RAM RATINGS

Media Release

RAM Ratings: Vietnam's vibrant manufacturing sector driving growth

RAM Ratings has reaffirmed Vietnam's respective global and ASEAN-scale sovereign ratings of $_{g}BB_{3}$(pi)/Stable/$_{g}$NP(pi) and $_{sea}BB_{1}$(pi)/stable/$_{sea}$NP(pi). The ratings take into account the country's strong economic performance in 2016 despite agriculture output having been affected by severe drought, cuts in oil production and global volatility. These positives mitigate the slower-than-expected reform of Vietnam's state-owned enterprises (SOEs), the risk posed by its troubled banking sector, the wide fiscal deficit and inadequate foreign exchange reserves.

Vietnam's economic performance has been impressive over the years, driven by a vibrant industrial sector, strong exports growth and a growing middle class which continues to drive private consumption. Although investments and manufacturing output are still largely concentrated in low- and labour-intensive output, there has been an increasing shift towards higher value-added manufacturing. "Market liberalisation, a growing number of free-trade agreements and an overall improving business climate continue to drive in investments," notes Esther Lai, Head of Sovereign Ratings at RAM. The government's pro-growth policies such as corporate income tax cuts in 2016, notably clearer regulations on foreign investment, and speedier permit processing, support the country's robust economic performance and facilitate strong FDI.

Meanwhile, Vietnam's persistent fiscal deficits (5-year average: -7.2%) have led to rising debt levels, which are expected to breach the statutory limit of 65% of GDP in 2017. We view the government's 2017 fiscal deficit target of -3.5% of GDP as ambitious, given that the expected increase in revenue would be derived mainly from the equitisation of SOEs, which is subject to market conditions and valuations. Slower-than-expected SOE reforms, limited progress in addressing their inefficiencies, poor corporate governance and transparency highlight the contingent risks arising from the sheer scale of these entities.

Elsewhere, Vietnam's property and financial sectors remain a concern. Banking sector risks stem from low and declining profitability, limited transparency, the poor quality of reporting standards and the Central Bank's inability to efficiently regulate the sector. Further, reforms such as phasing out explicit loan classification forbearance and strengthening supervision are ongoing. On a related note, the Central Bank has also increased the risk weight for real estate loans to avoid a real estate bubble. Property prices have risen rapidly in urban areas such as Ho Chi Minh City and Hanoi, reflective of the growing economy, recovery from the 2010 property meltdown and the easing of macroprudential measures such as allowing Vietnamese living abroad to own properties locally.

The ratings may be adjusted upwards if sustained fiscal consolidation plans lead to narrower government debt levels and/or improved banking sector stability. Conversely, negative rating action could be triggered by macroeconomic instability arising from a shift in policy, severe ebbs of capital flow, and crystallisation of banking and/or SOE sector risks that would increase government debt.

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Date of release: 18 April 2017

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Published by RAM Rating Services Berhad