

Viet Nam

Economic Assessment

Similar to the year-earlier period, GDP strengthened by 7.0% in the first half of 2004. The industry sector, which covers mining, manufacturing, and construction, led the expansion with 10.0% growth, and contributed 3.8 percentage points. The services sector grew by 7.0%, contributing 2.8 percentage points. However, agriculture, which includes forestry and fisheries, was up by just 2.0%, accounting for only 0.4 percentage points of the total.

Improvements in the investment climate led to an increase in realized investment by 14.0% to D116.9 trillion in the first half of 2004 from a year earlier. Foreign investment climbed by 22.9% and investment in the state sector, which accounts for just over half of the total, rose by 12.8%. In the increasingly important private sector, investment rose by 10.5%. A total of 280 foreign-invested projects were licensed in the first half, the same as in the year-earlier period, although the total registered capital for the FDI projects was \$807 million, up from \$710 million a year earlier. One third of the FDI projects were in heavy industry and one quarter in light industry. About one third of the FDI originated from Taipei, China. A 17.3% rise in the value of retail sales suggested that household consumption was robust in the first half.

On the external trade front, the value of exports grew by about 20% in the first half of 2004, well above the full-year target of 12%. Imports were 14.7% higher, responding to growing demand for industrial inputs. The trade deficit, at around \$2.4 billion, was similar to the year-earlier level. Viet Nam is a net exporter of oil and its exports of crude oil exceeded its imports of petroleum products by nearly \$1 billion in the first 6 months of the year.

Remittances from Vietnamese living abroad have become a major source of foreign exchange, exceeding either FDI flows or official aid flows.

During the first half of 2004, private remittances recorded by Ho Chi Minh City banks rose by 11.0% from a year earlier to \$900 million.

Consumer price inflation picked up to 7.2% in the first 6 months, the highest rate since 1998 and exceeding expectations for the period. Food prices rose because of prolonged drought in central and northern areas and the spread of avian flu, which prompted the culling of millions of chickens and a temporary ban on the selling and processing of poultry products. This ban pushed up prices of alternative meats and seafood. Prices for imported steel, refined petroleum products, fertilizer, and other commodities were also bumped up by the global price pressures on these items.

Revenue collection in the first half was on track at D73.2 trillion, or 49% of the full-year target. Government expenditures for the period were slightly higher than revenues at D73.4 trillion, or 44.5% of the total estimated spending for the year, and the budget deficit (excluding onlending) narrowed.

Policy Developments

Concerned about the rise in inflation and rapid expansion in net domestic credit (up 10.9% in April from December 2003), the Government sharply raised the reserve requirement ratio for commercial banks in July 2004 to damp their lending. For dong deposits, this was lifted from 2% to 5% (less than 12 months) and from 1% to 2% (12–24 months). For US dollar deposits, this was doubled from 4% to 8% (less than 12 months) and from 1% to 2% (12–24 months). However, the prime interest rate was left at 7.5%.

Measures to improve the business climate included a cut, effective 6 August, in the corporate tax rate levied on newly established enterprises in industrial zones to 10–20%, from the usual corporate tax rate of 28%. The Government also started work on preparing one unified law

Table 2.12 Selected Economic Indicators, Viet Nam, 2004–2005, %

Item	2004		2005	
	ADO 2004 Update	ADO 2004 Update	ADO 2004 Update	ADO 2004 Update
GDP growth	7.5	7.5	7.6	7.6
Inflation (CPI)	4.5	9.0	4.5	6.0
Current account/GDP	-5.7	-4.1	-5.7	-4.1

Source: Staff estimates.

for all types of enterprises and one investment law for investments, aiming to simplify procedures, enhance transparency, and promote good corporate governance. Such policy developments have helped raise the status of Viet Nam among international investors. What also may help foreign investment is, for example, the fact that the semiannual meeting of the Viet Nam Business Forum reported that the Government had made reasonable progress in reducing telecommunications costs, though costs of infrastructure and of housing and office rents are still high in comparison with other countries in the region, and access to markets for the private sector remains limited.

In an effort to spur development of the nascent capital market (Viet Nam has just 24 listed companies with a market capitalization equivalent to 3.4% of GDP), the State Securities Commission is expected to soon issue implementing guidelines for Decree 144, which deals with the securities market. A more comprehensive securities law is expected to be approved by 2006. In a related move, the Government mandated the equitization and listing of five SOEs to build up the supply of securities. Furthermore, the State Bank of Vietnam has issued a regulation to allow joint-stock commercial banks to be listed, and a proposal to list the Viet Nam Securities Investment Fund, the country's first such fund, is under review. Against this, efforts to promote the bond market are constrained by a lack of secondary markets, a benchmark yield curve, domestic credit rating agencies, and weak disclosure practices.

Viet Nam took some steps to improve the quality of governance in the early months of 2004 by strengthening the State Inspectorate (the anticorruption watchdog) and the Public

Administration Reform Steering Committee, and by allowing the State Audit (which audits state spending) to operate outside the executive branch and report its results to the National Assembly. A draft competition law also was prepared.

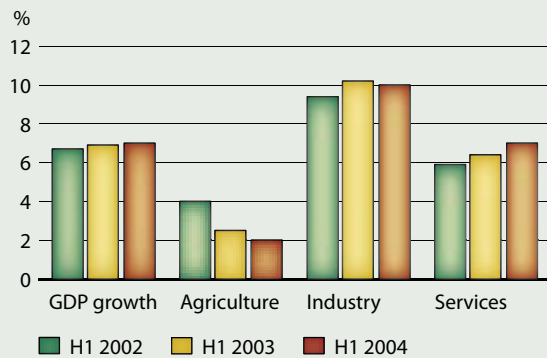
Preparations have also begun for the 5-year plan 2006–2010, with planning guidelines circulated to all provinces and government agencies. The guidelines indicate that the annual average GDP growth target rate during the period will be 7.5–8.0%. The sector growth targets will be 3.0–3.5% for agriculture; 10.0–15.0% for the industry sector; and 7.2–7.5% for services. The aim will be to create about 8 million additional jobs over the 5 years.

The Poverty Reduction and Growth Facility (PRGF) arrangement with IMF expired in April because the Government did not agree to an IMF request that the central bank's foreign exchange reserves be verified by an external auditor proposed by IMF. IMF has continued its presence in Viet Nam and provides advice on macroeconomic management and tax issues. The loss of IMF assistance, which was used to support foreign reserves, is not expected to cause any immediate difficulty because it constituted a small part of the country's donor funding, which is valued at more than \$2.8 billion in 2004. Also, the country's foreign reserves, estimated at about \$5.5 billion or the equivalent of 10 weeks of imports, have been bolstered by strong private capital inflows, especially remittances from overseas Vietnamese (estimated at \$3 billion in 2004) and FDI (probably \$600 million net). However, the Government's decision against external auditing may undercut its attempt to join WTO next year since WTO rules require transparency and compliance with international standards.

Outlook for 2004–2005

The first-half performance, combined with improvements in the business environment and robust external demand, suggests that GDP growth will be 7.5% in 2004 and 7.6% in 2005, unchanged from the *ADO 2004* forecasts (Figure 2.12). Domestic demand is forecast to increase by 8.7% and 8.1%, and exports by 16.3% (revised up from 12.0% in *ADO 2004*) and 12.0% (unchanged from *ADO 2004*), over the 2 years.

Figure 2.12 First-Half GDP and Sector Growth, Viet Nam, 2002–2004



Source: General Statistics Office.

The Government is expected to continue an expansionary fiscal stance, partly a result of raising civil servants' salaries and pensions, scheduled for October 2004. This will support domestic demand. The level of gross investment will likely be maintained at about 35% of GDP in both years. Budgetary deficits will be 4.6% of GDP in 2004 and 4.2% in 2005, unchanged from the *ADO 2004* forecasts.

On the supply side, the industry and services sectors will be the main sources of GDP expansion. Growth in industry is revised up to 10.3% in 2004, from 9.8% in *ADO 2004*, and to about 10% in 2005, from 9.9% in *ADO 2004*, partly because of the rise in international oil prices. Growth in services is estimated at 7.5% in both years, unchanged from *ADO 2004*. Agriculture's forecast growth is revised down to 2.5% in 2004 from a previous forecast of 3.3%, because of lower than expected strengthening in the first half and slower growth in fisheries, but it is expected to pick up to 2.7% in 2005.

With the ending of the MFA quotas at the end of this year, WTO members will no longer be subject to quotas for market access for their garment exports, with the result that Viet Nam's competitors, such as the PRC, will secure greater export opportunities. Viet Nam, yet to enter

WTO, will still face constraints on its garment exports. In an effort to reduce the impact of the end of quotas, the Ministry of Trade plans to concentrate the disbursement of its quotas in larger, more competitive enterprises. Along with a new quota worth \$1.8 billion with the US, an expanded quota with the EU, and diversified markets to Canada and Japan, this will make the prospects reasonable for garment and textile exports in 2005.

The trade deficit is now forecast at \$3.6 billion in 2004 (from \$4.2 billion in *ADO 2004*) and \$3.8 billion in 2005 (from \$4.5 billion) because of a better than expected first-half export performance and higher prices for export commodities such as oil, rice, pepper, tea, and coffee. The current account deficit for 2004 is estimated at around \$1.6 billion, excluding official transfers, or equivalent to 4.1% of GDP (slightly lower than the *ADO 2004* forecast). Such a deficit is manageable because of foreign exchange inflows in the form of remittances from Vietnamese living abroad, official aid, and FDI.

Inflation is likely to reach 9.0% by end-2004 because of the higher food prices and the impact of rising international commodity prices, and is then expected to ease to 6.0% in 2005. Against a background of estimated unemployment of 2.5 million, the Government aims to create 1.5 million jobs in 2004. Whether this is achieved or not, the economy needs to create jobs faster than it has in recent years to absorb the greater numbers of new entrants to the labor market.

Risks to the outlook include rising inflation and possible public health scares. Inflation could exert upward pressure on the prime interest rate (to avoid a negative real rate), on real wage rates, and on the foreign exchange rate, if more people revert to holding their savings in foreign currency. On the subject of public health, avian flu has been reported as recurring in 11 provinces over recent months. So far there has been no serious spread of the disease to humans, but this will require the careful and continuing attention of the public health authorities.