

Viet Nam

Robust growth has continued in 2006, with strong expansion in industry and services. Investment surged in the first half of the year, bolstered by ongoing improvements in the business environment and the country's expected accession to the World Trade Organization (WTO). The full-year growth forecast is maintained at 7.8%, though inflation is revised up to 8.3% in part because of rises in administered fuel prices to reduce the cost of fuel subsidies. Next year, GDP growth is seen edging up to around 8%, underpinned by vigorous business investment. There are signs that the ongoing fight against corruption is being stepped up.

Updated assessment

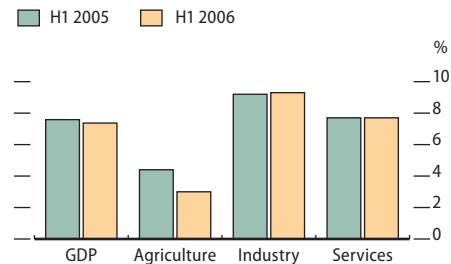
Underpinned by rapid growth in private investment, strong consumption, and robust exports, the economy grew by 7.4% in the first half of 2006, close to the 7.6% rate in the year-earlier period. Industry (rising by an estimated 9.3%) and services (7.7%) continued to drive the expansion (Figure 2.9.1). Industry accounted for 3.7 percentage points of growth, with a particularly strong performance from the private sector, especially manufacturing, while services contributed 3.1 percentage points (Figure 2.9.2). Good performances were recorded in the trade, finance, and hotels and restaurant subsectors as consumption and tourism remained buoyant.

Agriculture, affected by prolonged cold weather in the north, by floods in the central area and the Mekong delta, and by avian flu, showed lackluster growth of 3.0% and contributed little to aggregate expansion. Agriculture's share of GDP has over the years declined steadily and was about 20% in 2005, down 4 percentage points since 1999. The sector still plays a critical role though, since it generates about 57% of total employment.

Industry and services continue to increase their share of the economy. This reflects market-oriented reforms, a gradual reduction in barriers to competition and to private-sector development, and improvements in physical infrastructure. Greater diversification in industrial production and services is laying the foundation for further sustained growth in output and employment. For all of 2006, industry is expected to expand by 10.0% and services by 8.0%.

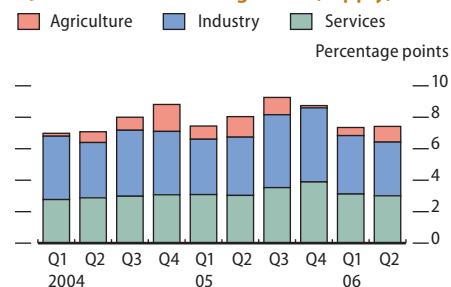
Looking at demand, both investment and consumption remained strong in the first half of 2006. Investment, spurred by improvements in the business environment, is estimated to have grown by about 24%. The domestic private sector has expanded its share of overall investment from

2.9.1 GDP growth by sector



Source: General Statistics Office of Viet Nam, available: <http://www.gso.gov.vn>, downloaded 3 August 2006.

2.9.2 Contributions to growth (supply)



Source: CEIC Data Company Ltd., downloaded 3 August 2006.

23% in 2001 to 34.5% in the first half of 2006. Private consumption was bolstered by higher farm incomes (reflecting rising prices for agricultural products), strong growth in employment in manufacturing and services, and buoyant remittance inflows. Retail sales of goods and services are estimated to have grown by 21.6% in the first half.

Surging exports are helping underpin GDP's rise this year. Merchandise exports for the first half of the year jumped by 28.8% to \$18.8 billion. As a net oil exporter, Viet Nam benefits from rising global oil prices, which more than offset a 6% decline in the volume of oil exports, resulting in export growth of 22.5% for oil in dollar terms during the first half (Figure 2.9.3). (The volume of oil shipments fell because output from existing oil fields is declining and production from new deposits has yet to begin.)

Exports of textiles and clothing rebounded by nearly 34.5% in the first half of 2006, following modest growth of 11.3% in all of 2005, after the abolition of global quotas enabled members of WTO to increase exports to the US, at the expense of Viet Nam and other non-WTO members. Other exports that strengthened were fisheries products, footwear, electronic goods, and wood products. Improved access to major export markets and higher prices supported the robust export growth.

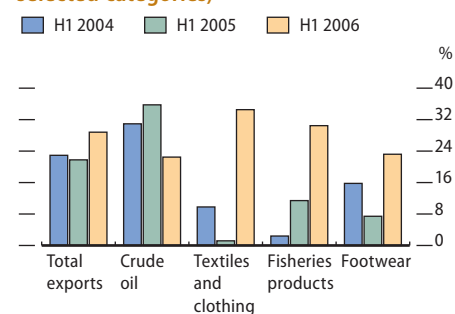
The structure of exports is becoming more diversified. While exports of largely unprocessed commodities such as crude oil, rice, fisheries products, and coffee remain significant, the share of manufactures such as clothing, footwear, and wood products in total exports is becoming more important (Figure 2.9.4). Exports for the full year are likely to rise by about 22%, faster than projected in *Asian Development Outlook (ADO 2006)* in April this year.

Imports grew by 15.3% in January–June. The trade deficit narrowed to an estimated \$2 billion, significantly less than \$3.6 billion in the first half of 2005. Stronger exports and vigorous expansion in both private remittances and tourism receipts have led to a revision of the 2006 current account deficit to 1.2% of GDP, from the 2.7% forecast in *ADO 2006*. Buoyant foreign direct investment (FDI) inflows further supported the balance of payments, resulting in a rise in gross official reserves.

GDP growth for 2006 is forecast at 7.8%, unchanged from the *ADO 2006* projection. However, the forecast for consumer inflation is raised. Inflation averaged 8.0% in the first half, pushed up by rising prices for food, housing construction materials, and transport (Figure 2.9.5); a further increase in administered fuel prices in August will maintain upward pressure on inflation. The forecast for 2006 is raised to 8.3% in annual average terms and to 7.6% in year-end terms. Monetary tightening by the State Bank of Viet Nam in 2004 and 2005 has had some impact on rapid credit growth, which has slowed from nearly 42% in December 2004 to about 32% in December 2005 and 25% in February 2006. The central bank targets 25% credit growth for this year.

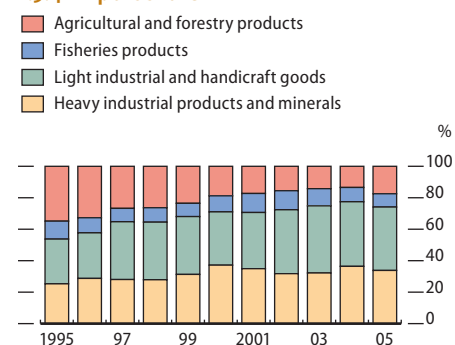
Reflecting an expansionary fiscal stance, government spending rose by an estimated 18.5% in the first 6 months of 2006, while revenue grew by about 14.6%, supported by the rapid economic growth and high crude oil prices (income from crude oil production accounts for more than 20% of total government revenue). The primary budget deficit, which excludes off-budget items, is forecast at 1.7% of GDP in 2006.

2.9.3 Export growth (total and selected categories)



Source: CEIC Data Company Ltd., downloaded 3 August 2006.

2.9.4 Export share



Source: CEIC Data Company Ltd., downloaded 22 August 2006.

In policy developments, Viet Nam finalized a series of bilateral trade agreements in its effort to join WTO, which looks likely to happen this year. Accession will allow the country greater access to international markets and provide impetus for a deepening of domestic structural reforms, particularly in banking and state-owned enterprises (SOEs).

As a prelude to WTO membership, the authorities are inking in further measures to strengthen the banking system. In May, the Government issued a plan for banking sector reform, under which the supervisory functions of the State Bank of Viet Nam will be separated from the management functions that it performs for state-owned commercial banks (SOCBs). These banks must increase their capital-adequacy ratio to at least 8% by April 2008.

Vietcombank, one of the biggest SOCBs, late in 2005 issued convertible bonds to raise second-tier capital ahead of a planned equitization (part-privatization). The Bank for Investment and Development, another SOCB, in May 2006 issued fixed-rate bonds to strengthen its second-tier capital base. For its part, the central bank is taking steps to bring prudential regulations on loan classification and loan-loss provisions closer to international standards. However, a strategy to resolve nonperforming loans and to recapitalize SOCBs has been delayed.

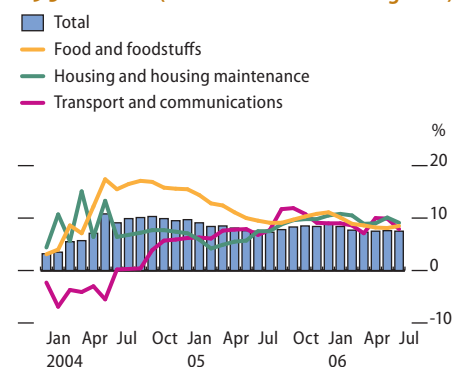
Viet Nam's fledgling securities market has grown this year, with the market capitalization of listed equities and bonds rising to the equivalent of nearly 10% of GDP by mid-2006 from 5% in mid-2005. The number of listed companies on the Ho Chi Minh City and Hanoi stock trading centers has increased to 51 from 28 over this period. Gains in corporate profits and strong business sentiment pushed share prices sharply higher in the first 5 months of 2006, although—in common with many other bourses worldwide—the market retreated in June and July (Figure 2.9.6).

To further develop the securities market, the National Assembly in June passed a law that provides a legal framework for market operations, protection for investors, as well as greater corporate disclosure and market transparency. The Securities Depository Center was established to build up the infrastructure for market operations. And to promote reforms of SOEs, a state corporation of investment capital has been set up to manage the Government's stakes in equitized SOEs. However, progress on equitizing the larger SOEs has been slow.

The Unified Enterprise Law and Common Investment Law (approved in December 2005 and effective July 2006) aim to simplify administrative procedures for firms and to enable equal treatment for local and foreign businesses. Such improvements in the business environment, coupled with the continuation of solid economic growth and the prospect of Viet Nam joining WTO, have supported investor sentiment: more than 20,000 new enterprises were established in the first half of 2006, and FDI commitments rose by 21% to \$2.3 billion.

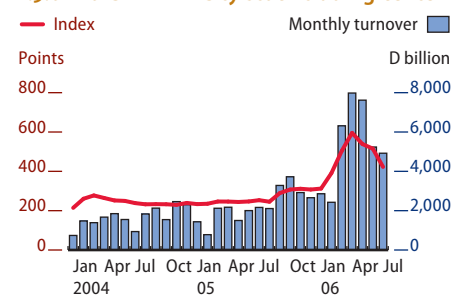
On broader policy issues, the 10th Congress of the Communist Party, a quinquennial event, was held in April, followed by the National Assembly's election in June of new government leaders and approval of the socioeconomic development plan for 2006–2010, which targets continued vigorous economic growth. The new leadership has indicated that it is committed to accelerating economic reforms.

2.9.5 Inflation (total and selected categories)



Source: CEIC Data Company Ltd., downloaded 21 August 2006.

2.9.6 Ho Chi Minh City stock trading center



Source: CEIC Data Company Ltd., downloaded 21 August 2006.

Prospects

Improvements in the business environment and expected WTO membership are likely to support continued strong investment through 2007. Investment is forecast to grow by around 15%, reaching 38% of GDP. Industry and services, together accounting for around 80% of GDP, will remain the engines of growth through 2007, expanding by projected rates of 10.4% and 8.0%, respectively. The forecast for GDP growth next year is maintained at 8.0%.

Implementation of commitments related to the Association of Southeast Asian Nations Free Trade Area and expected WTO accession will provide opportunities for further export growth, albeit at levels below those reached in the first half of 2006. In 2007, exports are projected to increase by about 18%, outpacing import growth and narrowing the trade deficit to 4.5% of GDP. Strong remittance inflows are expected to help turn the current account into a surplus equivalent to 0.3% of GDP, a turnaround from the deficit forecast in *ADO 2006* (Figure 2.9.7). Higher inflows of FDI are likely to produce a surplus on the capital account, such that foreign exchange reserves rise again.

Inflation will continue to feel upward pressure from expansionary macroeconomic policies, continued strong domestic demand, and likely wage rises in both public and private sectors. The Government has said that it will raise wages for state employees in October 2006, while many private firms are expected to follow suit because of high inflation, a need to attract labor into expanding industries, and an increase in the minimum wage. Subsequently, the forecast average inflation rate for 2007 is revised up to 7.8% (Figure 2.9.8), from 5.0% in *ADO 2006*.

The primary budget deficit could widen slightly in 2007, as fiscal policy remains supportive of growth. An expanding formal sector is broadening the tax base, and the rising price of crude oil is a boon for the Government, with oil revenue up by 46% in 2005 to 4.6% of GDP. Fuel prices are subsidized, but retail price increases—two this year after three last year—have kept the cost of subsidies to about 1.6% of GDP in the first 7 months of 2006. Raising prices also helps remove the incentive for smuggling fuel to neighboring countries, particularly Cambodia. A 5% gasoline import tax was also eliminated, in April this year.

Further ahead, the 2006–2010 socioeconomic development plan sets ambitious targets for achieving the Viet Nam Development Goals and the Millennium Development Goals, including annual GDP growth of 7.5–8% over the period to lift per capita income to \$1,100. These targets appear achievable, given both the momentum already built up, especially in investment, and the private sector's rate of expansion.

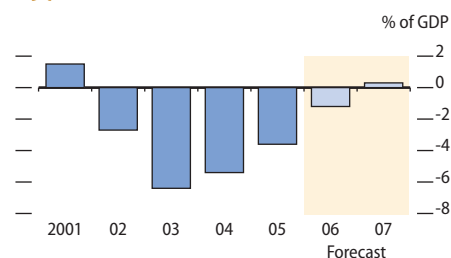
One major challenge is to use resources better and reduce corruption. A widely publicized scandal known as the PMU-18 case involved a project management unit under the administration of the Ministry of Transportation, with senior officials accused of corruption and misappropriation of public funds. The head of PMU-18 was arrested in January, a deputy transport minister who was a former head of PMU-18 was also detained, and the transport minister resigned. Recognizing increasing public concern, political leaders have stepped up their efforts against corruption.

2.9.1 Selected economic indicators, %

	2006		2007	
	<i>ADO</i> 2006	<i>Update</i>	<i>ADO</i> 2006	<i>Update</i>
GDP growth	7.8	7.8	8.0	8.0
Inflation	6.0	8.3	5.0	7.8
Current acct. bal. (share of GDP)	-2.7	-1.2	-2.8	0.3

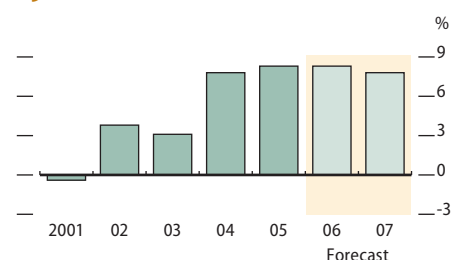
Source: Staff estimates.

2.9.7 Current account balance



Sources: Asian Development Outlook database; staff estimates.

2.9.8 Annual inflation



Sources: Asian Development Outlook database; staff estimates.