever
[4]https://www.lse.ac.uk/business/consulting/reports/climbing-up-global-value-chains

place, "*Until the day that China chooses a path to have its economy operate more like ours*"[5] essentially ensures that multinational firms will continue pouring FDI into Vietnam for years to come.

Moving Up the Value Chain Propels GDP Growth

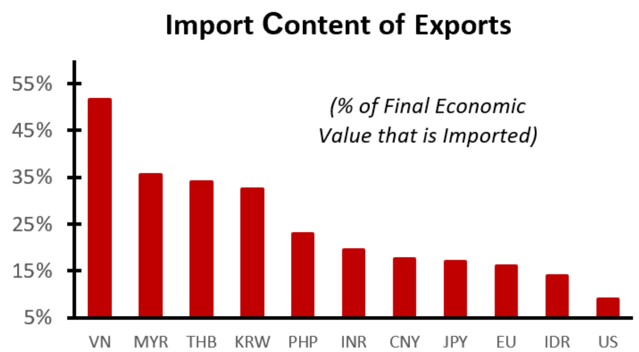
FDI has the single biggest impact on a country's economic upgrading according to research from the London School of Economics and others, but the immediate impact of the newly announced foreign investments will be the creation of relatively high-paying jobs, by local standards (*The Economist* magazine noted that Apple's relocation of production to Vietnam spurred a "war for talent",[6] in the country).

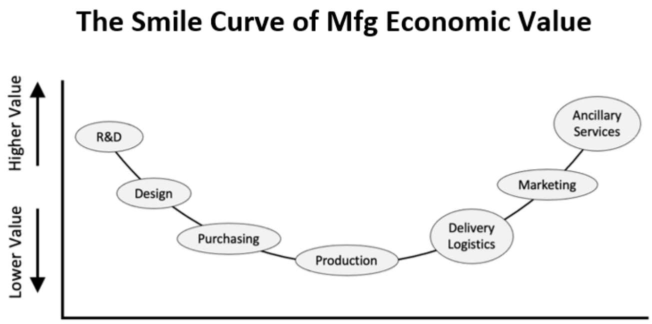
Consequently, high tech FDI boosts Vietnam's GDP two ways: first, by lifting incomes, and second by improving the country's capability to product complex products. The former supports GDP growth in the short-term, since domestic consumption accounts for two-thirds of Vietnam's GDP, while the latter boosts Vietnam's long-term economic prospects. The net result of these two effects (higher incomes and improved capability to produce complex products) is that the production of smartphones, home electronics, and other products with a relatively high degree of complexity ultimately contributed over USD1,000 of Vietnam's circa USD3,000 per capita GDP in 2020, according to the above-mentioned Harvard economists.

Finally, the revenues and earnings of most companies listed on Vietnam's stock exchange are primarily linked either directly or indirectly to domestic consumption. This gives active stock managers ample opportunities to outperform the benchmark VN-Index by assessing which companies' stock prices are likely to benefit the most from their exposure to the higher spending by Vietnam's emerging middle-class consumers that ultimately results from increased high-tech FDI inflows.

How Moving Up the Value Chain Will Propel Vietnam's GDP Growth

FDI factories in Vietnam still import most of the components/production inputs that they require to produce the products that they export, especially for high tech products like consumer electronics and smartphones, as can be seen in the chart below on the left. We expect the "imported content" of Vietnam's exports to plunge and the "local content" contribution to soar as local firms develop their ability to supply FDI companies with production inputs in the years ahead.





Next, the nascent wave of FDI into the production of some of the most complicated products ever manufactured in Vietnam should lead to more "spillover effects" that will lead local manufacturers to diversify into higher value-added segments of the value chain. According to manufacturing researchers at LSE and the World Bank, the actual assembly/production of manufactured products only accounts for around one-third of the total economic value embedded in such products, the lowest value in the value chain, as can be seen in the "smile curve" chart (above, right); this is the segment that is currently the primary focus of Vietnam's manufacturing industry.

[5] https://www.scmp.com/news/china/article/3191736/us-keeping-tariffs-chinese-imports-till-beijing-opens-economy-trade
[6] https://www.economist.com/briefing/2022/06/16/the-structure-of-the-worlds-supply-chains-is-changing

Conclusions

The plans of Apple and Samsung to produce some of the most technologically products ever made in Vietnam will *significantly* boost Vietnam's GDP growth in the years ahead, and ensure that the economic "decoupling" that Vietnam achieved this year can be sustained in 2023. Recent research shows that improvements in a country's capability to produce complex products is the single best predictor of economic growth, and our "bottom's up" view of developments in Vietnam's economy corroborates that "top down" research.

Our day-to-day interactions with a wide range of Vietnamese businesses – from large cap listed companies to ultra tech-savvy small entrepreneurs – continually makes us appreciate the strong parallels between Vietnam's economy in the 2020s and Japan in the 1970s, when that country embarked on its multi-decade climb up the global value chain. We remain extremely bullish on Vietnam's economic prospects – and by extension on the prospects for much higher stock prices in the years ahead.