

VIET NAM

I. Macroeconomic assessment

Despite some adverse impact of unfavorable environment due to the conflict in Iraq, the SARS epidemic in Viet Nam and in its neighboring countries, and drought in some parts of the country, the economy in the first half of 2003 maintained a growth of 6.9 percent. The strong economic growth was underpinned by a domestic demand led by both consumption and investment. While the growth rate was slightly less than the Government's planned target of 7.5 percent for the whole year, considering the unfavorable environment, it showed the importance of domestic market and the responsiveness of policymakers and the outcomes of their prudent economic management.

On the supply side, a robust performance of the industry sector, including construction sub-sector provided impetus for a continuing strong economic growth. The total output of the industry and construction sector posted an increase of 16.1% on a yearly basis. Of which, the non-state sector and the foreign sector recorded a better performance with the industrial output growth of 18.2 percent. A stronger industrial growth of the foreign sector as compared to that of previous year was partly attributable to the increase of oil price. The continuing strong growth of the non-state sector is a clear indication of the result of the improved business environment. Furthermore, registration of domestic private enterprises continued to grow, with additional 7,657 in the first five months of 2003. The agricultural performance has maintained a growth at 2.5 percent. The growth in agriculture sector is largely due to a strong growth of the fishery sub-sector, which recorded a growth at 8.5 percent. The service sector was hardly hit particularly during April-May as the receipts from tourist-related sub-sectors were adversely affected by the impact of SARS epidemic. The impact of SARS on GDP growth due to the consequential demand effects in various activities such as hotel, food and beverage, transport, communications, and retail trading is estimated to be about 0.2 percentage point. The service sector in general posted a growth at 6.4 percent in the first half of 2003, which was higher than the growth during the same period in the previous year (5.9 percent).

On the demand side, both consumption and investment remained strong during the first half of the year. Total receipt of retail sale of goods and services recorded a growth of 10.5% on a yearly basis. Total investment in the first half of the year is estimated to be 34 percent of GDP, representing an increase of 20.5 percent on a yearly basis. A continuing strong economic growth, and further improvement of legal framework and administrative procedures have made the business environment more conducive to lure more investment from both domestic private and foreign investors. Investment of the non-state sector and of the foreign sector posted a growth of 24.5 percent and 22.0 percent, respectively, on a yearly basis.

Growth in exports accelerated in the first six months of 2003 in both oil and non-oil exports. Total export value in the first half of 2003 was estimated at \$9.8 billion, representing an increase of 32.6 percent on a yearly basis. This was mainly due to the strong growth of major export items, namely crude oil, textiles and garments, fishery and footwear. A growth of crude oil export at the rate of 35.7 percent was largely attributable to the increase of oil price since the output of crude oil increased only at 4.6 percent. The strong growth of export of the textile and garments (66.4 percent) was mainly due to the export to the US market as enterprises tried to maximize their export sale prior to the imposition of US quota on Viet Nam's textiles and garments export. US market has become the top export market for Viet Nam with a about 20.0 per cent share, followed by EU, Japan and People's Republic of China with 19.1, 13.3 and 7.4 percent of total export value of Viet Nam, respectively, in the first half of 2003. The import (\$12 billion), however, outweighed

exports, pushing the trade deficit to \$2.4 billion during the first half of the year. In the last three months, imports hiked further adding another \$1.0 billion to the deficits. The strong growth in imports is attributable to (i) demand of industry sector, including construction, export processing and the preparation for the upcoming South East Asia Games in December, (ii) increase of price of some imported items; and (iii) more liberal import regime as compared to previous years. Tourism sector experienced a 17 percent drop in tourist arrivals due to prolonged SARS epidemic in the neighboring countries. According to the Vietnamese tourism authority, the tourism sector experienced output loss of about \$570 million.

On the capital account, in the first half of the year, 281 FDI projects were licensed with a total capital amount of \$710 million, representing an increase of 13.7 percent in terms of registered capital. It is also reported that a total remittance of Vietnamese overseas in the first six months of 2003 was around \$1 billion. Consumer price index was quite stable with a moderate increase at 2.1 percent during the first half of the year.

On the social front, SARS was fully contained within a short span of time and precautionary measures have been put in place to avoid likely reoccurrences. Further progress has been achieved in poverty reduction. According to Multipurpose Household Survey 2002, the poverty headcount for 2002 was 29 percent down from 37 percent in 1998. The rural poverty headcount was 36 percent down from 45 percent and the urban figure was 6.6 percent down from 9 percent. Geographically, Mekong Delta shows the most dramatic drop from 37 percent in 1998 down to 23 percent, while the poverty in the Central Highlands still remains at 52 percent.

II. Policy developments

Viet Nam is stepping up its reform process for enhancing its external competitiveness, in nurturing the rapidly growing domestic private enterprises and in furthering its regional and global economic integration. Prime Minister's Directive No.08/2003 of 4 April 2003 on enhancing the efficiency and competitiveness of enterprises, among others, reinforces the stepping up of the reorganization and raising efficiency of SOEs, resolutely carrying out the merger, dissolution and bankruptcy of enterprises having chronically losses, periodically organizing meetings with enterprises for direct and open dialogues, promptly settling problems and complaints of enterprises.

To create a more conducive business environment and to enhance the competitiveness by reducing administrative complexities and associated transaction costs, the Government has further emphasized the need for accelerating the public administration reform (PAR). The Government has made resolute efforts to implement the PAR and has achieved encouraging results in all the focus areas covering legal and institutional, organization, and administrative procedures, including computerization and e-government initiatives, improving the quality of public officials, and decentralization. Major steps have been made, such as redefinition of the roles and functions of government agencies to facilitate decentralization; realignment of the role of the state, by reducing hands-on government interventions in enterprises; and the strengthening of the law-making process to make it more participatory and transparent.

The Government has issued a decision last June regarding a nation-wide replication of the 'one-stop-shop' model for administrative procedure reforms and service delivery. The model has proven to be successful already in 29 provinces and big cities. Participatory poverty and governance assessment in 12 different provinces have been carried out to gather feedback from citizens and service providers on social and administrative service delivery. The outcomes of the participatory assessments are expected to be useful inputs for further improving public spending as well as the quality of public service delivery. In general, investors' perception on Viet Nam has improved. A recent survey of the perceptions of foreign business people in Viet Nam showed marked improvements in ratings of government performance relative to the ratings of previous

years. Recent issues of the Political and Economic Risk Consultancy reports also indicate improvements in investors' perception on Viet Nam.

On the economic integration front, Viet Nam has already carried out various policy measures under the framework of ASEAN Free Trade Agreement (AFTA), and the recent bilateral trade agreement with the US (US BTA). Tariffs on imports (700 items) from ASEAN have been further reduced with effect from last July as part of the implementation of AFTA commitments. AFTA commitment has an ultimate target of achieving 0 to 5 percent tariffs on ASEAN imports by 2006. While significant measures are under way to comply with US BTA commitments many commitments made by Viet Nam will require substantial changes in its laws, regulations and administrative procedures and upgrading its institutional capacity to implement those changes. However, the implementation of these commitments will help Vietnam in aligning its domestic standards and practices with international trade standards and practices, including transparency of laws, intellectual property rights protection, foreign investment regulation, customs procedures, which also pave the way to WTO accession. The integration process has also started yielding positive impacts. As a consequence of the reduction of US tariff on import from 40 percent to around 3-4 percent, despite some trade disputes such as catfish, export of Viet Nam to US market grew by 128 percent in 2002 and by 138 percent in the first six months of 2003. Viet Nam is now pushing ahead with its preparation for acceding WTO by 2005. The 6th session of the working party on Vietnam's accession to WTO was completed in May 2003 and the next session is expected to take place some time towards the end of 2003.

Due to the continuing strong economic growth in the first half of 2003 and to the strengthening of tax management, total revenue in the first half of 2003 was estimated to have grown at 9.5 percent on a yearly basis, making up 52 percent of the target for the whole year. Total fiscal expenditure of the first half of 2003 grew at 14 percent on year-on-year basis, making up 45.2 percent of the projected target of the whole year, of which outlays for capital expenditure increased by 6.8 percent. On current expenditure side, outlays for education, training and health care posted an increase of 3.9 percent and 4.6 percent, respectively.

On the equity market front, last month (July 2003) marked the third anniversary of the inauguration of the stock exchange market in Viet Nam. The market is still at early stage of development since a current total market capitalization after three years of operation stands about 0.6 percent of GDP. As of June 2003, 21 company shares are listed on the stock exchange in Ho Chi Minh City. The stock market is vulnerable as the index fell steeply from a peak at 571 points in June 2001 to around 143 points in August 2003. The average trading volume of each trading also dropped to 1.9 billion/trading in the first half of 2003, accounting of 43 percent and 28 percent of that in 2002 and 2001, respectively. With only 21 listed companies and limited trading volume, the current stock market plays a minor role in the financial sector. The volatility of the market is due to (i) a lack of institutional investors; (ii) a limited listed companies, particularly absence of blue chips companies; and (iii) a high bank deposit rates. Corporate governance is another area, which investors usually look at as well. As price of shares fell, many individual investors withdrew money to invest in other businesses such as in property or simply to deposit in the banks, which consequently make the market volatile. To develop the equity market so as to achieve a target of 2-3 percent of GDP by 2005 as market capitalization and 10 percent of GDP by 2010, under the assistance of ADB, a capital market roadmap has been developed and was approved by the Prime Minister on 5 August 2003.

To deepen the process of the implementation of the Government's Comprehensive Poverty Reduction and Growth Strategy (CPRGS), efforts are being made to integrate the CPRGS with the local and provincial planning processes. The Government is also considering the inclusion of demand-driven large infrastructure in the CPRGS. which would broaden its scope for both economic growth and poverty reduction.

III. Outlook

Given a strong growth in the first half of 2003, the continuous improvement of the business environment, and the recovery of external demand, our projection of GDP growth in 2003 remains around 7 percent. This is partly due to robust performance of the industry sector and of the service sector as tourist-related sub-sectors will recover in the latter part of the year. Consumption and investment will continue to be strong to underpin the GDP growth. Nevertheless, the export growth of textiles and garments to the US in the second half of 2003 will slow down a bit due to the quota imposition (a limit of \$1.7 billion value). However, Viet Nam is likely to be successful in diversifying its textile export to other markets, including EU. The crude oil price may stabilize to a lower rate of \$22-24 per barrel. On the whole, our projection of export growth for 2003 is likely to be around 10.5 percent (slightly higher than our previous estimate as per ADO2003).

On the current account, as import growth accelerated in the first three quarters of 2003, and is likely to remain at high level in the last quarter due to largely strong demand from industry (including construction) and to a certain extent strong demand from the households in response to more liberal import regime, the current account deficit is likely to widen to about 10% of GDP (higher than our earlier estimate). Foreign direct investment, private remittances of Vietnamese living overseas, and the stable official development assistance will finance the deficit. The Government will maintain an expansionary fiscal policy to cover the cost of ongoing and forthcoming reforms, however, improvement in fiscal revenue during the first half of the year will help reduce the deficits. It is estimated that the government budgetary deficit will be around 4.8 percent - slightly lower than the previous estimate (5.3 percent as per ADO 2003). Inflation is expected to be around 3-4 percent as the implementation of AFTA commitment is likely to reduce the cost of imports to a certain extent. Other macroeconomic indicators are expected to be stable.