

Public Sector Practice

Emerging from the pandemic, Vietnam must position itself for recovery

As it emerges from COVID-19, Vietnam's domestic economy is set to return to growth, but not until the global economy bounces back.

by Bruce Delteil, Matthieu Francois, and Nga Nguyen



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It's been two months since the last known case of community transmission of the coronavirus in Vietnam, enabling the country, hailed recently as one of the 11 outperformers among emerging economies, to be among the first to fully reopen its domestic economy.

While recurrence remains an ever-present threat, Vietnam's government is now turning its attention to repairing a damaged economy. Vietnam has fared better economically than many countries, but it has not been completely spared. GDP growth in the first quarter was at its lowest level since 2010, although it was still in positive territory at 3.8 percent. With exports and tourism severely affected, domestic consumption has been (and is expected to continue to be) critical to hold the economy together.

Staying afloat in 2020, largely thanks to spending on essentials

Buoyed by a rapidly growing middle class and rising disposable income, domestic spending has long been a key engine of growth for Vietnam, accounting for 68 percent of GDP. Although under pressure from falling demand—two-thirds of Vietnamese surveyed in April 2020 said their income had been disrupted by COVID-19, and 55 percent said they had cut back on spending—the “engine” has largely remained in gear.

Vietnam's suspension of nonessential activities lasted only 22 days—significantly shorter than many other countries, easing some of the downward pressure on consumption. A VND 27 trillion stimulus package released in March, targeting households and small businesses, also helped shore up demand.

It remains to be seen how long domestic consumption can keep the economy afloat in the absence of a return to growth in other key sectors of the economy, but a closer look at Vietnam's spending characteristics gives some reason for confidence. The main reason for optimism lies in spending on essential goods and services, which accounts for 42 percent of national GDP, compared with just 26 percent for discretionary spending.

Spending cutbacks are mostly being felt in the discretionary-spending category (Exhibit 1), so a significant slice of the country's economy could be relatively well insulated.

Vietnam will still be reliant on the world economy to recapture its promising growth trajectory

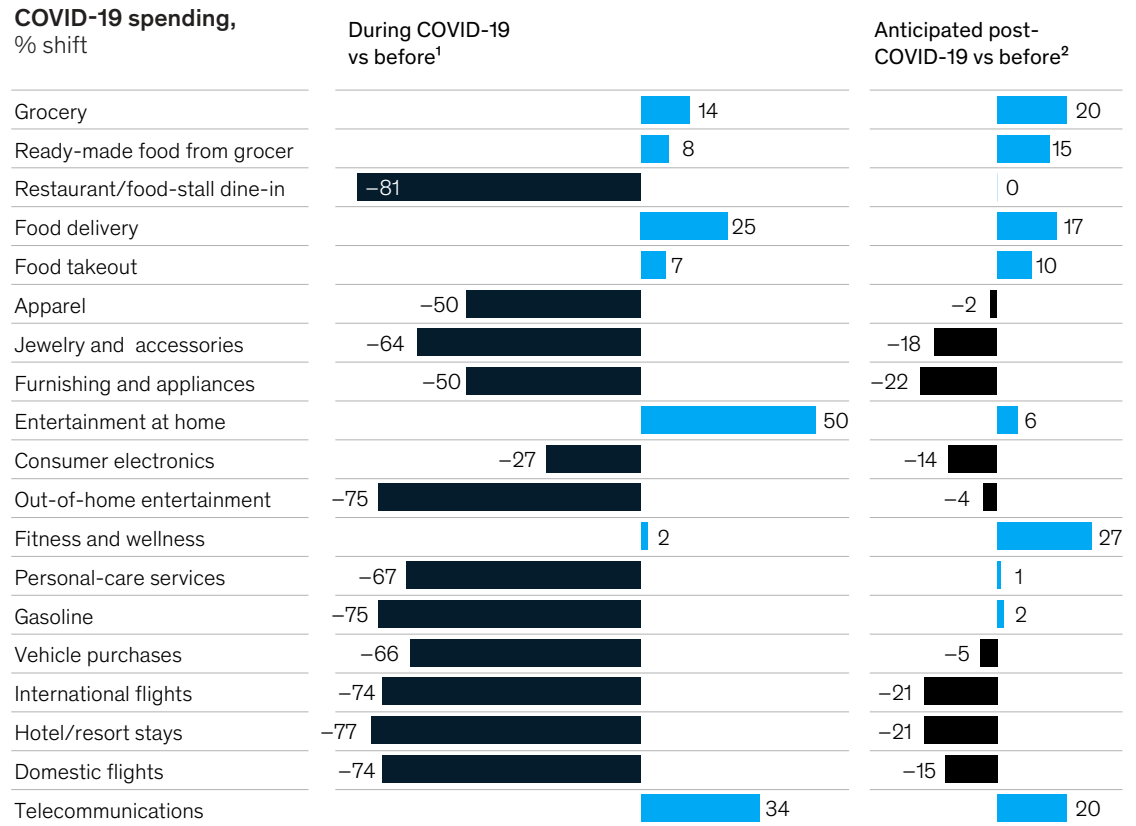
Domestic consumption alone will not likely return Vietnam to anywhere near its pre-COVID-19 growth trajectory. Its short-term outlook is therefore closely tied to the global economy's ability to restart, and for the rest of the world's consumption to return. Most international agencies expect that to begin happening later this year and to accelerate in the next year, with the Asian Development Bank, World Bank, and International Monetary Fund all releasing forecasts at the end of the first quarter predicting Vietnam's GDP growth to reach 6.8 to 7.0 percent in 2021.

A rebound in international tourism and labor-intensive manufacturing exports will be critical for this growth. Given the unpredictable nature of COVID-19, it is difficult to analyze how the tourism recovery will play out, but it's likely that the industry will restart first within the ASEAN region as borders reopen. Vietnam's relatively virus-free status leaves it well positioned to receive an outsize share of international tourists, as long as it takes precautions to prevent a recurrence of the virus.

But even a strong rebound in intra-ASEAN tourism will not prevent the number of international tourists from sliding 50 to 70 percent for the year. This drop will obviously have a significant impact on a sector that has already seen the closure of thousands of tourism operators. However, aside from promoting the country as a safe and enjoyable place to visit, there is little that Vietnam can do until more countries reopen and relax their own travel restrictions. While some countries can promote domestic tourism to replace some of their lost international earnings, with per capita GDP just three times the \$900 that a typical foreign tourist spends per trip, it will be challenging to bridge

Exhibit 1

In multiple sectors, Vietnam consumers anticipate decreased spending even after COVID-19.



¹Question: "How has your spending per month changed during the COVID-19 outbreak compared with before the COVID-19 outbreak for each of the below items?" Figures may not sum to 100%, because of rounding. Net behavior (ie, how much people consume) and net intent are calculated by subtracting the % of respondents stating they expect to decrease spend from the % of respondents stating they expect to increase spend.

²Question: "For each of the following product/service options, how do you expect your spending per month to change after the COVID-19 outbreak compared with before the COVID-19 outbreak?" Figures may not sum to 100%, because of rounding.

this gap if Vietnam relies only on the current local spending power. The country may have to proactively advocate travel from nearby Asian markets, such as China, as the borders reopen.

In 2021, prospects positive for manufacturers once demand returns

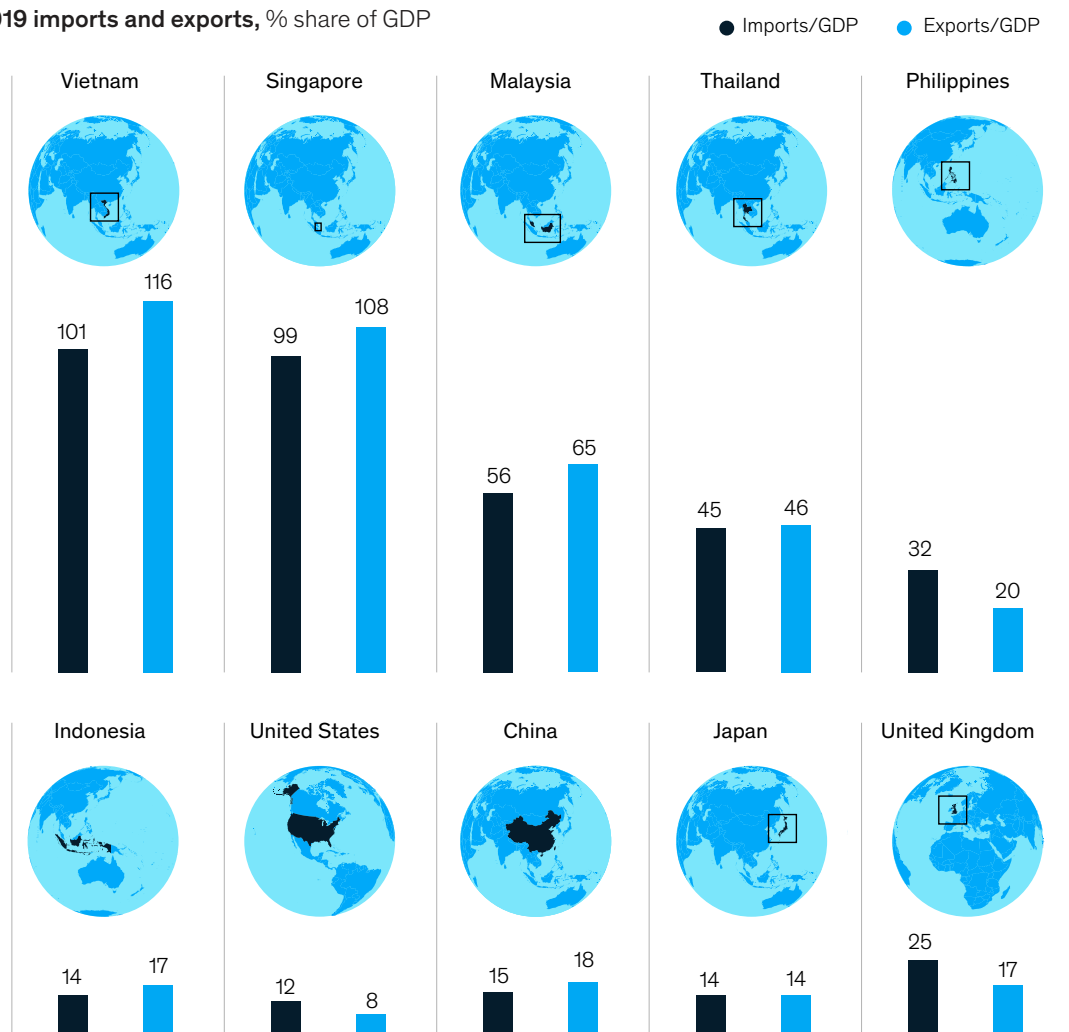
Manufacturing has been a crucial sector for Vietnam's growth, leading Vietnam to achieve one

of the highest trade-over-GDP ratios in Southeast Asia (Exhibit 2). And COVID-19 hit it hard—first through supply disruptions, when China went into lockdown, and then by plummeting demand as key export markets stalled. With exports falling and the prospects of a near-term recovery looking uncertain, companies began putting planned investments on the back burner, contributing to a 21 percent drop in foreign-direct-investment commitments in the first three months of the year.

Exhibit 2

Vietnam is an import-dependent exporter and has the largest percentage of imports and exports among Southeast Asian and other peer economies.

2019 imports and exports, % share of GDP



Note: The boundaries and names shown on maps do not imply official endorsement or acceptance by McKinsey & Company.
Source: UN Comtrade Database; World Bank

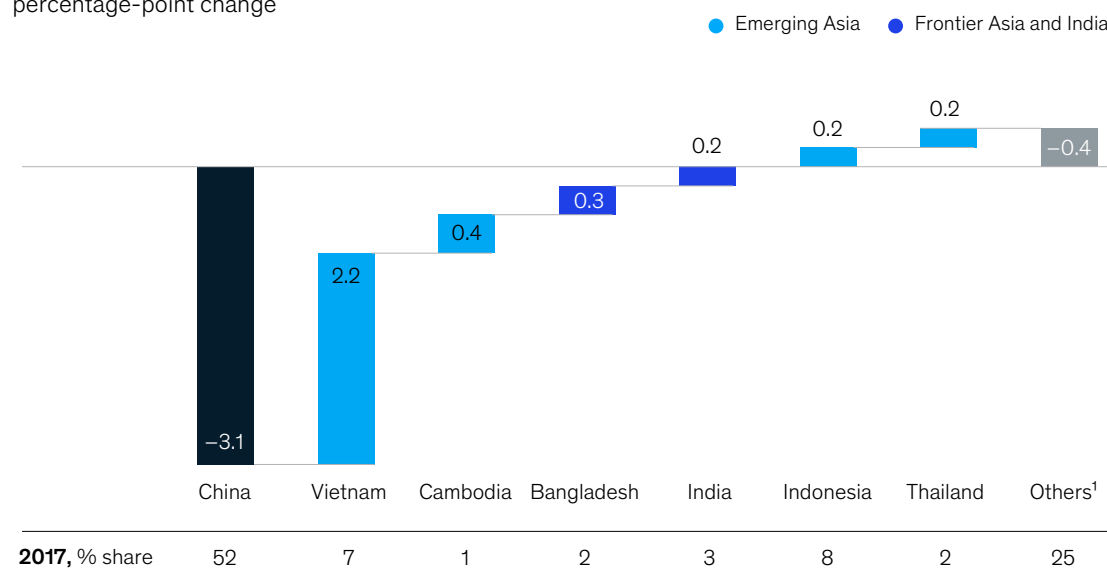
But there are some encouraging bright spots on the horizon. The manufacturing sector's importance to Vietnam's overall economy is clear, and so key steps have been taken to keep operations running despite lockdowns in other countries. For example, engineers from two major international electronics manufacturers were allowed to enter Vietnam earlier this year to ensure their factories continued to run at full capacity. The government also collaborated with local businesses to ramp up production of personal protective equipment (PPE) for essential workers, helping them to gain access to global markets.

As manufacturers across the globe start to rethink their supply-chain strategies to address the frailties exposed by the pandemic, Vietnam remains in a strong position. The country has long been an attractive offshoring destination: its share of labor-intensive manufacturing exports from emerging markets grew 2.2 percent between 2014 and 2017 (Exhibit 3). Its offshoring subsector could grow, especially if companies make greater efforts to diversify their supply chains in the wake of the pandemic. A McKinsey survey of fashion-sourcing executives published in May supports this view, with

Exhibit 3

As China shifts away from labor-intensive manufacturing, other countries in Asia, including Vietnam, are picking up a share of this activity.

Change in share of emerging-market exports in labor-intensive manufacturing, 2014–17, percentage-point change



¹Non-Asian economies.

Source: International Monetary Fund; World Trade Organization; McKinsey Global Institute analysis

24 percent of respondents saying they expect to see an increase in production in Vietnam—more than any other location in Asia.

This year will no doubt continue to be a challenging one, but Vietnam could expect the strong growth of recent years to return next year, and it will likely see its position as an offshoring location reinforced once the global economy begins to recover. Harnessing this energy to become a middle-

income nation will require multiple longer-term investments—in the smart technologies of Industry 4.0 and infrastructure development, for example.

If Vietnam can continue its enviable record of keeping community transmission of COVID-19 at bay while also making the right structural shifts to drive growth over the next decade, it could not only recapture its pre-COVID-19 economic position but drive new economic growth.

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This is the first of two articles examining the immediate impact of COVID-19 on Vietnam's economy and the long-term challenges the country faces as the global economy recovers.

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