

# Viet Nam

## Summary

**G**DP growth in the first 6 months of 2005 was 7.6%, the highest first-half rate in 5 years. Investment grew strongly, as did consumption and exports. Projected growth for all of 2005 is 7.6%, unchanged from the *ADO 2005* forecast, and the economy is broadly on course to sustain this momentum through 2006. Likely World Trade Organization (WTO) accession and an improving business environment have spurred foreign investment.

Inflation continues to run at a fast pace and this *Update* revises up slightly the forecast for 2005 to 6.0%. The authorities aim to rein in rapid domestic credit growth this year.

A net oil exporter, the economy benefits as higher global oil prices push up the value of exports and boost fiscal revenues, though this fiscal gain is partly offset by government subsidies on some fuels, and by the economic opportunity costs of spending the gains from higher oil prices on these subsidies.

## Updated assessment

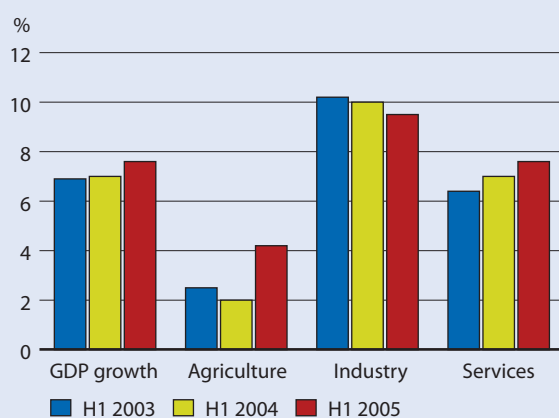
Strong growth continued from 2004 in the first half of 2005, with GDP up by 7.6% year on year (Figure 2.9). The industry sector, which covers manufacturing, mining, construction, and utilities, contributed 3.7 percentage points to first-half growth; services, 3.0 percentage points; and agriculture, including forestry and fisheries, 0.9 percentage point. Avian flu outbreaks continued, though with little impact on the economy, in contrast to drought, which affected some food crops and the coffee industry. In services, the hotel and restaurant subsector

recorded robust growth of 15% in the first half, more than double the rate in the year-earlier period, as tourist arrivals rose by 24%. On the demand side, consumption and investment were robust. Retail sales increased by 9.0% and investment rose to the equivalent of about 37% of GDP at current prices. Consumer inflation has continued to run at a fast pace: the CPI rose by 7.5% in July from the same month in 2004. The average inflation rate for 2004 was 7.7%. Higher food prices, partly a consequence of the drought in some areas, and rising prices for fuels have been major causes of inflation. The forecast for average inflation in 2005 is now put at 6.0%, up from 5.7% in *ADO 2005*.

Exports in the first half rose by 17.4% to \$14.4 billion, helped by higher prices for crude oil and some agricultural commodities. The country shipped out an average of \$527 million of crude oil a month during the first half and imported \$362 million of refined petroleum products for domestic use. (Viet Nam does not have refining capacity, although there is a plan to complete a domestic refinery by 2008.) The value of oil exports for the whole of 2005 is forecast to rise by about 45% to \$8.3 billion if the global oil price is at around \$60 a barrel. Exports of textiles, benefiting from a policy to diversify markets, grew despite intensified competition from textile manufacturers in the PRC and elsewhere who benefited from the ending of the Multifibre Arrangement.

Imports grew by 22% to \$18.0 billion in the first half, outpacing export growth. This was a result of strong domestic demand and higher prices for imported petroleum products, steel, fertilizer, paper, and plastic products. The merchandise trade deficit widened to \$3.6 billion

**Figure 2.9 GDP and sector growth, Viet Nam, H1 2003, H1 2004, and H1 2005**



Sources: General Statistics Office.

in this period. For all of 2005, the current account deficit is projected at 5.6% of GDP, unchanged from *ADO 2005* and similar to the 2004 balance. The projected balance-of-payments deficit will be financed by strong inflows of official development assistance, FDI, and private remittances.

Higher global oil prices raised the cost of government subsidies on petroleum products (mainly on diesel and kerosene) to an estimated \$440 million in the first half of 2005. The authorities have increased prices of gasoline, diesel, and kerosene three times so far this year to reduce the cost of the subsidies and to discourage the smuggling of these products out of the country.

For the full year, the subsidies are expected to cost \$790 million, equivalent to 1.6% of GDP. However, the oil sector is also a major source of tax revenue for the Government, accounting for 21% of total receipts (equivalent to 4.9% of GDP). The net contribution of oil to the fiscal balance is equal to 3.3% of GDP. Other revenue sources expected to improve this year, due to improved collections and the expanding economy, include VAT and corporate income tax.

Import tariff receipts, in contrast, will decline as Viet Nam reduces tariffs in compliance with its Association of Southeast Asian Nations trade commitments. Total government revenue is forecast to grow by 15% and total expenditure by

10%, with the fiscal deficit estimated at 4.4% of GDP for 2005.

Monetary policy has been tightened because of rapid growth in domestic credit. Total bank credit soared by 42% in 2004 after some SOEs launched large investment projects financed by state-owned banks. Among tightening measures taken this year, the Government increased the prime lending rate from 7.5% to 7.8% in February, the first move in the rate since May 2003. In April, the rediscount rate was raised from 5.5% to 6.0% and the discount rate from 3.5% to 4.0%. Prudential regulations for credit institutions were revised to limit medium- and long-term lending by commercial banks to 40% of their short-term funds. As yet, it is not clear if the authorities are meeting their goal to hold back domestic credit growth to 25–30% this year.

In the financial sector, the Government continued its efforts to strengthen the banking system. A new regulation on asset classification and loan-loss provisioning was issued in April to align national rules with international standards and to force banks to undertake quantitative and qualitative assessments of their loan portfolios. The slow progress with restructuring state-owned commercial banks continued. In the fledgling capital market, a stock trading center in Hanoi was opened in March to trade stocks of smaller-sized companies and to assist in handling public share offerings by SOEs. It supplements the Ho Chi Minh City securities trading center, which trades just 29 stocks.

The Government has announced that it wants 253 “equitized” (partly privatized) companies to list on these centers by the end of the year. Development of the secondary market in bonds is proceeding slowly. The Bank for Foreign Trade of Viet Nam in August became the first bank in the country to conduct both bond buying and selling activities in the domestic market.

The Government has accelerated its efforts to become a member of WTO by the end of 2005, revising various trade and investment laws and regulations. Likely WTO accession, this year or next, and an improved business environment have helped spur foreign investment, with FDI commitments of \$1.8 billion in the first half of 2005, close to the level achieved in all of 2004. Moody’s Investors Service upgraded the

**Table 2.9 Selected economic indicators, Viet Nam, 2005–2006, %**

Item	2005		2006	
	ADO 2005	Update	ADO 2005	Update
GDP growth	7.6	7.6	7.6	7.6
Inflation (CPI)	5.7	6.0	5.2	5.2
Current account/GDP	-5.6	-5.6	-5.8	-5.5

Source: Staff estimates.

Government's foreign-currency credit rating in July to Ba3 from B1, citing the country's implementation of a trade accord with the US and likely accession to WTO.

Efforts to improve the business environment made progress. The number of newly registered private enterprises under the new Enterprise Law, which is aimed at encouraging private sector development, rose slightly in the first half to 19,122, with total registered capital of about \$4 billion. The Government is working on the consolidation of various laws related to enterprises and investments in order to simplify procedures and to enhance transparency and predictability for businesses. A new Competition Law, effective in July, provides the first legal framework for regulation of unfair competition. Implementing the law will be a challenge, though, because many industries are still in the state sector. The pace of SOE reform was much slower than the authorities had targeted in the first half.

### Prospects

Reflecting the likely 2005 outturn, annual GDP growth of 7.6% for 2006 is expected, supported by an expansion of consumption and investment. The improving business environment is expected to prompt investment growth of about 14% in 2006, or slightly higher than anticipated in *ADO 2005*.

In current prices, investment as a ratio of GDP is projected to edge above 37% of GDP next year.

The Government is expected to maintain an expansionary fiscal stance, at a manageable level, with the fiscal deficit forecast to widen to 5.0% in 2006. A projected slowing of inflation toward 5% is contingent on government efforts to rein in credit growth, on slower growth of food prices (which in turn depends on no serious outbreak of avian flu or another drought), and on the degree to which fuel price increases flow through the economy.

The growth rate of exports is forecast to slow in line with international commodity prices, while strong domestic demand is expected to sustain fast import growth. As a result, the trade deficit is likely to widen. The current account deficit, estimated at 5.5% of GDP in 2006, should be comfortably financed by FDI, private remittances, and foreign aid, keeping the overall balance of payments in surplus.

Viet Nam may experience difficulties with market access for items such as textiles and seafood if the planned WTO accession is delayed, thereby postponing the most-favored-nation treatment that WTO members enjoy and keeping exports subject to quotas in major markets. When it gains accession, the granting of most-favored-nation treatment in the markets of other member countries will provide a boost to exports.

At the same time though, domestic enterprises will face external competition with further opening of the economy and will also have to comply with WTO technical standards for their exports. Importantly, WTO membership and associated legal and technical requirements should help advance the Government's agenda for domestic economic reform and international economic integration, and will attract more FDI. Other benefits, including access to WTO dispute-settlement mechanisms, will also follow.