Vietnam: Long-term Prospects Intact

- Vietnam to be the most resilient Southeast Asian economy due to swift policy actions
- Well-positioned to be Asia's next manufacturing hub over the longer term
- Real estate to benefit from economic transformation and middle-class growth

Introduction

In this commentary, we will assess the impact of COVID-19 on Vietnam's economy, as well as the country's longer-term economic prospects and the implications on the real estate sector.

Asia's economic success story

Since the implementation of the 1986 Đổi Mới economic reforms, Vietnam has transformed from one of the world's poorest nations into a thriving middle-income economy. Vietnam's GDP growth averaged 6.9% p.a. between 2015 and 2019, the fastest among major Asian economies[1]. Growth was driven by a robust export sector, which accounted for 107% of GDP in 2019 (2015: 73%[2]).

Alongside Vietnam's rapid economic development, the country's GDP per capita rose by a compound annual growth rate (CAGR) of 6.8% between 2015 and 2019 to reach USD2,700 while its middle-class expanded by a CAGR of 7.9% over the same period to reach 12.5 million (13% of total population)[3]. Ho Chi Minh City (HCMC)'s GDP per capita increased by a CAGR of 5.9% in the same period to reach around USD6,300[4], more than double the national average.

Vietnam also did well in other non-economic development indicators such as the degree of information and communications technology (ICT) adoption and quality of human capital[5], which it ranked second in Southeast Asia (SEA).

Navigating through COVID-19

Vietnam's integration with the global economy has amplified the impact of COVID-19 to its economy, with 1H2020 GDP growth coming in at just 1.8% year-on-year (yoy) as the accommodation and food services and transport and storage sectors contracted amid a slump in international travel.

With the COVID-19 threat showing no signs of abating globally, the recovery in Vietnam's external-oriented economy is likely to be subdued in 2H2020. Domestic demand should be more resilient on the back of strong policy support.

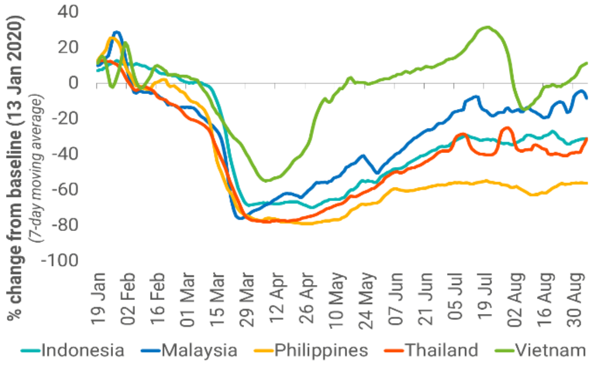
The government has introduced a fiscal stimulus package worth VND279 trillion (~USD11.8 billion, or 4.5% of GDP), which includes measures such as the deferment of tax[6] and land rental fee payments to the end of 2020, cash transfers for affected workers and households and a reduction of corporate income tax rates for small and micro firms[7]. The State Bank of Vietnam (SBV) also reduced the refinancing and discount rates to a historical low of 4.5% and 3.0% respectively in May 2020, as well as directed commercial banks to reschedule loans, waive or reduce interest payments and provide loan forbearance for customers affected by COVID-19[8].

To a greater extent, the government's early and effective COVID-19 containment measures allowed the economy to be re-opened earlier than other SEA

[1] IMF, World Economic Outlook, Apr 2020
[2] CEIC, General Statistics Office of Vietnam, KepCap Research; includes both merchandise and services (e.g. tourism) exports
[3] Source: World Bank
[4] Source: Savills, Vietnam Chart Book 2016, Aug 2016, General Statistics Office of Vietnam, KepCap Research
[5] World Economic Forum, The Global Competitiveness Report 2019, Oct 2019; World Bank Human Capital Index
[6] Covers value-added tax, corporate income tax and personal income tax
[7] IMF, Policy Responses to COVID-19 as at 1 Jul 2020
[8] Ibid

nations[9]. Apple's Mobility Trends reports show that Vietnam's pedestrian traffic was back at pre-COVID levels between mid-May and July, before dipping in the first half of August as certain restrictions were retightened following a new COVID-19 outbreak in Danang on 25 July (Figure 1).

Figure 1: Comparison of pedestrian traffic levels



Source: Apple Mobility Trends Reports, KepCap Research

Rather than implementing another nationwide lockdown, Vietnam's central government will only quarantine areas considered to be virus epicentres (e.g. Danang) and reinstate certain social distancing measures (e.g. closure of non-essential businesses such as entertainment facilities and the mandatory wearing of face masks) in HCMC, Hanoi and other provinces to minimise disruption to the domestic economy.

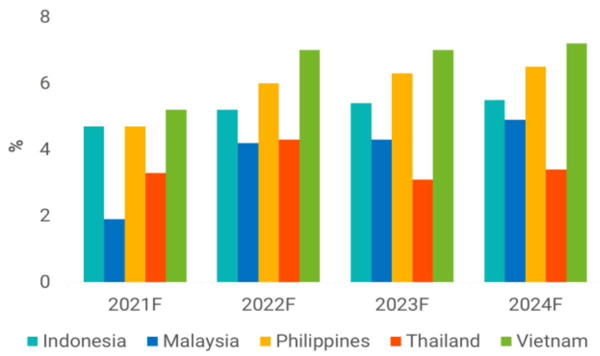
These measures, coupled with aggressive contract tracing and testing efforts, have helped to bring the outbreak under control towards the end of August and allowed authorities to partially loosen social distancing measures in certain cities such as Danang.

According to Bloomberg consensus forecast, Vietnam's economy is projected to expand by 2.8% in 2020[10], making it one of the few countries in the world to avoid a recession this year.

Long-term growth prospects intact

As global economic conditions gradually normalise over the longer term, EIU expects Vietnam's economy to expand at an average annual pace of 6.6% from 2021 to 2024, which would put it ahead of other major emerging SEA markets (Figure 2).

Figure 2: Projected GDP growth, 2021 to 2024



Source: EIU

Foreign direct investments (FDI) will remain the cornerstone of the central government's strategy to modernise Vietnam's economy and deepen the country's integration into the global supply chain[11].

Beneficiary of "China plus one" policy

The protracted US-China trade tensions coupled with the severe disruptions caused by the closure of Chinese factories at the early stage of the COVID-19 pandemic have highlighted the danger of overreliance on a single production base. Indeed, a recent PwC survey showed that 51% of CFOs worldwide cited the development of alternate sourcing options as a top priority in their supply chain strategy[12]. Certain countries such as Japan, South Korea and Taiwan are also encouraging their companies to diversify their supply chain. For example, Japan's government will provide each company with a subsidy of up to JPY5 billion (USD46.7 million) to shift production from China to SEA markets[13].

[9] Preventive actions such as increased monitoring at border crossings, airports and seaports were put in place nearly a month before Vietnam recorded its first COVID-19 cases on 23 Jan 2020. Stronger measures were subsequently adopted to curb community transmission, such as imposing a full lockdown on communes which experienced cluster outbreaks. Vietnam also barred entry for all foreigners from 22 March, except those entering the country on diplomatic and special purposes.

[10] As at 7 Sep 2020
[11] Nikkei Asian Review, Vietnam Vows 5% Growth in Post-Outbreak Foreign Investment Pitch, 11 May 2020
[12] PwC's COVID-19 CFO Pulse, 11 May 2020
[13] VNExpress, 15 Japanese firms opt for Vietnam after China, 19 Jul 2020

As more multinational corporations (MNCs) look to diversify their production out of China, Vietnam has emerged as the most attractive destination in Asia Pacific (APAC)[14] due to the following key factors:

- Extensive free trade agreements (FTA) with major markets such as US, EU and Japan;
- Government reforms and the effective handling of the COVID-19 pandemic;
- Competitive manufacturing wages, which are less than half of China and the second lowest among major emerging SEA markets[15]; and
- Proximity to China, which minimises interruptions or delays to existing supply chains.

COVID-19 is expected to accelerate the nearshoring of lower value-added products to Vietnam. Prior to the pandemic, MNCs have already been diverting their production away from China to mitigate the impact of rising labour costs and tariff hikes by the US on profit margins. For example, nearly half of Adidas and Nike's footwear was manufactured in Vietnam in 2019, up from an average of 34% in 2009. In comparison, around 20% of Adidas and Nike's footwear was produced in China in 2019, down from 39% in 2009[16].

Original equipment manufacturers (OEM) companies are also relocating production of more labour-intensive segments from China to Vietnam which offer greater cost advantages. For example, Samsung has over the last decade shifted its smartphone production to Vietnam, which now accounts for 50% of total output[17]. More recently, the Japan External Trade Organisation (JETRO) announced that eight Japanese OEM companies will be expanding their production bases in Vietnam under the aforementioned government support scheme[18].

Concerns about the growing technology conflict between US and China could prompt some MNCs to shift production capacities of cybersecurity-sensitive products such as network equipment and servers to Vietnam as a hedge, while retaining facilities in China for the domestic market.

Services: Vietnam's new growth engines

Vietnam's ICT sector is expected to flourish, supported by a growing talent pool and the country's ongoing digital transformation. For example, the central government has set a target for Vietnam's digital economy (e.g. e-commerce, fintech) to account for 20% of GDP by 2025 and for each economic sector to achieve a digital penetration rate of at least 10%[19].

The tourism sector is also expected to become a key economic sector in the longer term, with the central government looking to increase the sector's share of GDP from around 6% in 2019 to 17% by 2030[20]. As part of Vietnam's tourism development strategy, the central government will accelerate the construction of new transport infrastructure and promote investments in accommodation and modern entertainment and exhibition centres.

Implications for real estate

Sentiments in Vietnam's real estate sector are expected to be subdued in 2020 as a result of the COVID-19 pandemic. The longer-term outlook however remains positive, backed by favourable socio-economic trends.

Residential: Growth in affluence and urban migration to drive housing demand

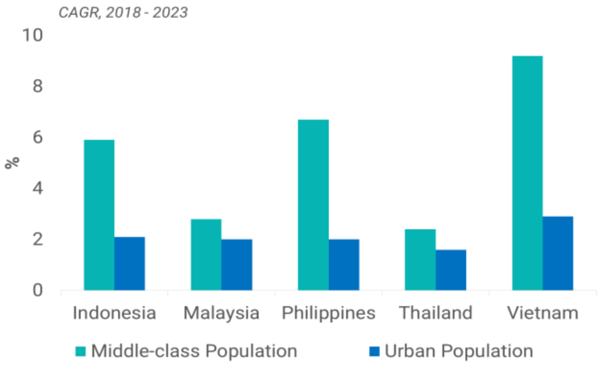
Due to the implementation of stricter social distancing measures and tighter residential development controls, demand and new apartment launches in HCMC and Hanoi fell by over 40% yoy to reach 15,200 and 13,600 respectively in 1H2020[21]. New apartment launches could remain constrained in 2H2020 as certain social distancing measures were retightened in late July following a fresh COVID-19 outbreak in Danang. For the whole of 2020, total new apartment launches in HCMC

[14] Savills, COVID-19 and Global Manufacturing Supply Chains, Jul 2020
[15] Krungsri Research, Vietnam Investment Handbook, Apr 2020
[16] Source: Company filings
[17] Reuters, Samsung to Shift Some Smartphone Production to Vietnam Due to Coronavirus, 6 Mar 2020
[18] Source: JETRO. Companies include Hoya Corporation (hard disk drive parts), Meiko Co., Ltd (smartphone components) and Yokoo Co., Ltd (automotive parts)
[19] Vietnam News, Digital Economy Hoped to Make Up 20% of Vietnam's GDP by 2025, 9 Jun 2020
[20] Vietnam Briefing, Vietnam's Tourism Sector: Opportunities for Investors in 2020, 13 Dec 2019
[21] Source: JLL

and Hanoi are likely to be well below the average annual figure of 67,600 recorded during the period 2017 to 2019[22]. Notwithstanding the tighter supply conditions, residential price growth in Vietnam is expected to moderate in 2020 as buyers turn more cautious amid a weak labour market.

Looking further ahead, Vietnam's ongoing economic transformation is expected to create more high quality, modern jobs which will in turn drive the growth of the country's middle-class population and rural-urban migration. Between 2018 and 2023, Vietnam's middle-class and urban population are projected to increase by a CAGR of 9.2% and 2.9%[23] respectively, the fastest among major emerging SEA markets (Figure 3).

Figure 3: Middle-class and urban population growth



Source: Euromonitor, UN World Urbanisation Propsects: 2018 Revision, KepCap Research

The aforementioned factors coupled with a young population[24] and downward trend in average household size[25] will support housing demand over the longer term. In the aftermath of the COVID-19 pandemic, buyers will demand higher standards of property management.

Growth in housing supply in both HCMC and Hanoi is expected to be relatively constrained in the near future, as the central government continues to adopt strict licensing procedures as part of its ongoing anti-corruption drive. In addition, a larger share of new developments will take place in the fringe districts of HCMC (e.g. District 2, Binh Thanh, Nha Be) and Hanoi (e.g. Hoai Duc)[26] as the expanse of developable land in the inner cities becomes increasingly scarce.

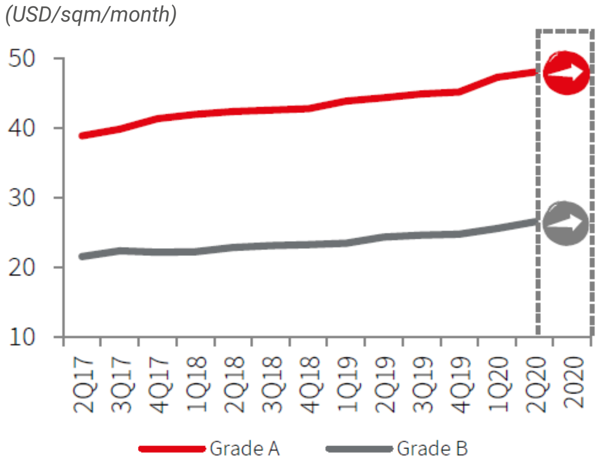
Within HCMC's District 2, the provincial government is seeking to accelerate the transformation of Thu Thiem into a modern, sustainable urban centre. Under a build-transfer agreement, land plots are granted to developers in exchange for investing in soft infrastructure such as schools, healthcare facilities, and ecological features (e.g. mangrove forest and urban canals). The upcoming completion of the Metro Line 2 and cross-river bridges over the next few years will also enhance Thu Thiem's connectivity with neighbouring provinces. Similarly, the construction of additional roads connecting HCMC to satellite cities such as Dong Nai has also boosted interest in the latter's residential market. Notably, Dong Nai's abundant supply of land plots allows for the development of lower density, integrated lifestyle residential projects which are favoured by high-end buyers and investors for the privacy and lifestyle.

Office: Broadening demand from manufacturing sector

Office rentals should hold steady or decline slightly in 2020 as tenants request for financial rebates amid a weaker business environment. Rents of Grade A offices could be more resilient due to the tight supply of high-quality office space and demand from MNCs (Figure 4).

Figure 4: HCMC average office rents

(USD/sqm/month)



Source: JLL

[22] Ibid.
[23] Euromonitor, UN World Urbanisation Prospects, 2018 Revision
[24] 63% of Vietnam's population were under the age of 40 in 2019. Source: UN World Population Prospects, 2019 Revision
[25] The average size of urban households has declined from 3.7 in 2009 to 3.3 in 2019. Source: Vietnam Population and Housing Census, Apr 2019
[26] Source: JLL

As Vietnam strengthens its position as Asia's next manufacturing hub over the longer term, office demand is expected to rise as more MNCs establish their regional headquarters and business support functions (e.g. accounting, sales and marketing, legal, HR) in HCMC and other major metropolitan areas.

Leasing by traditional office-occupying sectors such as financial services and ICT will also continue to grow in line with the modernisation of Vietnam's economy. For instance, SBV noted that more foreign banks are expanding their presence in the relatively undeveloped retail banking market[27].

Foreign insurers such as AXA and Manulife are also increasing their footprint in Vietnam's lucrative insurance market[28]. According to Vietnam's Insurance Supervisory Authority, the country has one of the world's lowest life insurance penetration rate at less than 1% of GDP. The growth of Vietnam's insurance sector could also fuel additional investment demand for real estate to match the insurers' long-term liabilities.

With COVID-19 underscoring the need for a healthy work environment, MNCs looking to relocate to Vietnam are expected to favour LEED-certified buildings which offer wellness and green features (e.g. quality ventilation system, natural lighting) going forward. As part of efforts to enhance their business resilience, tenants will also look to distribute their workforce into various office locations outside of the CBD, including HCMC's Districts 2 and 7 which have good pipelines of high-quality office developments[29]. HCMC's new metro lines, which are scheduled to enter into service from 2021 onwards, will further support the decentralisation of the office market.

Unlike other SEA markets such as Malaysia, Thailand and Indonesia where work-from-home (WFH) was either mandated or encouraged by the government as part of efforts to contain the spread of COVID-19, workers in Vietnam were allowed to continue working in office as long as their employers saw fit[30]. This was especially the case for smaller companies which do not have sufficient IT resources to support WFH arrangements.

As a result of the low WFH adoption rate, demand for office space in Vietnam is not expected to change significantly as a result of COVID-19 or shifts in occupier behaviour.

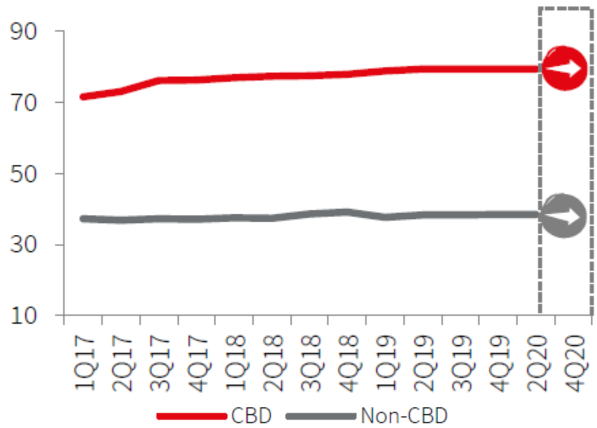
Retail: Near-term outlook still uncertain but fundamentals supported by growing middle-class

Retail rents softened in 1H2020 as more tenants were forced to downsize due to the implementation of social distancing measures. Weak leasing demand resulted in vacancy rates in HCMC and Hanoi rising to 30% and 11% respectively[31].

Notwithstanding the re-opening of the economy, the outlook for the retail sector remains uncertain in the near term due to the lack of foreign tourists, while domestic spending could be crimped by the weak labour market. Suburban retail rents could face greater downward pressure given that over 80% of pipeline supply from 2H2020 to 2021 are located outside of the CBD[32] (Figure 5).

Figure 5: HCMC average retail rents

(USD/sqm/month)



Source: JLL

[27] Vietnam News, Foreign Institutions Set Up Expansion Plans in Vietnam, 12 Jul 2019
[28] Vietnam Investment Review, All Change at the Top as Insurers Look to the Future, 10 Jul 2020
[29] Source: JLL
[30] CBRE, Vietnam Occupier Flash Survey, Apr 2020
[31] Source: JLL
[32] Savills, HCMC and Hanoi Market Brief 1H2020, Jul 2020

Over a longer horizon, Vietnam's retail market remains well supported by the country's burgeoning middle class, which is expected to boost consumer spending from USD185 billion in 2019 to USD340 billion in 2030[33]. Landlords and retailers will however need to evolve in order to thrive in the post-COVID environment.

In the immediate future, there will be greater emphasis on the building manager's ability to maintain a high standard of hygiene, sanitisation and crowd management to minimise the risk of widespread transmission within the premises.

The COVID-19 outbreak has also accelerated the shift in consumer buying behaviour towards online shopping, especially for fashion and accessories, groceries and healthcare products. It is thus imperative that retailers develop omni-channel platforms to engage their customers more effectively. Landlords on their part can support their tenants by reconfiguring part of the malls to support ship-from-store arrangements.

Hospitality: Strong tourism infrastructure to support longer-term recovery

Following its earlier success in containing the COVID-19 pandemic, the central government lifted restrictions on the number of domestic flights and passengers on 7 May and worked with industry associations to launch a variety of promotions (e.g. discounted airfares, free admission to tourist attractions) to support Vietnam's tourism sector.

However, the recent COVID-19 outbreak in the tourist city of Danang has highlighted the fragility of the tourism sector's recovery as domestic tourist flows were curtailed by the retightening of certain social distancing measures. While the central government is looking to resume international flights from 15 September starting with Japan and South Korea, the number of foreign visitor arrivals is likely to be subdued given the onerous border control measures (e.g. mandatory serving of 14-day quarantine and payment of related expenses).

Over the longer term, Vietnam is well-positioned to ride on the anticipated resumption in international travel given its diverse and vibrant tourism assets.

According to the World Economic Forum's 2019 Travel and Tourism Competitiveness Report, Vietnam has the highest number of UNESCO World Heritage Sites[34] in SEA and ranked among the top three in the region in terms of the appeal of its natural, cultural and entertainment attractions. Vietnam also ranked favourably among major emerging SEA markets in terms of the standards of safety and security as well as health and hygiene.

Conclusion

As a relatively open economy, Vietnam's GDP growth will inevitably come under pressure in 2020 as supply chains and international travel are disrupted by the COVID-19 pandemic.

On a positive note, Vietnam will likely avoid a recession this year as the central government's decisive handling of the pandemic helped to facilitate an early re-opening of the domestic economy in mid-May. By drawing on its earlier experience and stepping up contact tracing and testing efforts, the central government should also be able to contain the second wave of COVID-19 infections effectively.

Over the longer term, we believe that Vietnam's growth prospects remain intact, with the country set to emerge as the top investment destination in SEA for MNCs looking to diversify their production bases out of China due to factors such as the US-China trade tensions and COVID-19 pandemic.

The government's move to modernise Vietnam's economy through the liberalisation of FDIs and development of the services sector is expected to accelerate the growth of the country's middle-class and urban population, which will in turn support the residential and retail markets.

[33] Source: Euromonitor, Statista

[34] World Heritage Sites are designated by UNESCO for having cultural, historical, scientific or other form of significance. Source: UNESCO

The anticipated entry of more MNCs from the manufacturing and services sectors will also bolster office demand, while the hospitality sector should benefit from the government's plan to boost tourist arrivals and receipts over the next decade.

Established commercial landlords which have consistently maintained high standards of property management, especially in the areas of hygiene and sanitation, should do well in the post COVID-19 environment.

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