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THE PLUNGE IN VIETNAM'S EXPORTS HAS BOTTOMED OUT

In 2023, the biggest drag on Vietnam's GDP growth[1] has been a plunge in the demand for "Made in Vietnam" products. This year, Vietnam has suffered its longest streak of falling exports in more than a decade, with the country's manufacturing output shrinking by 1% in 7M23 since most products manufactured in Vietnam are sold abroad. However, there are concrete signs that Vietnam's exports, which dropped 10% yoy in 7M23, are set to recover in Q4 driven by a bottoming out of the US inventory cycle and by an acceleration in multinational firms' movement of manufacturing from China to Vietnam, which will be the subject of our next Insights report.

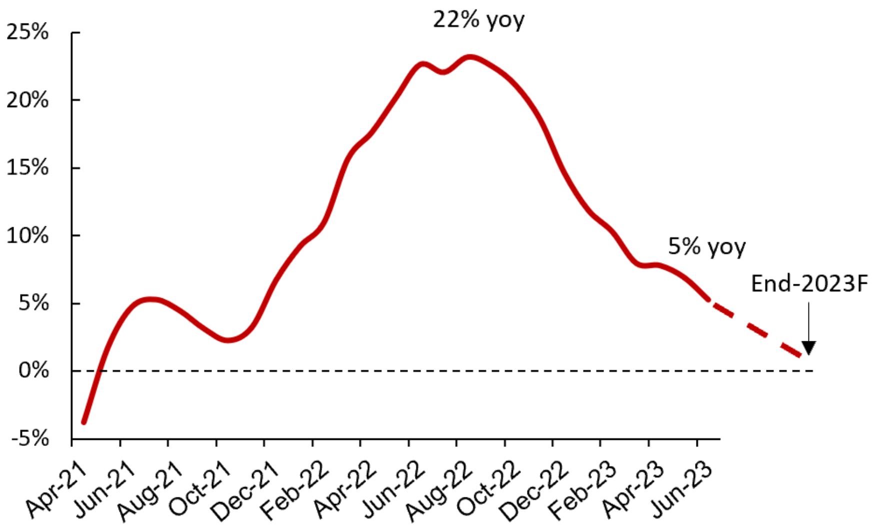
We expect a full recovery in Vietnam's exports and manufacturing activity next year (back to 8-9% growth for manufacturing), which will in-turn drive a recovery in the country's GDP growth from below 5% in 2023 to 6.5% in 2024 (recent Government measures to support the country's economy, including policy rate cuts, will also support Vietnam's economic growth next year, which we discussed in this report). Finally, the export-driven recovery in Vietnam's economy should help propel an increase in the earnings growth of the VN-Index (VNI) from 6% in 2023 to over 20% in 2024, which should support the VNI in the months ahead.

The US Inventory Cycle is Bottoming Out

The US is Vietnam's biggest export market, accounting for about one-quarter of Vietnam's total exports. But US retailers and other consumer products companies bought too many Made in Vietnam/Made in Asia products last year in anticipation of a post-COVID re-opening boom that never came. Instead of buying more manufactured products when COVID lockdowns lifted, US consumers splashed out on services like travel and going out to eat. To make matters worse, companies had "over ordered" products from factories in Asia in response to supply-chain issues and shortages, so the net result was that the inventories of companies like Walmart, Target, and Nike ballooned by over 20% yoy in late-2022, as can be seen below.

[1] Vietnam's GDP growth dropped from 6.4% in 1H22 to 3.7% in 1H23, which was almost entirely explained by a decline in the country's manufacturing output growth from 10% in 1H22 to 0% growth in 1H23.

US Retailer Inventories (% yoy)



US retailers slashed orders at factories in Vietnam this year in response to their bloated inventories, which explains why Vietnam's exports to the US fell by more than 20% yoy in 7M23 after having surged by more than 20% in the same period last year. However, US firms have been aggressively de-stocking throughout 2023 according to both the ISM and S&P Global PMI (the ISM's Inventory Sub-Index hit a nine-year low in June and bounced slightly in July, suggesting that the rate of inventory depletion has hit bottom).

US retail inventories are still up around 5% yoy, as can be seen above, but inventories of "Made in Vietnam" products like home electronics and garments are probably flat year-on-year according to our estimates. Last week, both Walmart and Target announced that their inventories are now down substantially year-on-year following aggressive efforts to reduce inventories throughout 2023.

All of this links closely with Vietnam's export figures. The aggressive inventory reduction efforts of firms like Walmart and others drove the plunge in Vietnam's exports in H1, but that destocking is now approaching its conclusion, and Vietnam's exports to the US increased by nearly 7% month-on-month in July. Consequently, the year-on-year decline in Vietnam's exports to the US improved from a 26% year-on-year drop in June to a 14% yoy decline in July, which helped reduce the fall in Vietnam's total exports from 12% year-on-year in 1H23 to 2% yoy in July.

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Finally, in addition to a cyclical recovery in exports to the US, Vietnam is also benefitting from companies moving their production from China to Vietnam, which helps explain why Vietnam's exports fell 2% yoy in July versus a 15% yoy drop in China, a 16% drop in Korea, and a 10% decline in Taiwan. All Asian exporters should be benefitting to some degree from a de-stocking-driven export recovery, but Vietnam is the only country in Asia that is also significantly benefitting from the establishment of new factories in the country. Related to this is the fact that FDI inflows to China hit a record low in Q2.

Sustainable Export Rebound

We are confident that the improvement in Vietnam's exports will accelerate as 2023 progresses based on several reliable leading indicators, including: 1) Vietnam's import growth finally caught up to export growth on a sequential basis in July, after having lagged significantly for much of 2023 (see below), 2) the ongoing decline in export orders for Vietnam's factories finally eased in July, and 3) firms' inventories of raw materials increased in July for the first time since late-2022.

Further to #1 above, Vietnam's imports have been falling faster than exports throughout 2023 (for example, exports surged 5% month-on-month in June, but imports only grew 1% m-o-m), so Vietnam's trade surplus swelled from 0% of GDP in 7M22 to 6%/GDP in 7M23 – despite weaker demand for "Made in Vietnam" products. In the first 7 months of this year Vietnam's imports fell by 17%, versus the above-mentioned 10% drop in exports, because FDI firms – which account for the vast majority of imports – slashed their imports of production materials in response to their weak order books.

However, FDI firms now appear to be getting ready to ramp up their production in the lead-up to the Christmas holiday season, evidenced by the fact firms' inventories of raw material inputs increased for the first time since late-2022, according to S&P Global, and that Vietnam's imports and exports both grew 2% month-on-month in July. Furthermore, the decline in firms' export orders moderated significantly last month and factory output grew 4% month-on-month in July, both of which helped push Vietnam's PMI up from 46.2 in June to 48.7 in July. We believe firms are ramping up their imports/purchases of raw materials in anticipation of a resurgence of factory orders later this year.

Export Recovery Driven by Consumer Electronics, Followed By Smartphones and Garments

Over one-half of Vietnam's exports to the US are of high-tech products (i.e., consumer electronics, smartphones), and of garments & footwear, with a range of other products such as furniture and agriculture accounting for the rest.

Earlier this year, global sales of personal computers were falling by more than 30% yoy (Vietnam's exports of high-tech products fell by more than 10% yoy in H1), but the decline in PC and consumer electronics sales has now ended according to senior Walmart executives, who noted a "modest improvement" in consumer electronics sales recently. Consequently, Vietnam's exports of such items surged from a 3% year-on-year decline in June to a 28% yoy increase in the month of July, making it the single biggest contributor to the rebound in Vietnam exports last month, and helping propel Vietnam's exports to above USD30 billion for the first time this year.

Next, Vietnam is the world's second biggest smartphone exporter, so new product launches can have a major impact on exports and manufacturing activity (Samsung alone accounts for a quarter of the country's total exports). Samsung recently announced that although its smartphone sales fell 12% yoy in Q2 (inline with a global drop in smartphone sales this year), it expects a rebound in H2 driven by the introduction of new phone models, especially of foldable phones. Apple and Google also have major project launches scheduled, and although those new phones will not be made in Vietnam, many of the components used to make those new phones will be manufactured in Vietnam by Foxxconn, Luxshare, Goertek, and other suppliers.

Finally, garments & footwear account for nearly 20% of Vietnam's exports and exports of those products to the US are unlikely to rebound until next year because the progress of retailers in the US destocking such products has been much slower than the progress in running down inventories of consumer electronics products. However, garment exports to Korea and Japan soared by about 30% m-o-m in July as demand for clothing rebounded in both countries, according to local consumer sentiment surveys.

Summary

The biggest drag on Vietnam's GDP growth this year has been a plunge in the demand for "Made in Vietnam" products, which weighed heavily on the country's manufacturing sector this year. We see concrete signs that Vietnam's exports are set to recover in Q4, driven primarily by a bottoming out of the US inventory cycle, but also by an acceleration in the relocation of manufacturing from China to Vietnam. This rebound is likely to help lift Vietnam's GDP growth from below 5% in 2023 to 6.5% in 2024, which in-turn should help propel an increase in the earnings growth of the VN-Index (VNI) from 6% in 2023 to over 20% in 2024, which should support the VNI in the months ahead.

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