Viet Nam

Steps taken by the government to stabilize the economy have contributed to an improvement in the external and foreign reserves positions. Economic growth quickened in the second quarter of this year relative to the first and is now forecast to be slightly higher in both 2010 and 2011 than anticipated in April. Projections for inflation are lowered a touch. This outlook assumes that policies during the forecast period focus on macroeconomic stability and that the policy stance is communicated effectively, while also addressing structural reforms.

Updated assessment

Viet Nam started to withdraw policy stimulus late in 2009, and GDP growth slowed from 6.9% year on year in the fourth quarter of 2009 to 5.8% in the first quarter of 2010 (Figure 3.10.1), before picking up in the second quarter. The government tightened policy late last year after credit growth accelerated to nearly 40%, resulting in a sharp deterioration of the balance of payments and a decline in foreign exchange reserves.

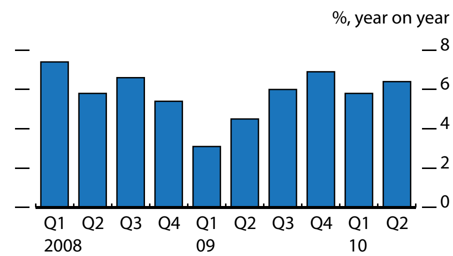
The shift from strong fiscal and monetary stimulus implemented during the global recession to a more balanced policy stance helped to stabilize financial and economic conditions and, together with the global economic recovery, paved the way for solid economic growth this year. GDP increased by 6.2% in the first half of 2010, compared with 3.9% in the same period a year earlier.

Industry expanded by 6.5% in the first half of 2010, with double-digit growth in production of electricity, gas, and water, and a rebound in manufacturing to nearly 8% growth (from just 2% a year earlier) as world trade in manufactured goods recovered. Construction slowed in the first quarter, after credit was squeezed, but it picked up to record 10% growth for the first 6 months. Production of crude oil, however, resumed a declining trend as oil fields matured, falling by 14.6% to 9.8 million metric tons in the first 8 months of 2010 (Figure 3.10.2). Industry as a whole contributed 2.6 percentage points of total GDP growth in the first half.

Reflecting higher levels of private consumption, business activity, and tourism, services grew by 7.1% in the first half, contributing 2.9 percentage points of the GDP growth. Visitor arrivals rose by about 35% to 3.4 million in January–August from a year earlier. The hotels and restaurants subsector recovered from a first-half contraction in 2009 to grow by 8.0% in the first 6 months of 2010. Robust growth was also recorded in transport and communications, as well as financial services.

Output of agriculture improved by 3.3% from 2009 levels. Favorable weather led to a better rice harvest, and fisheries production rose in the first half of 2010. Agriculture made a small contribution to GDP growth.

3.10.1 Quarterly GDP growth



Source: General Statistics Office of Viet Nam.
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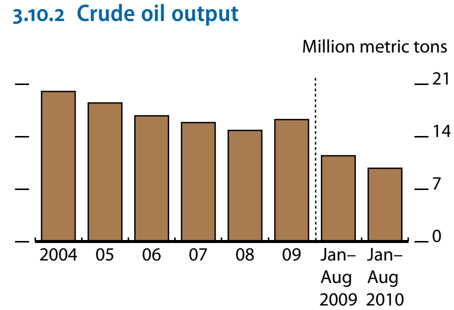
3.10.2 Crude oil output



Source: General Statistics Office of Viet Nam.
Click here for figure data

This chapter was written by Lei Lei Song of the Office of Regional Economic Integration, ADB, Manila, Yumiko Tamura, Chu Hong Minh, and Nguyen Luu Thuc Phuong of the Viet Nam Resident Mission, ADB, Ha Noi.

Solid domestic demand was reflected in retail sales growth of about 27% in nominal terms in the first 8 months of 2010, with growth accelerating in more recent months. Growth in government-funded investment moderated to about 11% in nominal year-on-year terms in the first 8 months from 48% in the same period of 2009, owing to the withdrawal of policy stimulus in early 2010.

Inflation quickened from 2.0% year on year in August 2009 (as economic and credit growth accelerated) until reaching an apogee of 9.5% in March 2010. Policy tightening and the good rice harvest contributed to pulling back inflation to 8.2% in July and August 2010 (Figure 3.10.3), although it increased to 8.9% in September.

The better global trade environment underpinned a 20.6% rebound in merchandise exports in customs-based US dollar terms in the January–August period. (Exports in 2009 fell by about 10% as global trade contracted.) Demand recovered for Viet Nam's textiles and footwear (about a quarter of all exports), and shipments of electronics and machinery tools jumped by about 40%. Merchandise imports increased by 25.7%, spurred by the recovery in manufactured exports, which rely on imported materials, and higher demand for both consumption and investment goods.

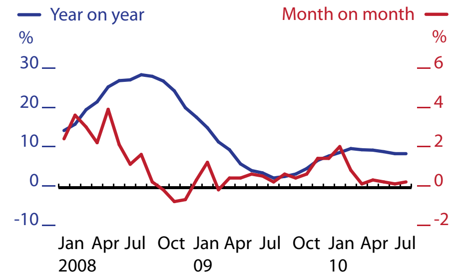
The trade deficit narrowed in the first half of this year from levels in the second half of 2009 (Figure 3.10.4). Preliminary data put the first half merchandise trade deficit at $3.8 billion on a balance-of-payments basis, a considerable improvement on the $8.1 billion gap in July–December 2009 (but wider than a $249 million deficit in January–June that year). Taking into account recoveries in remittances and tourism earnings, the current account deficit narrowed to an estimated $2.7 billion in the first half (5.6% of GDP) from $8.0 billion in July–December 2009. (A surplus of $0.6 billion was recorded in the first half of 2009.)

With an improvement in the capital account, the overall balance of payments likely turned to a small surplus in the second quarter of 2010, after recording deficits since the start of last year. Gross official reserves were estimated at $13.5 billion at end-June 2010 (representing 9.6 weeks of imports of goods and services), a modest rebuilding from $11.8 billion in March 2010, although still down from $14.1 billion at end-2009 (Figure 3.10.5).

Sizable trade deficits and relatively high inflation, coupled with residents switching from local-currency assets into US dollars and gold, continued to put downward pressure on the dong exchange rate. The spread between the black market rate and the reference rate of the central bank (the State Bank of Viet Nam, or SBV) widened to 6.8% in mid-February. That prompted the SBV to devalue the currency by 3.4% in February against the US dollar, followed by a further 2.1% devaluation in August (Figure 3.10.6). The trading band for the dong was maintained at ±3%. Subsequently, the gap between the black market and reference rates narrowed to about 3% in September. From November 2009 to August 2010, the dong was devalued three times, by a total of about 11% against the US dollar.

Monetary tightening steps taken by the SBV included an increase in the base interest rate and removal of interest rate caps and subsidies.

3.10.3 Monthly inflation



Sources: General Statistics Office of Viet Nam; ADB estimates.

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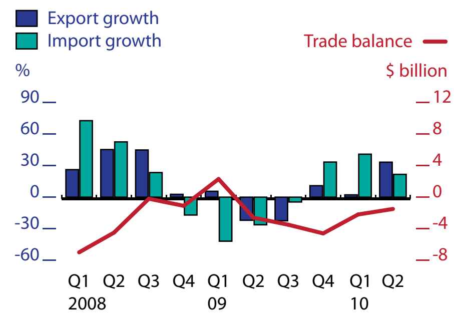
3.10.4 Trade indicators



Sources: State Bank of Viet Nam; ADB estimates.

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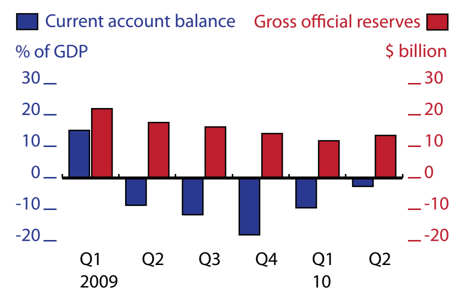
3.10.5 Current account and reserves



Note: Gross official reserves exclude the government's foreign exchange deposits at the State Bank of Viet Nam and the foreign exchange counterpart of swap operations.

Source: State Bank of Viet Nam; ADB estimates.

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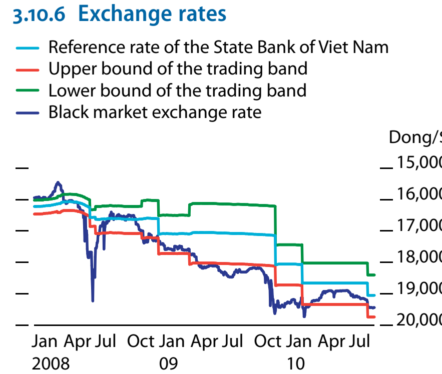
3.10.6 Exchange rates



Sources: State Bank of Viet Nam; ADB observations.

Click here for figure data

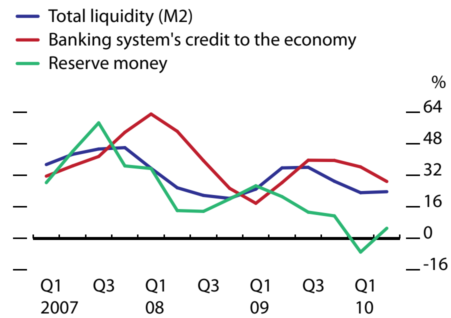
During the global financial crisis, the central bank had cut by half the base rate to 7% (from October 2008 to February 2009), in order to support economic growth. The SBV started to unwind that stimulus in December 2009, when it raised the base rate by 1 percentage point to 8.0% and ended interest rates subsidies on short-term loans. The central bank removed interest rate caps on medium- and long-term loans in February 2010 and on all dong-denominated loans in April.

Consequently, monetary conditions tightened in the first quarter of 2010, although they eased somewhat in the second. Total liquidity (M2) at midyear was up by 12.7% from end-2009 and by 23.7% from June 2009. Commercial banks pushed lending rates above 15% when interest rate caps were removed. However, the authorities responded by urging the banks to moderate the increases, so that lending rates were trimmed to 13%–14% in the third quarter. The VN index of stock prices declined by 8.0% in the first 8 months of 2010.

Credit in the first quarter grew by just 3.6% from end-2009, but by midyear credit growth had picked up to 11.7% from end-2009. That put the year-on-year growth in credit at 28.9%, slowing from the near 40% rate in the second half of 2009 (Figure 3.10.7) toward the official 2010 target of 25% credit growth.

Most of the fiscal stimulus measures implemented during the global financial crisis expired at end-2009. Reflecting a somewhat more restrained fiscal stance, the government is targeting a 2010 budget deficit equivalent to 6.2% of GDP, narrower than the actual deficit in 2009 of 7.0%.

3.10.7 Growth of money and banking indicators



Note: Banking system data changed since 2007.

Sources: State Bank of Viet Nam. International Financial Statisics online database; ADB estimates.

Click here for figure data

Prospects

The outlook assumes that the government will maintain macroeconomic stability during the forecast period, so that the balance of payments gradually improves and the fiscal deficit narrows. It is assumed that the authorities target growth in credit at 25% and maintain efforts to safeguard and enhance banking system soundness.

On these assumptions, government investment could be restrained by fiscal consolidation, but recoveries in world trade and financial conditions will underpin growth in private investment. Illustrating improvements in the investment environment, Viet Nam's ranking in the Global Competitiveness Index compiled by the World Economic Forum was upgraded to 59 of 139 countries in 2010 (from 75 in 2009), and its ranking in the Forum's Enabling Trade Index rose to 71 of 125 economies (from 89 in 2009). Progress being achieved in a government drive called Project 30, to simplify bureaucratic procedures, is reducing red tape for businesses.

Private consumption growth is projected to get support during the forecast period from rising incomes and recovering remittance inflows.

Viet Nam is benefiting substantially from the rebound in world trade, which is projected to continue through 2011 at nearly the same pace as this year. Growth in the country's merchandise exports was running at about 30% in July–August, supporting growth in industry and, to a lesser degree, in agriculture. In particular, trade with the People's Republic of China (including Hong Kong, China) has stepped

3.10.1 Selected economic indicators (%)

	2010		2011	
	ADO 2010	*Update*	*ADO 2010*	*Update*
GDP growth	6.5	6.7	6.8	7.0
Inflation	10.0	8.5	8.0	7.5
Current acct. bal. (share of GDP)	-7.6	-7.5	-5.5	-5.4

Source: ADB estimates.

up owing to a rebound in those economies reinforced by a free trade agreement that came into effect in January 2010 between the PRC and the Association of Southeast Asian Nations.

The impact on the trade deficit from the real devaluation of the dong (due to a larger nominal devaluation than inflation differentials) is expected to be limited, largely because exports of manufactured goods usually require substantial imported materials and equipment.

GDP growth for 2010 is, on this basis, seen at 6.7% (Figure 3.10.8). The forecast is raised slightly from April's Asian Development Outlook 2010 (*ADO 2010*) in light of the pace of growth in the first half coupled with expectations of a quickening in the second half, as well as the upward revision in the ADO baseline assumptions for the recovery in world trade in 2010. The economic expansion rate is expected to pick up slightly in 2011, to about 7%, as investor confidence improves in tandem with more subdued inflation and a more robust external position.

The current account deficit, as a ratio to GDP, is forecast to narrow in the forecast period (Figure 3.10.9) due to an improving trade account, inflows of remittances, and the recovery in tourism. Deficit forecasts (7.5% of GDP in 2010 and 5.4% in 2011) are little changed from ADO 2010. The overall balance of payments is expected to continue improving, supported by foreign direct investment attracted by the expanding economy as well as by capital inflows. Foreign reserves are seen increasing modestly to more comfortable levels.

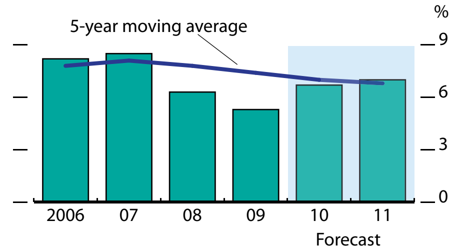
Inflation is projected to average 8.5% in 2010, easing to 7.5% next year (Figure 3.10.10) on the assumption that domestic macroeconomic stability is maintained and that global oil and commodity prices are relatively steady in 2011. These forecasts are lowered slightly from April owing to the improvement in macroeconomic conditions and moderate growth in credit. However, large swings in inflation (from 28% year on year in August 2008 to 2% in August 2009, then up to over 8% this year), together with expectations of dong devaluation, suggest that inflation expectations, too, are not firmly anchored.

The government is putting in place regulations that would enable it to impose price controls on a range of goods sold by private companies. Such controls, if implemented, could limit price increases to some extent in the short term, but would also risk eroding business sentiment.

In a significant step to strengthen the authority of the SBV in implementing monetary policy and safeguarding the financial system, the National Assembly in June 2010 approved a new SBV Law and a new Credit Institutions Law (Box 3.10.1).

Separately, the SBV has taken steps to address the issue of banking system stability with new prudential policies that take effect on 1 October 2010. Under these changes, the capital-adequacy ratio for banks is raised from 8.0% to 9.0% and restrictions are introduced on banks expanding into higher-risk businesses, such as securities and real estate trading. Banks must meet a minimum capital requirement of VND 3 trillion ($158 million) by end-2010. The SBV indicated that it is ready to assist banks to meet the capital requirement, including by facilitating mergers and acquisitions. There have been concerns about

3.10.8 GDP growth



Sources: General Statistics Office of Viet Nam; *Asian Development Outlook* database.

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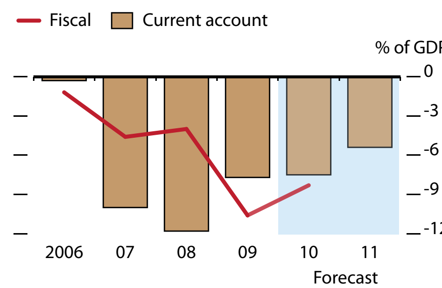
3.10.9 Fiscal and current account deficits



Note: This is overall fiscal balance, including off-budget expenditure and on-lending, not the fiscal balance based on government's definition.

Source: Asian Development Outlook database.

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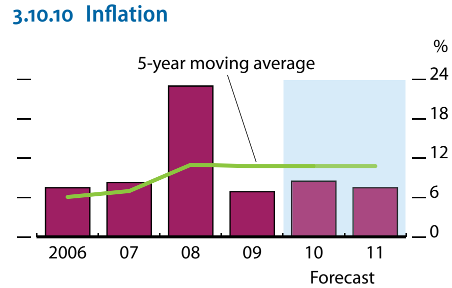
3.10.10 Inflation



Sources: General Statistics Office of Viet Nam; *Asian Development Outlook* database.

Click here for figure data

some banks' capital adequacy, risk-management capacity, and the quality of their loan portfolios.

Domestic risks to the economic outlook in the forecast period center on any premature easing of monetary or fiscal policies (or both), or a perception of looser policy by financial markets and domestic investors. An early easing, or the perception of a relaxation, could derail the macroeconomic stabilization efforts, putting inflation on an upward trajectory and pressure on external accounts.

Such developments would erode consumer and business confidence and deplete already low foreign reserves. The resulting macroeconomic instability would likely require more stringent policy tightening, which would undermine the growth prospects for next year. It will be crucial that the authorities maintain a firm and consistent policy stance, and communicate such a position effectively to the market, until inflation is clearly on a downward track and foreign reserves increase.

The other major challenge is to raise the efficiency of the economy and reduce supply-side constraints through structural reforms. Much has been achieved in lifting Viet Nam to "lower-middle-income" status (a World Bank classification for economies that graduate from the "low income" group when per capita annual gross national income reaches $996). The government is now preparing a new socioeconomic development strategy for the next 10 years, scheduled to start in 2011. This provides an opportunity to address infrastructure bottlenecks, deficiencies in the legal and regulatory framework for the private sector, inefficiencies and corporate governance problems at state-owned enterprises, and shortages of labor skills.

Structural policies that promote productivity growth and support development of higher valued-added activities hold the key to sustaining growth and extending its benefits to more people.

3.10.1 Strengthening the financial framework

Two laws approved by the National Assembly in June 2010—a new State Bank of Viet Nam Law and a Credit Institutions Law—together with various legal documents issued by the central bank and other agencies, mark important progress in strengthening the framework for conducting monetary policy and safeguarding banking system stability. The laws go into effect on 1 January 2011.

The new SBV Law will enhance the central bank's autonomy and accountability in formulating and implementing monetary policy. It explicitly stipulates that the key objectives of monetary policy are to stabilize the value of the currency and to control inflation, putting more emphasis on these objectives than the current law.

Furthermore, the SBV's authority for surveillance and supervision of credit institutions is enhanced by the legislation.

The new Credit Institutions Law will allow credit institutions greater autonomy and flexibility in doing business, for example in setting fees and interest rates and in providing a wider range of financial services.

This law also simplifies administrative procedures for banking and sets out that institutions are to gradually adopt best international practices. It applies both to banks and nonbank financial institutions.