Macro
Vietnam Economics

HSBC Global Research

Let's go Vietnam

HSBC manufacturing PMI debuts

- **The Vietnam HSBC PMI is the first and only independent high-frequency indicator to survey business conditions in Vietnam**
- **Referencing government data, we believe the PMI accurately gauges economic activity and is a good leading indicator**
- **For April, the PMI shows a modest fall in production, but with export orders accelerating sharply**

Joining the ranks

Vietnam gets a lot of attention for a small economy, but a dearth of statistical data makes tracking economic activity there a tricky business. To fill this gap, HSBC has partnered with Markit Economics to launch a Vietnam manufacturing purchasing managers' index (PMI). The PMI is an independently-sourced survey that follows a methodology that is consistent with other such surveys by Markit, making international comparison possible. The launch of the Vietnam HSBC PMI underlines HSBC's belief that Vietnam has strong growth potential and will become increasingly important to global trade and capital flows.

In April, the PMI dipped slightly below 50 to 49.5, indicating a moderate deterioration in economic conditions from March. As mentioned in our last *Vietnam at a Glance*, limited access to credit has hurt business and production. Looking at the sub-indices of the PMI, employment and export orders are holding up, suggesting producers are expecting economic activity to pick up in coming quarters. However, given the magnitude of the slowdown in manufacturing activity in 1Q, the economy is unlikely to be able to keep up with its long-term growth rate (averaging 7% p.a. in the past decade) this year. Amid a sharp slowdown in domestic demand, we forecast growth will fall to 5.1% in 2012 from 5.9% in 2011.

Through its transformation from a war-torn nation to a thriving emerging economy in the past 40 years, Vietnam has shown an impressive ability to make progress in the face of adversity. Today, we believe the country stands at a crossroads. With favourable demographics, geographical proximity to China and a strong entrepreneurial culture,

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Table 1. Vietnam manufacturing PMI and its sub-index

	Jan 12	Feb 12	Mar-12	Apr-12	One-year average
PMI Index	47.2	46.2	50.0	49.5	50.1
Output					50.7
New Orders					50.6
New Export Orders					51.0
Backlogs of Work					49.9
Stocks of Finished Goods					49.6
Employment					50.5
Output Prices					54.1
Input Prices					60.2
Suppliers' Delivery Times					51.2
Stocks of Purchases					48.3
Quantity of Purchases					50.0

Source: Markit, HSBC; Note: Less than 50 and falling Less than 50 and rising or same Greater than or equal to 50 and falling Greater or equal to 50 and rising or same

the economy has robust fundamentals. But without reforms to eliminate longstanding structural bottlenecks – such as inefficient state-owned enterprises, public investment, and the banking sector – the country could be stuck on a below-trend growth trajectory over the medium term.

A closer look at Vietnam's Manufacturing PMI

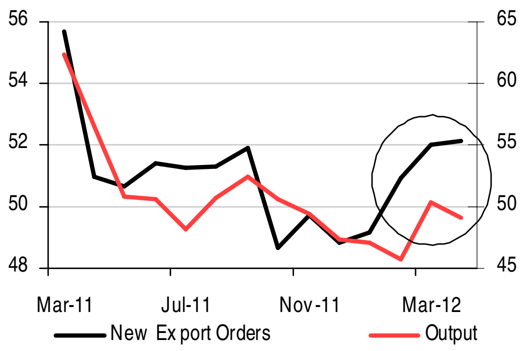
April: activity slows, but export demand is stronger

The Vietnam HSBC PMI is the first non-government high-frequency indicator to be launched for the country. Table 1 shows how the PMI index performed in the past four months. Grey denotes an increase from the previous month, whereas red reflects a decrease. The numbers for the 11 sub-components are not shown because the information is proprietary.

The decline from 50.0 in March to 49.5 in April shows manufacturing activity continued to fall in the past month, albeit at a slower rate than in the first two months of the year. This deterioration reflects the tough domestic operating environment; access to credit is limited, and both businesses and consumers remain cautious.

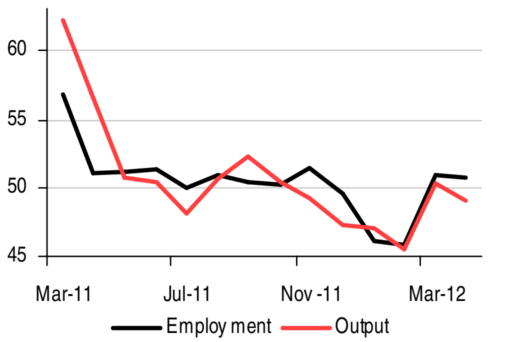
There are reasons for optimism, however. While new orders, quantity of purchases and stocks of purchases stalled in April, new export orders increased by the most since the survey began (from 52.0 in March in April 2011 to 52.1). This was driven by a rebound in demand from China and stronger-than-expected orders for

Chart 1. Output slowed but new export orders are up



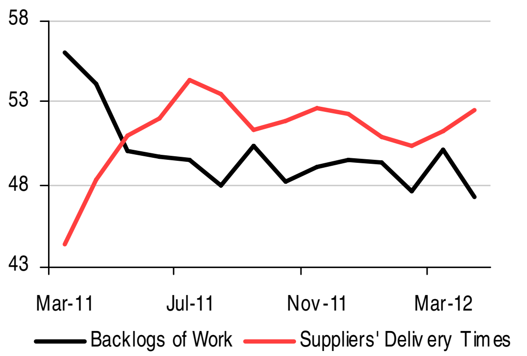
Source: Markit, HSBC

Chart 2. But employment is holding up, suggesting an improvement in outlook for the coming months



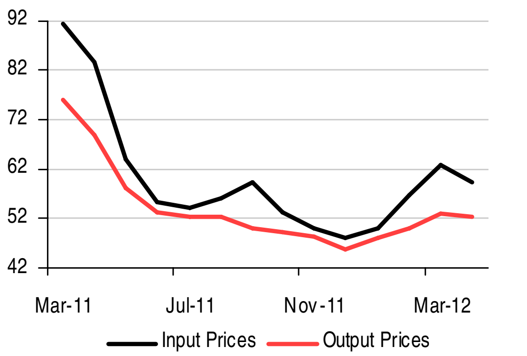
Source: Markit, HSBC

Chart 3. Business productivity has increased recently



Source: Markit, HSBC

Chart 4. Higher energy costs force firms to pass the rise in prices to consumers



Source: Markit, HSBC

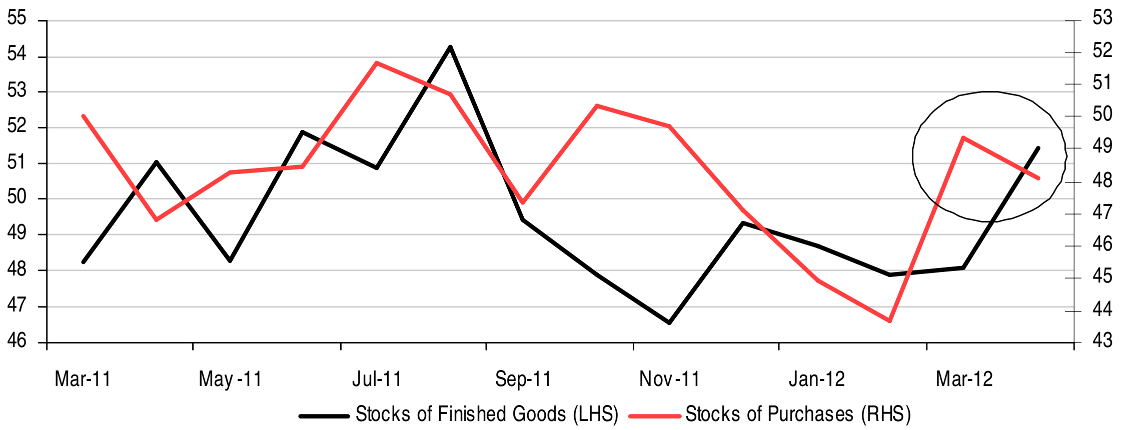
manufactured goods from the U.S. and Japan. In the coming months, we expect exports to bounce back on the back of increased external demand, although some of this is likely to be offset by the tough domestic operating conditions and an expected softening in commodity prices.

It is also encouraging to see both employment (from 50.9 in March to 50.8 in April) and new orders from manufacturers rise, albeit modestly, for a second consecutive month. This suggests the outlook for demand remains relatively positive for companies. We expect growth to rebound to 4.8% y-o-y in 2Q from 4.1% in 1Q.

Business productivity also improved in April. The backlog of work index (outstanding business) declined to 47.2 after a sharp rise in March to 50.2 due to improved productivity and higher staffing levels in April. The suppliers' delivery time index also rose to 52.5 from 51.2 in March. The shorter delivery times among suppliers probably highlights a continued improvement in vendor performance, although it should be noted that it could also signal lower overall demand.

Costs of input prices, on the other hand, have been high, although they have decelerated substantially since April 2011. Increased input costs in April to 59.1 from 62.9 in March are linked to higher oil-related prices, especially transportation fees. The cost burden continues to weigh on Vietnam's manufacturing sector. Added to this, lending rates

Chart 5. Lower-than-expected sales motivated manufacturers to implement stock reduction policies



Source: Markit, HSBC

continue to be elevated, limiting firms' access to capital. Although input prices have risen significantly, firms have only been able to pass off some of the costs to consumers, as shown by the large gap between input and output prices (rose to 52.2 in April from 51.2 in March).

With higher prices and lower demand, some firms found their sales weaker-than-expected. As a result, inventories rose in April to 51.4 from the previous month's reading of 48.1. In response to this, manufacturers adopted a cautious approach to prevent unwanted stock accumulation. The quantity of purchases index as well as the stocks of purchases index declined in April to 47.5 and 48.1 from 50.8 and 49.2, respectively, reflecting deliberate stock reduction policies among manufacturing companies.

With business activity decelerating, as reflected in the sharper-than-expected slowdown of GDP to 4.1% y-o-y in 1Q from 6.1% in 4Q2011, the State Bank of Vietnam (SBV) reduced policy rates by 2% in one month (1% in March and 1% in April). The move is part of the central bank's efforts to pump credit into the economy, after credit contracted in real terms in 2011 and declined in the first quarter of 2012. We expect the weak PMI print, coupled with weak import data and decelerating exports, will prompt the SBV to reduce rates further in coming quarters. We expect the next cut to come in early July, along with administrative measures, to boost ailing industries. Although this will help growth accelerate in the coming quarters, the effect of negative credit growth has already been felt in the first quarter. As such, we expect GDP to expand 5.1% this year, much lower than Vietnam's long-term potential.

Methodology

The Vietnam manufacturing PMI is compiled by Markit Economics, which has developed similar indicators for almost 30 countries. It is a continuous survey that measures business conditions through simple and factual questions to deliver accurate and timely data for a wide range of audience, including but not limited to central banks, government departments, investment banks, worldwide investment community and the corporate sector. The Vietnam HSBC PMI follows the same tried and tested methodology used by other surveys for more than fifty years.

The PMI has 11 subcomponents that gauge business conditions. However, only five of the sub-indices are used to determine the headline PMI and the weights are: a) new orders (0.3), b) output (0.25), c) employment (0.2), d) suppliers' delivery times (0.15, the index is inverted), and e) stocks of items purchased (0.1). These are considered the best indicators to gauge the future direction of the manufacturing sector in Vietnam.

Similar to other PMIs, the Vietnam survey includes more than 400 companies that best

Table 2. Breakdown of firms by type

ISIC Rev 3 Sector	Sector	% of the Manufacturing Sector	Number of firms surveyed by size (employees) Total	0-49	50-199	200+
15-16	Food and Drink	20.30%	87	15	16	56
17-19	Textiles and Clothing	14.40%	62	2	5	55
30-33	Electrical and Optical	9.40%	40	1	7	32
24-25	Chemicals and Plastics	9.00%	39	3	11	24
34-35	Transport	11.40%	49	1	4	44
20-22	Timber and Paper	3.90%	17	3	6	8
27-28	Basic Metals	11.10%	48	5	15	28
29	Mechanical Engineering	1.40%	6	1	1	4
23,26,36,37Other	Other	19.00%	82	8	14	60
	Total		**429**	**38**	**80**	**311**

Source: Markit, GSO, HSBC

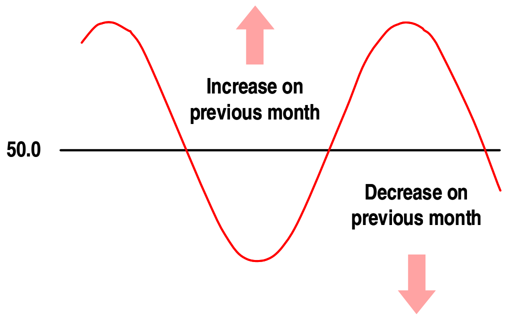
Graphic 1. Calculating the PMI index

Is the level of output at your company higher, the same or lower than one month ago?

Weights used for index:
- % responding higher = 1.0
- % responding no change = 0.5
- % responding lower = 0.0

Source: Markit, HSBC

Graphic 2. Interpreting the PMI index



Source: Markit, HSBC

represent the manufacturing sector in Vietnam. Firms are chosen to reflect the sectoral contribution of the manufacturing sector to GDP using data from the General Statistics Office of Vietnam. Table two shows the sectoral breakdown of the firms and the number of companies that are chosen for that particular sector through a randomized sampling method. The survey has a response rate of more than 70% each month.

Of the chosen firms, the panel members are surveyed at the senior level. Purchasing managers and senior executives are asked to answer questions similar to the one in graphic 1 for each of the level sub-indices. The sub indices are then calculated to generate the headline PMI using their respective weights (see above). The results are interpreted based on their relative results to 50. A number below 50 reflects a worsening from the previous month. A number above 50 reflects an improvement from the previous month.

As stated earlier, the Vietnam HSBC PMI is the first and only high-frequency non-government economic indicator available for Vietnam. Table 3 compares the HSBC PMI with the already available economic indicators. The only economic measure that is comparable to the PMI is the industrial production index, which is released every month by Vietnam's General Statistics Office (GSO). All other non-government indicators that measure business activity are either released on a quarterly or semi-annual basis.

How useful is HSBC PMI?

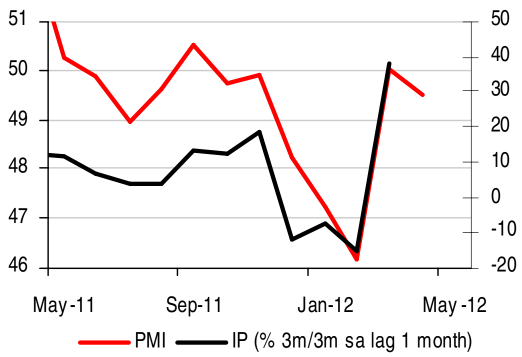
While the methodology for the PMI is tried and tested in many nations, the Vietnam survey is only useful as long as it serves as an accurate gauge of economic conditions and leading indicator for how the economy will fare in coming months. To assess the reliability of the PMI, we compared not only headline PMI but also its sub-components to the GSO's main indicators: inflation, exports, industrial production (IP), retail sales, and GDP. Chart 6 shows that the PMI index tracks well with the IP level and serves as a good lead indicator for the

Table 3. Comparing HSBC PMI with already available economic indicators

Survey	Frequency	Panel Size	Indicators	Timing
HSBC Vietnam Manufacturing PMI	Monthly	429	12	First working day of each month
GSO Industrial Production Index (official)	Monthly	-	-	Last week of each month
Ifo World Economic Survey	Quarterly	1107 (across 12 countries)	-	Last month of each reference quarter
GSO Gross Domestic Product (official)	Quarterly	-	-	Last day of each reference quarter
VCCI Business Insight Survey	Quarterly	500 target	10	First working day of each quarter
Neilsen Business Barometer Survey	Bi-annually	35	-	First working week of the following reference period

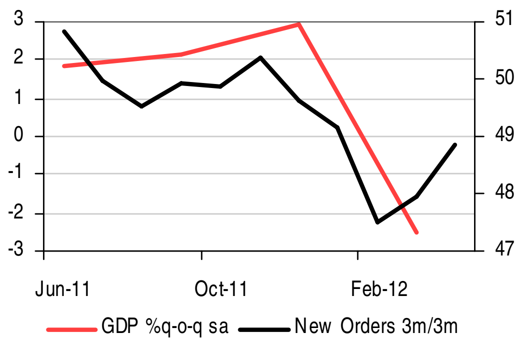
Source: Markit, HSBC

Chart 6. PMI is a good lead indicator for industrial production



Source: Markit, HSBC

Chart 7. New orders indicate that the economy will rebound in the next quarter



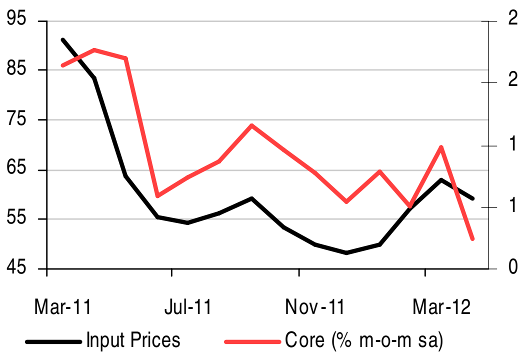
Source: Markit, HSBC

following month's activity. Using trend data of IP (three month over three month moving average), the PMI leads IP by one month. In addition to the headline PMI, the new orders sub-index is a good predictor for the future direction of the economy (as shown in Chart 7). As GDP numbers are only released on a quarterly basis, they are not as good at picking up high-frequency trends as the analysis of new orders, which is available on a monthly basis. Looking at the uptick in new orders, which is consistent with our growth forecast, we expect q-o-q sa growth to pick up in 2Q due to increased demand and a pick-up in global activity.

Exports, although still robust, have decelerated this year due to limited access to credit. New export orders closely tracks GSO export trend data. On a trend basis, exports appear to be slowing in the coming months due to tough operating conditions. However, as easing measures filter through, we expect business conditions to improve. Coupled with growth in external demand, this should bolster export growth this year.

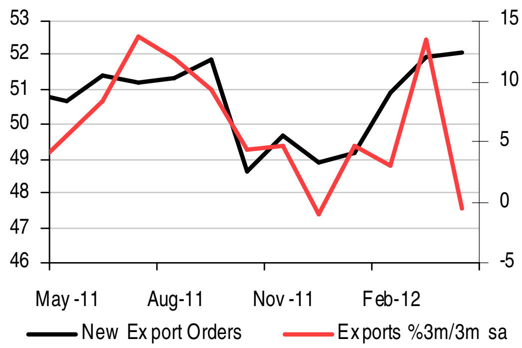
After a year of persistently high inflation, price pressures have eased recently to 10.5% y-o-y from their peak of 23.0% in August 2011. Chart 8 shows the steep decline of input prices since early 2011. However, prices have recently perked up due to higher oil prices, which has a secondary effect on business production. Sequential monthly core inflation, which excludes food and energy, tracks closely with the input prices sub-index. This suggests that input prices can be used to gauge the price pressures that businesses face.

Chart 8. Input prices are decelerating along with core inflation



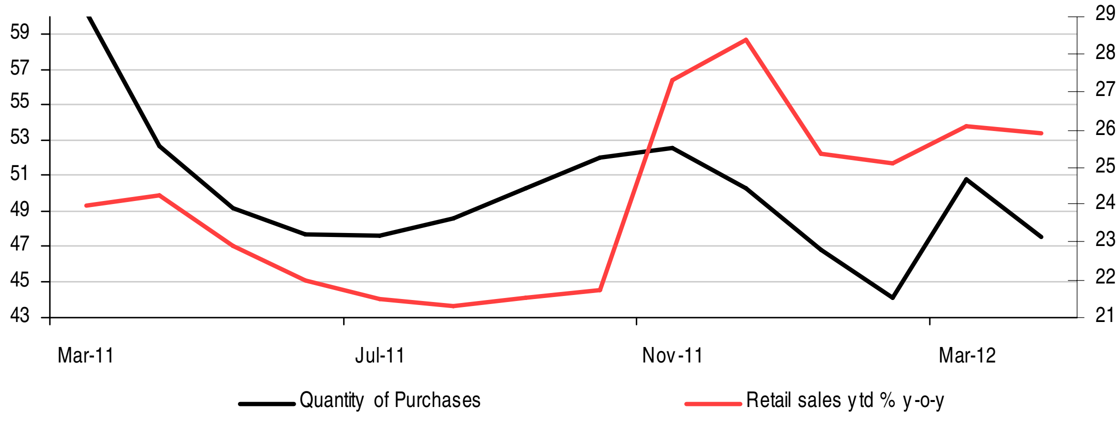
Source: Markit, HSBC

Chart 9. Export order sub-index shows the trend of exports



Source: Markit, HSBC

Chart 10. Quantity of purchases track well with retail sales



Source: Markit, HSBC

Measures to curb inflation, including limiting credit growth, have dampened demand in Vietnam. With private consumption making up around 70% of GDP, understanding the trend of consumer behaviour is particularly important for predicting growth. Retail sales, prior to the release of the PMI, was the only proxy for private consumption in the economy. With the release of the PMI, we have another proxy for demand in Vietnam. The quantity of purchases by manufacturing firms, as shown in Chart 10, tracks closely with retail sales. The decision to purchase materials by managers signals not only firms' current demand but also their prediction of future needs. As such, with quantity of purchases decelerating in April, domestic demand in Vietnam is still low. Some pick-up in consumption will occur in the second half of the year but it will not be enough to restore growth to its long-term average of 7%.

Thus, Vietnam is at a crossroads. With favourable demographics, cheap labour, geographical proximity to large markets as well as strong entrepreneurial culture, the economy has strong fundamentals. But without reforms to eliminate many longstanding structural bottlenecks – such as inefficient state-owned enterprises, public investment, and the banking sector – the country could be stuck on a below-trend growth trajectory. Encouragingly, last year's aggressive tightening of credit shows that the government is willing to prioritize the economy's long-term health over short-term gains. Efforts to reform the banking sector as well as inefficient investment are also in place.

The launch of the Vietnam HSBC manufacturing PMI underlines HSBC's commitment to Vietnam economic research. Underpinned by Markit Economics' independent research and well-tested methodology, this high-frequency economic indicator gives followers of Vietnam the means to accurately track the country's economic activity on a monthly basis and gauge future trends, as our comparison with the GSO indicators demonstrates.

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