VIET NAM

Growth in 2001 is expected to slow as the external environment worsens and agriculture sector performance weakens. In an attempt to boost the economy, the Government has allowed faster depreciation of the dong, focused its fiscal stimulus on reviving rural demand, and liberalized interest rates. However, a more potent source of higher growth would be the removal of distortions in the economy.

Economic Indicator (percent)	1998	1999	2000	2001		2002	
				Current	*ADO 2001*	Current	*ADO 2001*
GDP growth	4.4	4.7	6.1	6.0	6.4	6.2	6.9
Inflation rate	7.9	4.1	-1.7	0.5	3.0	3.0	5.0
Current account[a]/GDP	-4.6	4.1	1.7	2.0	-0.1	-3.0	-1.9

[a] Excludes official transfers.

Economic Assessment. The 11 September terror attacks on the US, compounding the effects of an already weakening global economy, have worsened the near-term prospects for Viet Nam. The sharp downturn in the US and the worldwide slump in the ICT sector are, however, likely to have a less direct impact on Viet Nam than on some other regional economies because its trade with the US is currently at a low level and its ICT sector remains undeveloped. However, these factors have indirect effects on the economy, which is experiencing slower trade with Asian economies (other than the PRC), particularly those that depend on trade with the US and on ICT exports. Moreover, the economy of Japan—the country's largest trading partner—continues to stagnate, affecting Viet Nam's economic performance. Expectations of a prolonged global slump weakening commodity and oil prices, and a softer rebound in 2002 than previously anticipated are also likely to hit the more cyclical exports.

GDP growth is now projected to slow to 6.0 percent in 2001, from 6.1 percent in 2000, and compared with the forecast of 6.4 percent in *ADO 2001*, due to the worsening external environment and weaker than anticipated performance of the agriculture sector. Low world prices of agricultural commodities have affected the sector's growth, which is expected to slow from 3.9 percent in 2000 to 3.5 percent in 2001. The strong recovery in industrial growth seen in 2000 is likely to moderate to 9.4 percent in 2001, reflecting slackening domestic demand and the slowdown in external demand. Although services sector growth has so far been sustained, this may not continue over the rest of the year as receipts from tourism are adversely affected due to heightened security concerns.

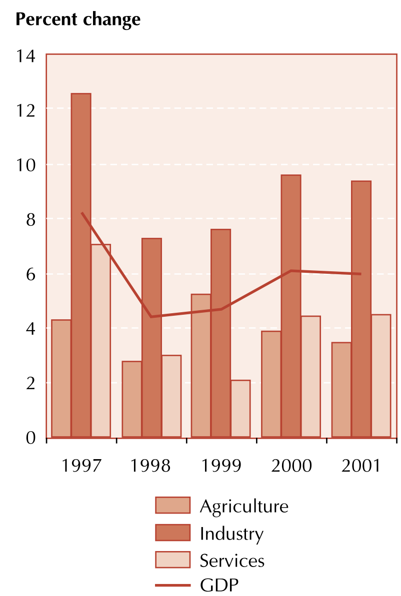
On the demand side, the resilience of domestic demand has so far counterweighed weakening external demand for Viet Nam's exports. While private consumption remained strong in the first half of 2001, weak rural demand due to the slump in agricultural prices is likely to dampen domestic demand over the year. The recovery in investment continues, led by domestic investment; the many new enterprises registered under the Enterprise Law bear witness to this. Although FDI commitments from Japan; Korea; and Taipei,China remain strong, realized investments are likely to be adversely affected by the economic slowdown in these three economies.

Export growth decelerated in the first half of 2001, in both oil and non-oil exports. The dip in crude oil prices has checked the surge in oil revenues that dominated export performance in 2000. Growth in the value of agricultural exports remains sluggish, particularly for rice and coffee, where higher export volumes have hardly offset declining world prices. Manufactured exports have also fared poorly, with slowing export growth of footwear and textiles due to subdued demand from the region and Europe. Against this broad weakening of export performance, marine products have stood out as strong performers. Merchandise export growth for the whole year is projected at around 12 percent. Compared to the strong recovery of imports in 2000, growth in 2001 has, thus far, been relatively modest; for the full year it is estimated at 10 percent. As a result of slower import growth, the current account balance is likely to remain in surplus in 2001. On the capital account, FDI inflows strengthened in the first half of 2001. Medium- and long-term loan disbursements have also risen, reflecting credits under IMF's Poverty Reduction and Growth Facility (PRGF), and the World Bank's Poverty Reduction Support Credit (PRSC). Due to these increased capital flows, gross reserves are expected to rise from $3.4 billion at end-2000 to $3.9 billion at end-2001, providing 12.6 weeks of import cover.

Consumer price inflation continued to fall in the first half of 2001 due to the decline in food prices, which dominate the CPI basket. It is, however, likely that inflation will rise in the latter part of the year as nonfood prices rise and the effect of faster dong depreciation feeds through to domestic inflation. After rapid expansion in 2000, credit growth slowed in the first half of 2001. The dong, relatively stable in the first quarter of 2001, began to depreciate faster in May. By end-August, it was trading at 14,980/$, down by 3.2 percent from the beginning of the year.

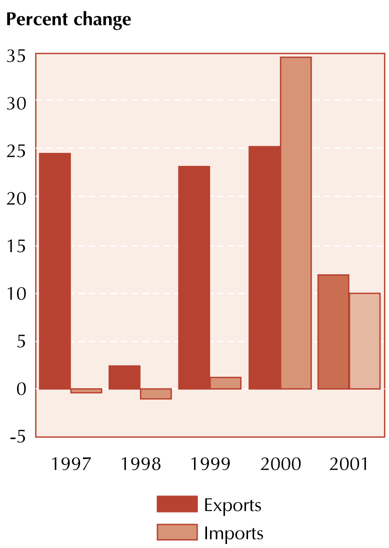
The Government's response to slower economic growth has been to maintain its fiscal stimulus and cut interest rates to buttress domestic demand, and allow a faster depreciation of the dong to boost external competitiveness. As part of the stimulus, to support farmers and exporters hurt by the slump in agricultural prices, the Government has stepped up public spending on rural infrastructure projects. In addition to lowering interest rates—on 1 May 2001 the State Bank of Viet Nam (SBV) reduced its prime monthly rate to 0.65 percent from 0.75 percent—the Government has further liberalized interest rate policies. Since 1 June, banks have been able to set dollar lending rates in line with the international market. On 1 August, the SBV relaxed its policy on the rates at which locally based companies borrow from overseas. To enhance export competitiveness, the Government has allowed the dong to depreciate since May 2001. However, the effects of the Government's announced intention to allow greater flexibility to SBV in managing the currency's crawling peg are likely to be tempered by its preference to minimize the dollar-denominated

Sectoral growth begins to moderate



Sources: General Statistical Office, staff estimates debt burden of SOEs. In another liberalization measure, and a further step toward current account convertibility, the SBV lowered the foreign exchange surrender requirement on export proceeds from 50 percent to 40 percent. As a result of the fiscal stimulus, the fiscal expenditure to GDP ratio (including on-lending) is expected to rise to 25.0 percent in 2001. Revenue growth in 2001 is forecast to slow, reflecting lower oil revenues and tax collection (income tax rates for professionals are being cut). The revenue to GDP ratio is estimated at 19.8 percent for 2001. Given these expenditure and revenue trends, the fiscal deficit is expected to widen to 5.3 percent of GDP in 2001.

Export growth will decelerate sharply in 2001



Sources: State Bank of Viet Nam, www.undp.org, staff estimates

Economic Management Issues. The above measures are expected to help sustain growth. However, a more potent source of higher growth would be the removal of distortions in the economy, including those in the key areas of banking, SOEs, trade, private sector development, and FDI. The Government's commitment to the removal of some of these distortions has recently been underscored by the successful conclusion of its four-year negotiations with IMF and the World Bank, which centered on a program of structural reforms. The program, to be supported by concessional assistance under the PRGF and PRSC, encompasses these key areas. The plans for banking sector restructuring include phased recapitalization of state-owned commercial banks conditional on improvements in their performance and greater transparency in policy-based lending. SOE reform plans include equitization/restructuring of around one third of the SOEs. They also call for strengthened financial discipline of SOEs through curbing credit to loss-incurring enterprises and monitoring the credit use of large SOEs that are targeted under the program. Trade reform plans are based on the implementation of commitments under the US Bilateral Trade Agreement and the ASEAN Free Trade Area and on the removal, on a multilateral basis, of quantitative restrictions on six out of the current 11 items by the start of 2003. Private sector development and FDI are to be promoted through easing barriers to entry and liberalizing the business environment for both domestic and foreign investors, and through improving policy transparency. It is estimated that the structural costs of reform could be as high as 12 percent of GDP. However, sustaining high growth will depend crucially on effective implementation of these reforms.

Forecast. The GDP growth rate in 2002 is likely to pick up slightly to 6.2 percent, in part due to a projected boost to exports, imports, and FDI induced by the US Bilateral Trade Agreement. This will, however, be partially offset by a delayed recovery in the US. The recovery in international rice prices will likely revive agriculture sector performance, but also lead to higher domestic inflation. It is anticipated that the fiscal deficit will widen further as the pace—and concomitant increase in fiscal costs—of implementing structural reforms increases. It is, however, likely to remain manageable. The current account balance will probably shift into deficit as import growth accelerates due to the greater volumes of intermediate goods imports that are needed to underpin higher investment. However, external borrowing and foreign investment will finance it comfortably.