

Quarterly Update: Growing Pains in a Promising Market

Autumn 2012

Summary: Today's Opportunity to Capitalize on Vietnam's Emergence

Vietnam's economy may be back on the road toward robust growth after inflation has been brought under control. Economic expansion improved somewhat from 4% in the first quarter to 4.4% in the second quarter of 2012. Retail and service sales are higher than last year. New companies outnumber those going bankrupt by a 7-1 ratio. Inventories are down 29%, another positive sign. But the international investment community remains skeptical about the government's ability to solve banking problems, especially bad loans. Investors question whether Vietnam will move forward with privatization of government-owned corporations as well as business culture reforms. The mixed signals have prevented Vietnam's 12-year-old stock markets from appearing on the radar screens of most global investors. Over the next few years, that will change. Today there are 105 securities companies in Vietnam, 1.2 million accounts, and a \$40 million market capitalization. That's still too small to merit listing in the Wall Street Journal, but Vietnam's day is coming.

A Renewed Call for Reform

Before the global slowdown started in 2008, Vietnam was experiencing an economic miracle driven by foreign investment. Four years later, the question facing Vietnam is whether it can win the global community back. That will depend on trust. Foreign direct investment (FDI) has declined radically — from \$71 billion in 2008 to just \$6 billion in the first half of 2012. That reflects dissatisfaction with the openness in the country; foreign investors are not getting accurate, adequate, and trustworthy information they need to devise investment strategies and assess risk. There's evidence Vietnam's slowdown has hit bottom, but the country needs global investors to get back on the high growth trajectory. Key elements must be addressed to boost confidence among international investors that the world's most promising frontier market is on the right track. They are:

- **Banking and Finance.** Now that inflation has been tamed, Vietnam's biggest current problem may be that one third of the country's commercial banks are said to be "critically injured" by \$12 billion in bad debts — up to 10% of their aggregate loan portfolio. One real-world example of the need for reform is bankrupt Bianfishco, which owes \$50 million to nine banks, partly because Vietnam doesn't have a systematic and centralized way of measuring credit worthiness.
- **Intellectual Property.** Vietnam's technology ministry identified 4,500 violations of intellectual property rights violations and collected about \$1 million in fines, which helps the country gain credibility. Even so, Vietnam faces a long-term challenge reforming a culture of piracy that evolved a decade ago as its highly entrepreneurial and creative consumers were exposed to Western technology and culture they couldn't afford.
- **Corporate Scandal and Privatization.** Three major corporate corruption cases have put a spotlight on Vietnam's need to reform state-owned corporations. First was the case that resulted in long prison sentences for senior executives of shipbuilder Vinashin, next the arrest of the top executives of shipping company Vinalines. Then Vietnam's public equity markets went into a tailspin this summer when banking executives, including one of the country's wealthiest, were accused of regulatory violations and corruption. Vietnam's Chamber of Commerce says half of Vietnamese companies bribe government officials to win contracts. International investors see privatization of corporations as a critical part of the solution. Vietnam says it will sell parts of 254 government-owned businesses this year. Because the government has a history of stalling privatizations, following through on that commitment will be essential.

Toward Domination in Commodities

Vietnam is expanding its range of products and its capacity to export them. The latest developments:

- A new report says Vietnam is claiming supremacy over India in commodities trading as Ho Chi Minh City continues to look like Southeast Asia's emerging commodities hub.
- Vietnam has become the world's largest exporter of pepper — with 125,000 acres growing well over 110,000 metric tons with a \$500 million export value, and the US its biggest customer.
- Add mushrooms the list of foods Vietnam intends to be a world leader in exporting (along with rice, cashews, tea, coffee, seafood, etc.). VN plans to export \$200 mushrooms million annually.
- Vietnam is likely to be a top supplier of herbal medicine because of a potent combination of venture capital from California, Vietnam's bio-diversity, and research taking place in its forests.

The American-Vietnam Connection

Nike reported 41% of its shoes were made in Vietnam last year (up from 39% the year before) while China's share declined a percentage point to 32%...*Vietnamese businessman Pham Dinh Nguyen purchased the entire 10-acre town of Buford, WY, America's smallest municipality, for \$900,000...*Nearly 15,000 Vietnamese students studied in the US last year, spending \$416 million and raising Vietnam's rank to 5th after China, South Korea, India and Canada...*First Solar, America's struggling global leader in solar panels, abandoned its \$1 billion investment in Vietnam...*21 US companies visited Vietnam this summer when US Secretary of State Hillary Clinton was there, including Chevron, Coca-Cola, Caterpillar, Unilever, Kimberly-Clark, and Pepsico... *GE is providing power transmission equipment for Vietnam and expanding its wind power turbine factory in Haiphong...* Intel's factory in Ho Chi Minh City exported \$462 million in chips last year...*Chevron is working with PetroVietnam to provide natural gas...* The US inaugurated a four-year, \$43 million effort to address Agent Orange pollution and other environmental effects of the Vietnam War.

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Key Vietnam Data

First half 2012 vs. first half 2011 from government monthly statistical reports

Gross Domestic Product – \$60.1 billion, up 4.4%

Consumer Prices – up 12.2%

Exports --\$53.1 billion, up 22%

Imports -- \$53.8 billion, up 7%

International Visitors – 3,363,400, up 14%

Foreign Investment -- \$6.4 billion, down 28%

VN Dong Exchange Rate -- 20,860, up 1.0%

Stocks -- Closed at 428.8, up 21% YTD

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