Economic commentary

30/11/2018

Week Ahead Asia-Pacific Economic Preview

- **Worldwide release of PMI surveys offer insights into Q4 economic performance and price trends**
- **Australia and India set monetary policy**
- **Australia GDP**
- **US non-farm payrolls and earnings**
- **Special focus on Vietnam**

Worldwide release of November PMI surveys will offer important clues into fourth quarter economic performance and price trends amid lower oil prices. A number of countries in Asia will also publish updated inflation figures. Australia and India will meanwhile decide on monetary policy. China also releases trade and inflation numbers over the next weekend.

Other data highlights for Asia include updated estimates to South Korea's GDP data, as well as trade figures for Malaysia and Taiwan.

Elsewhere, US nonfarm payrolls and wage data will be keenly watched for insights into the pace of future Fed rate hikes.

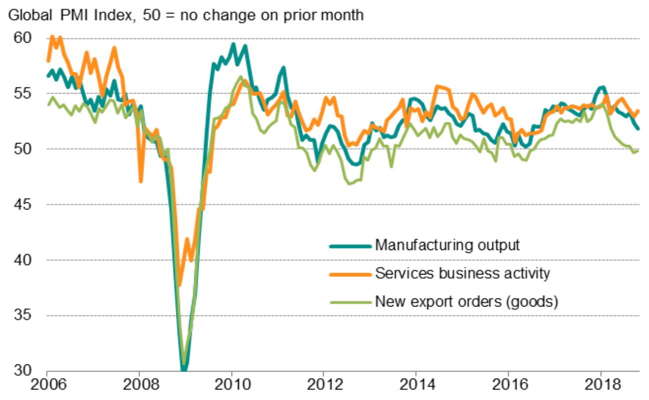
Our special focus this week looks at the rapid expansion and projected future development of the Vietnamese economy.

PMI surveys offer early insights to growth

Worldwide PMI data, covering manufacturing and service sectors, will provide important advance signals of economic performance midway through the closing quarter of the year. The data follow October's global PMI data, which indicated another month of decline in worldwide export orders, and the Global Business Outlook surveys, which signalled the gloomiest outlook in two years. The surveys highlighted mounting risk aversion amid rising concerns over trade wars and tariffs, albeit with the US showing greater resilience than Europe and China.

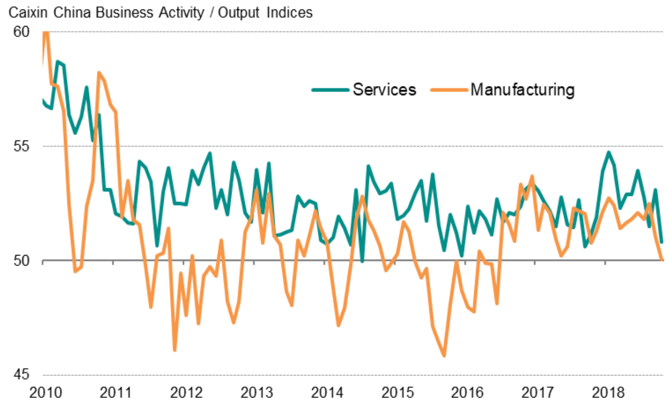
In China, the PMI data will come under heavy scrutiny. The October Caixin PMI surveys signalled the weakest business activity growth in two years, with export orders under pressure from trade war jitters. China watchers will also be particularly eager to see November updates to trade and inflation figures, released over the weekend of 8-9 December. Export growth is expected to wane to 11% during November, down from 15.6% in October.

Global PMI output and export indices



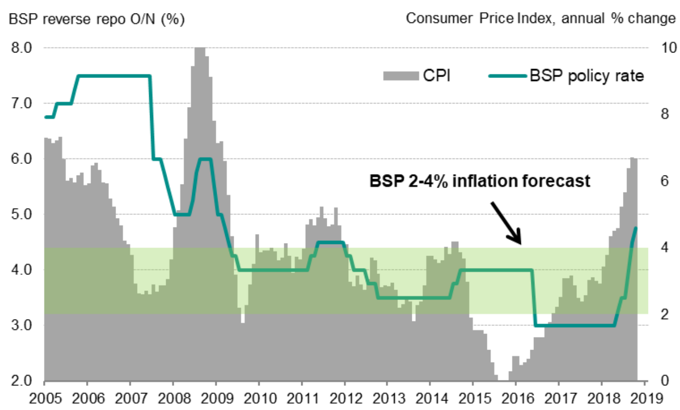
Sources: IHS Markit, JPMorgan

China PMI: manufacturing and services



Sources: IHS Markit, Caixin

Philippines monetary policy and consumer inflation



Sources: PSA, BSP

Continued…

Asia inflation

A number of countries across Asia, including Taiwan, Thailand and Indonesia, report consumer price updates, though it is likely that the Philippines' inflation figures will attract the most attention for insights into future monetary policy. Expectations are for a slower annual rate of growth in headline CPI in November, following a 6.7% annual rise in October. However, the headline inflation rate has likely remained above the upper limit of the central bank's 2-4% target range.

Australia monetary policy and GDP

The Reserve Bank of Australia decides on interest rates in the coming week, but no change to monetary policy is expected. The pace of wage growth has been central to the RBA's expectation for higher rates. While the annual growth in hourly pay rates reached a three-year high in the September quarter, it remained well below rates seen at the start of each of the five previous rate hike cycles since 2002.

In the same week, third quarter GDP figures will be released for Australia. The annual pace of GDP growth is expected to moderate to 3.0% from 3.4% in the second quarter. However, in a sign that momentum could pick up into the end of the year, flash PMI surveys indicated that Australian private sector output growth recovered more ground in November.

US employment report and UK PMI

Elsewhere, the major release of the week is the US employment report. The report provides an update on jobs growth and employee earnings ahead of the next FOMC meeting scheduled for 18-19 December, for which the futures markets are currently pricing in an 80% chance of a rate hike. This would be the fourth hike this year and take the policy rate to 2.25-2.50%.

Current data suggest the employment report should bring further good news on the labour market, adding to the bullish picture. IHS Markit's Flash PMI employment index is pointing to a 185k rise in non-farm payrolls. However, any disappointment in the report, especially in terms of wages, could cause analysts to reconsider the pace of tightening in 2019, especially after markets seized on Fed Chair Powell's recent comments that US interest rates are approaching "neutral" levels.

UK PMI data will also come under particular scrutiny as the government vote of the Brexit withdrawal agreement approaches, especially after October PMI data showed a sharp slowing of the economy among increasing widespread uncertainty about reaching a workable deal on leaving the EU.

Monday 3 December

Worldwide release of IHS Markit manufacturing PMI surveys (Nov)

Indonesia and Thailand inflation (Nov)

US ISM manufacturing (Nov)

Tuesday 4 December

South Korea GDP (final, Q3) and inflation (Nov)

Australia interest rate decision

UK Construction PMI (Nov)

Brazil industrial production (Oct)

Wednesday 5 December

Worldwide release of IHS Markit services PMI surveys (Nov)

Australia GDP (Q3)

Philippines inflation (Nov) and unemployment rate (Q4)

Malaysia trade (Oct)

Taiwan inflation (Nov)

India monetary policy decision

Euro area retail sales (Oct)

US ADP job report (Nov)

US ISM non-manufacturing (Nov)

Thursday 6 December

Australia trade (Oct)

Germany construction PMI (Nov) and factory orders (Oct)

Russia inflation (Nov)

US trade and factory orders (Oct)

Friday 7 December

Japan average cash earnings (Oct)

Australia home loans (Oct)

Taiwan trade (Nov)

Indonesia foreign exchange reserves (Nov)

Germany industrial production (Oct)

France industrial production and trade balance (Oct)

UK Halifax House Price Index (Nov)

Italy retail sales (Oct)

Euro area GDP and employment change (3rd est, Q3)

Brazil inflation (Nov)

US nonfarm payrolls, earnings and jobless rate (Nov)

US Michigan sentiment surveys (Dec) and wholesale inventories (Oct)

Special Focus

Vietnam: Asia's Rising Manufacturing Star

By Rajiv Biswas, Asia-Pacific Chief Economist, IHS Markit

This article analyses Vietnam's impressive economic growth over the past decade and considers the opportunities and risks the country faces in the next phase of its development as it transitions to an upper-middle income nation over the next decade.

Overview

Rapidly increasing manufacturing wage costs in China over the past decade have boosted the relative competitiveness of Vietnam as a leading Asian manufacturing export hub for products such as low-cost textiles and electronics assembly. Vietnam has also increased its trade competitiveness via trade liberalization, including through the new EU-Vietnam Free Trade Agreement and by its membership of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

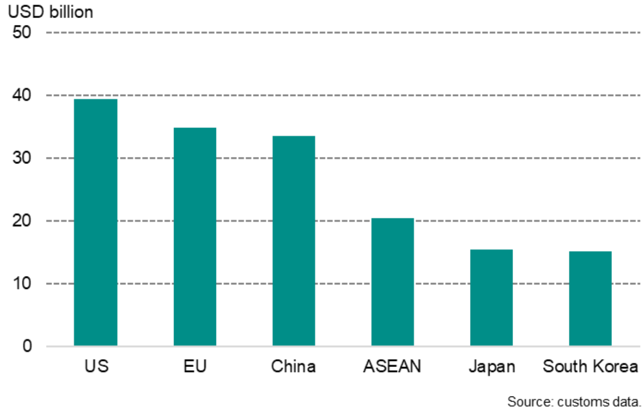
Vietnam's emergence as a manufacturing export hub

Vietnam has emerged as one of ASEAN's most dynamic manufacturing hubs over the past decade, with the average annual growth rate for Vietnamese industrial production having been 10% between 2013 and 2017. A key factor that has driven the economic upturn in Vietnam since 2010 has been the rapid growth of electronics manufacturing. The importance of Vietnam's electronics industry has risen dramatically, with the electronic industry's share of total GDP rising from 5.2% in 2010 to around one- quarter by 2017, a key factor helping to drive rapid growth of both exports and GDP.

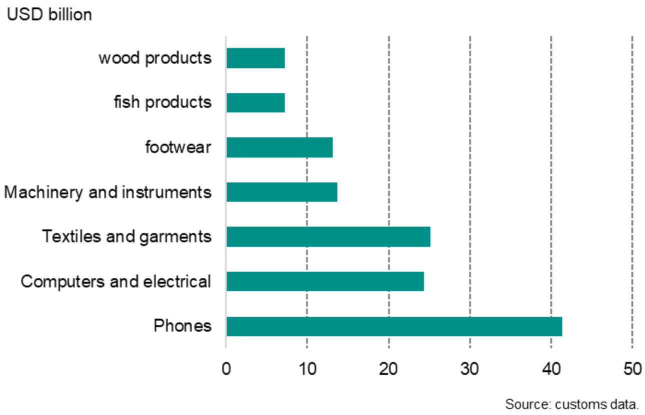
In 2017, Vietnamese exports grew by 21% year-on-year, to reach USD 214 billion, resulting in an annual trade surplus of USD 2.7 billion. The US remained Vietnam's largest export market in 2017, although the new EU-Vietnam Free Trade Agreement is expected to significantly boost Vietnamese exports to the EU market once it is implemented. The EU-Vietnam trade agreement will eliminate over 99% of all tariffs, with EU duties on imports from Vietnam to be eliminated progressively over a seven-year timeframe.

Strong export growth has continued during 2018, with total Vietnamese exports rising to USD 202 billion for the January to October 2018 period, up 15.2% on the same period a year ago.

Vietnam exports to key markets, Jan-Oct 2018



Vietnam's major exports, Jan-Oct 2018



As a result of rapidly growing exports, external account difficulties have also eased. The current account position has improved from a deficit of 10.9% of GDP in 2008 and 6.2% of GDP in 2009 to sustained current account surpluses between 2011 and 2017. This has contributed to a significant improvement in foreign exchange reserves, from around USD 12 billion in 2011 to USD 63.5 billion by mid-2018. Import cover has improved commensurately, up from around one-and-a-half months' cover in 2011 to around three months' cover by the end of 2017.

Impact of US-China trade war

The escalating US-China trade war is expected to cause significant collateral damage to other Asian economies that are part of the East Asian manufacturing supply chain, since around one-third of the value added in Chinese exports consists of imported foreign raw materials and intermediate goods, much of which is sourced from East Asian economies.

However, there will also be some trade diversion effects away from China which may benefit some Asian low-cost manufacturing hubs that produce substitutes for Chinese low-cost manufactures. As well as low-cost electrical and electronic goods, Vietnam produces garments and textiles that US importers could source as substitutes for some Chinese products.

Furthermore, the US-China trade war is likely to add to a number of other factors that have already resulted in strong foreign direct investment by global manufacturing multinationals in Vietnam since 2010. These investment flows have reflected a number of factors, including the competitiveness of Vietnam's relatively low manufacturing wages compared to rapidly rising wage costs in coastal Chinese provinces, a well-educated and skilled Vietnamese workforce, rapidly improving infrastructure and good port logistics for export shipments. The Vietnamese government has also implemented policy changes to encourage FDI in the electronics and IT sectors as part of a trade strategy to improve the share of higher value-added manufacturing. Total FDI inflows into Vietnam's manufacturing sector averaged USD 8 billion per year during 2015-16.

Outlook for Vietnam's economic development

Buoyed by rapid growth in manufacturing exports and foreign direct investment, as well as strong growth in private consumption spending, the Vietnamese economy has grown at between 6% and 7% per year since 2014, with a similar pace of growth forecast to continue over the medium-term outlook from 2019-2023. Over the past decade, the total size of Vietnamese GDP has risen from USD 100 billion in 2008 to around USD 250 billion by 2018.

By 2028, the Vietnamese economy is forecast to have grown to USD 590 billion, helped by the continued rapid expansion of its manufacturing export sector as well as tourism exports, while consumer expenditure is buoyed by strong growth in per capita GDP.

Over the next decade, annual per capita GDP is expected to double, from around USD 2,550 in 2018 to USD 5,600 by 2028, helping to drive rapid growth in the total size of the Vietnamese consumer market. This will likely result in Vietnam transitioning from the ranks of the lower-middle income countries to become an upper-middle income country, representing far-reaching economic progress for the nation. This will make Vietnam a fast-growing market for a wide range of goods and services, ranging from manufactures such as white goods, autos and fast-moving consumer goods to services such as telecommunications, real estate services, financial services and health care.

The sustained strong growth of the domestic consumer market will also catalyse further industrial development, as Vietnam's manufacturing sector broadens and deepens into sectors such as auto manufacturing and petrochemicals.

Rapid infrastructure development

Large-scale infrastructure investment as well as residential and commercial real estate development is meanwhile driving strong growth in construction activity. Total construction spending growth is forecast to grow at around 6% per year over the medium-term outlook, according to IHS Markit Global Construction Service forecasts.

Major infrastructure megaprojects include the new JICA-funded MRT system in Ho Chi Minh City, as well as the new Lach Huyen International Gateway Port in Haiphong and the construction of Metro Line 3 in Hanoi. Ho Chi Minh City's Tan Sohn Nat International Airport will also be expanded with the addition of a new runway and terminals. Meanwhile work on a feasibility study has commenced for the new Long Thanh International Airport for Ho Chi Minh City, which is planned to be operational by 2025 with a capacity of 25 million passengers per year. In addition, there are many hotel and industrial construction projects underway which will also contribute significantly to overall construction activity over the medium-term outlook.

The fast-growing Haiphong-Hanoi northern industrial corridor is becoming a leading hub for new foreign direct investment, as large-scale infrastructure investment catalyses industrial development. Major infrastructure development in Haiphong has resulted in a new highway between Haiphong and Hanoi which has cut travel time dramatically. The new Lach Huyen International Gateway Port has meanwhile created a deep water port that will allow manufactures from Haiphong and its hinterland to be shipped directly to key international markets such as the US and EU.

Haiphong International Container Terminal commenced operations in May 2018.

The infrastructure of the Haiphong economic region has also been boosted by the upgrading of Cat Bi International Airport in Haiphong and the Red River Delta Expressway from Hanoi to Haiphong. Large foreign direct investment inflows have been attracted into the Haiphong economic region, including by LG Electronics, Bridgestone ad Kyocera.

Medium-term outlook

With the Vietnamese economy having emerged as one of East Asia's leading new manufacturing export hubs , rapid economic growth is anticipated over the medium-term outlook. IHS Markit forecasts the economy to grow at an annual rate of 6% to 7% over the 2019-2023 period. Strong growth in per capita GDP levels are also projected over the next decade.

However, there are a number of significant economic risks. One key potential source of vulnerability is the continued high level of non-performing loans in the commercial banking system. The pace of banking sector consolidation and restructuring has been slow and protracted, since the government has very limited fiscal capacity to recapitalise the banks.

The Vietnamese economy is also facing the risk of overheating of the domestic economy, as rapid economic growth could generate another boom-bust cycle. The real estate sector looks particularly vulnerable to speculative cycles.

Another risk is from the transmission effects of a hard landing in the Chinese economy. While a China hard landing remains a low-probability downside risk scenario, Vietnam has become more vulnerable to this risk as Vietnamese exports to China have risen significantly since 2010.

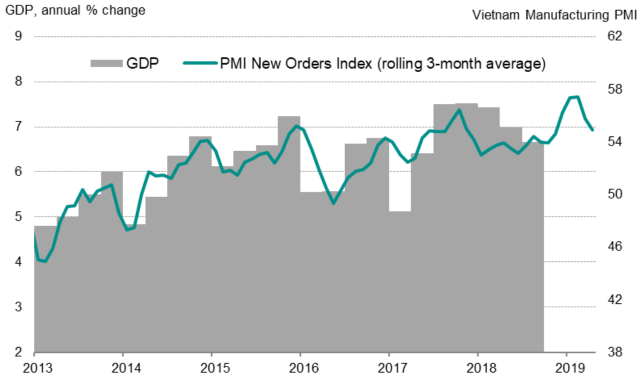
Vietnam PMI

A key source of up-to-date information and data on the health of the Vietnamese economy is provided by the Nikkei Vietnam PMI, compiled by IHS Markit and forming part of the global PMI family

The October update to PMI data eased fears of a protracted slowdown across Vietnam's manufacturing sector resulting from escalating trade war developments. Growth of production, headcounts and input purchasing gathered pace on the back of a robust and accelerated increase in new work during the month. At the same time, the rate of input cost inflation softened to the weakest since July 2017 and charges were lowered for the second month in a row.

With order book inflows remained reassuringly robust, supported by growth in export sales and defying a wider global manufacturing slowdown, the PMI data add to expectations that the pace of Vietnamese GDP growth has accelerated as we move towards the end of 2018.

Nikkei Vietnam PMI (6-month lead) and GDP



Sources: IHS Markit, Nikkei, General Statistics Office of Vietnam

Please contact economics@ihsmarkit.com for more information about the PMI series.

For further information:

If you would like to receive this report on a regular basis, please email economics@ihsmarkit.com to be placed on the distribution list.

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