Viet Nam

Substantial and timely policy responses helped the economy weather the global recession, allowing for reasonably high economic growth in 2009. GDP growth is projected to accelerate in 2010 and 2011, although not to the rapid rates seen in 2001–2007. Devaluation and inflation pressures built up in late 2009, in part a result of economic stimulus policies. Inflation is forecast to accelerate in 2010. The authorities face a challenge to ratchet up economic growth while safeguarding macroeconomic stability.

Economic performance

Growth slowed sharply in the first quarter of 2009 as the impact of the global recession intensified. Spurred by a strong fiscal and monetary stimulus, the economy picked up over the rest of the year (Figure 3.31.1), putting full-year growth at 5.3%, the slowest since 1999.

On the demand side, the expansionary fiscal and monetary policies supported both consumption and domestically financed investment. Net exports improved because imports fell more steeply than exports (though the country is still a net importer in real terms). But foreign-financed investment declined owing to a downturn in foreign direct investment (FDI) inflows.

As for the sectors of production, agriculture (including forestry and fisheries) expanded by 1.8%, weaker than its average growth of about 4% in 2004–2008. The main cause was a poor summer–autumn rice harvest, which largely offset an abundant winter–spring harvest.

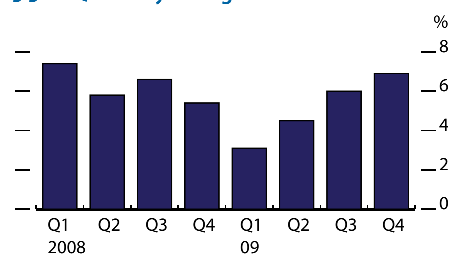
Industry grew by 5.5%, slowing from rates of about 10% in most recent years. Declining demand for exports as a result of the global recession weighed on manufacturing production. However, construction got a boost from the government's policy stimulus, and output of crude oil rose by 9.8% to 16.4 million metric tons, as new fields came on stream.

Services expanded by 6.6%, the pace easing a little from recent years. The expansionary policies and generally buoyant consumption bolstered financial services and domestic trade. At the same time, declines in foreign trade and tourist arrivals hurt the transport industry, and tourism-linked services such as hotels.

Businesses shed labor early in 2009 as the economy sagged, then, when many reversed course, employment picked up in the second half. The proportion of people living below the official poverty line declined to an estimated 12.3% in 2009 (from 13.4% in 2008), despite the global recession, suggesting the positive impact of government support programs.

Inflation pulled back abruptly last year, suppressed by the domestic economic slowdown and lower world commodity prices. Year-average

3.31.1 Quarterly GDP growth



Source: General Statistics Office of Viet Nam. http://www.gso.gov.vn (accessed 15 March 2010).

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This chapter was written by Dao Viet Dung, Yumiko Tamura, Chu Hong Minh, and Nguyen Luu Thuc Phuong of the Viet Nam Resident Mission, ADB, Ha Noi.

inflation slowed to 6.9% from 23.0% in 2008 (Figure 3.31.2). Toward the end of 2009, though, rapid growth of money supply and a depreciation of the exchange rate stoked inflation again, and by March 2010 the consumer price index was rising at a year-on-year rate of 9.5%.

When the global recession hit the economy in late 2008, the State Bank of Viet Nam (SBV), the central bank, loosened monetary policy significantly. It slashed the base rate from 14.0% in October 2008 to 7.0% in February 2009 and sharply reduced the reserve-requirement ratio for banks' domestic currency deposits. Late in 2009, however, the SBV raised the base rate to 8.0% (Figure 3.31.3) in an effort to reduce devaluation pressure on the dong.

Lending interest rates fell to single digits in early 2009. The lower rates, coupled with interest-rate subsidies launched in February 2009 as part of the stimulus package, prompted rapid growth of credit and money supply. Bank credit to the economy expanded by 39.6% and M2 money supply by 29.0% in 2009 (Figure 3.31.4). Many banks started experiencing a shortage of liquidity in late 2009, partly a result of a slowdown in growth of deposits due to expectations of rising inflation. A subsequent tightening of bank credit continued into 2010.

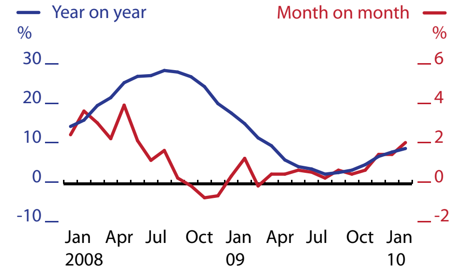
Expansionary fiscal measures adopted in the first half of 2009 included tax reductions and deferrals, additional financial assistance to poor households, a 4 percentage point interest-rate subsidy on short- and medium-term bank loans for certain sectors, and a hike in capital expenditure. The measures, as approved, totaled the equivalent of $8.5 billion, or 8.8% of GDP. About 70% of these measures were actually implemented, given financing and other constraints. Still, the overall fiscal deficit jumped to an estimated 11.8% of GDP, from 4.1% in 2008 (Figure 3.31.5).

Viet Nam's foreign exchange market remained turbulent in 2009. Declines in exports, tourist arrivals, remittances, and capital inflows reduced the supply of foreign exchange, while rapid growth of credit increased demand for it. The shortage of foreign currency in the formal market that had emerged in late 2008 persisted, despite extensive interventions by the central bank. The SBV widened the dong's trading band against the United States (US) dollar to 5% around its reference rate in March 2009, but kept the rate itself roughly unchanged until November 2009 (Figure 3.31.6).

Sales of foreign exchange by the central bank, as well as a deterioration in the balance of payments, cut into official foreign reserves, raising expectations of a devaluation. Exporters began hoarding foreign currency, and capital flight (mostly in the form of speculative imports and residents shifting their portfolio toward gold and US dollar-denominated assets) intensified. The spread between the black market rate and the SBV's reference rate increased to more than 15% in November 2009.

In response, the SBV devalued its reference rate by 5.4% and narrowed the trading band to ±3.0% in November 2009. In February 2010, it devalued the reference rate by another 3.4%, lowered the reserve-requirement ratio for foreign exchange deposits, and introduced a 1% cap on dollar deposit rates for non-individuals. The SBV also ordered that gold-trading floors in Viet Nam and residents' gold trading accounts abroad be closed by 30 March 2010. The government instructed several

3.31.2 Monthly inflation



Source: General Statistics Office of Viet Nam. http://www.gso.gov.vn (accessed 15 March 2010).

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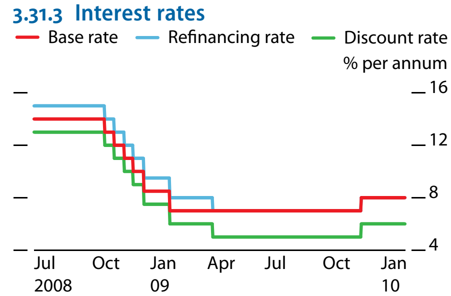
3.31.3 Interest rates



Source: State Bank of Viet Nam.

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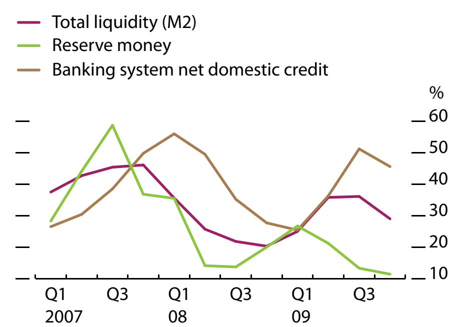
3.31.4 Growth of money and banking indicators



Source: State Bank of Viet Nam.

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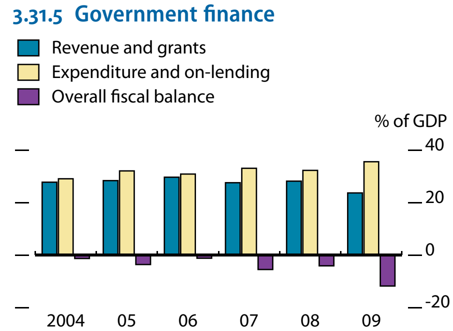
3.31.5 Government finance



Note: Data include expenditure financed by official development assistance and by issuance of sovereign debt but exclude amortization of debt and lending through the Viet Nam Development Bank and Bank for Social Policies.

Source: Ministry of Finance of Viet Nam.

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large state-owned enterprises to sell their foreign exchange (to the government). These measures reduced capital flight and improved the availability of foreign exchange. Consequently, the spread between the black market rate and the SBV's reference rate decreased to 3.5% in February 2010.

Weaker external demand reduced exports in 2009, particularly for rice, coffee, rubber, and shoes. Total exports fell by 8.9% in US dollar terms, and imports by 13.3%, the latter brought down by weaker economic activity and lower global commodity prices. (The start of domestic oil refining contributed to declines in exports of crude and imports of refined products.)

A sharply narrower trade deficit reined in the current account deficit to 7.4% of GDP in 2009 from 11.8% in 2008 (Figure 3.31.7). The overall balance of payments recorded a deficit, and gross official reserves dropped to an estimated $15 billion (equivalent to 2.8 months of imports, the lowest since 2004 on this basis) (Figure 3.31.8), from $23.0 billion a year earlier.

In the business environment, Viet Nam's ranking in the World Bank's *Doing Business 2010* report declined to 93 of 183 countries listed, from 87 in 2008. Aware of shortcomings, the government took steps to improve governance and the business environment in 2009. On the former, it adopted a national anticorruption strategy and consolidated most public debt management in one department within the Ministry of Finance.

On the latter, it strengthened the regulatory framework for small and medium-sized enterprises, simplified procedures for business registration, and eased some restrictions on foreign investment.

Equitization (partial privatization) of VietinBank was completed in 2009 and equitization plans for Vietnam National Petroleum Company and Vietnam Steel Corporation were approved in early 2010. Government efforts to reduce administrative procedures by about a third should benefit the business climate.

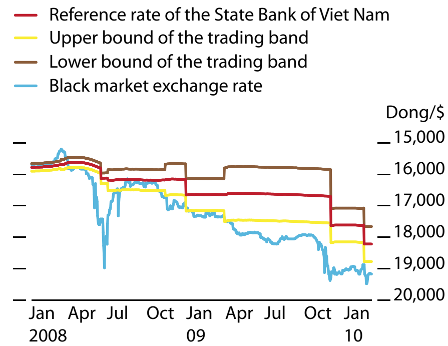
Economic prospects

As Viet Nam completes the Socio-Economic Development Plan 2006–2010, aimed at raising the economy to middle-income status (Box 3.15.1), the challenge is to ratchet up economic growth while safeguarding macroeconomic stability.

Fiscal policy has been tightened somewhat: the 2010 budget targets a narrower overall fiscal deficit of 8.3% of GDP. On the monetary side, interest rate subsidies on short-terms loans have been ended, but subsidies are maintained for medium-term loans to selected sectors at a reduced level of 2 percentage points. The central bank also removed interest rate caps on medium- and long-term loans in February 2010, enabling banks to raise lending rates. In addition to the increase in the central bank's base interest rate in late 2009, the authorities set a target for credit growth in 2010 at 25%, below the actual growth rate of 39.6% last year.

Forecasts are based on the assumption that the government will do the following: tighten monetary and fiscal policies further during 2010 to limit inflation and devaluation pressures, and keep the policies

3.31.6 Exchange rates



Sources: State Bank of Viet Nam; ADB observations.

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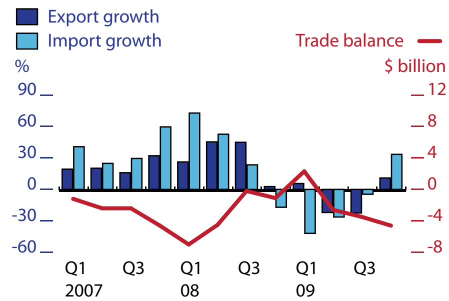
3.31.7 Trade indicators



Sources: State Bank of Viet Nam; ADB estimates.

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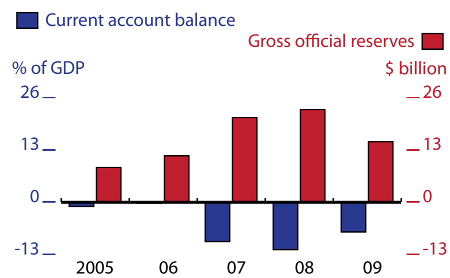
3.31.8 Current account and reserves



Sources: State Bank of Viet Nam; ADB estimates.

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3.31.1 Achieving middle-income status

Under the World Bank's classification, developing countries graduate from "low income" to "lower middle income" when per capita gross national income reaches $976. In Viet Nam it stood at $890 in 2008, according to the World Bank.

moderately tight in 2011; not resort to administrative measures to control inflation; and maintain stability of the banking system.

On these assumptions, GDP growth is projected to accelerate to 6.5% in 2010 and to 6.8% in 2011 (Figure 3.31.9). Expected increases in remittance inflows and incomes will speed up growth of private consumption. Improvement and consolidation of global financial conditions will bring about an upturn in FDI inflows and foreign-financed investment. At the same time, growth of public consumption and domestically financed investment will moderate due to the decline in budget spending and tighter bank credit.

The strengthening of external demand is set to spur growth of agriculture and manufacturing in both 2010 and 2011. Oil output will likely stay at about 16.5 million metric tons in 2010 but slip in 2011 as output at old fields declines. Construction will be damped by the weakening of domestically financed investment. The services sector will benefit from the projected expansion of foreign trade and increase in tourist arrivals.

Inflation in 2010 is forecast to accelerate to average about 10.0%, on account of the rapid growth of money supply in 2009, the dong devaluations, and projected pickup in economic activity and world commodity prices in 2010. Inflation rose to 8.5% year on year in the first quarter of 2010. Assuming monetary and fiscal policies are tightened this year, inflation could ease to about 8.0% in 2011 (Figure 3.31.10).

Exports will pick up in 2010 as external demand strengthens. Tourism and remittance flows are projected to rise in line with improvements in the performance of industrial economies. However, imports will rise more than exports because of the projected acceleration of domestic growth and higher import prices.

Trade with the People's Republic of China is expected to expand rapidly now that a free trade agreement between the PRC and the Association of Southeast Asian Nations has come into force from 1 January this year.

On these factors, the current account deficit is forecast to widen slightly to 7.6% of GDP in 2010.

FDI inflows will rebound, as global financial conditions improve. Inflows of portfolio investment will likely remain small and outflows of short-term capital will probably moderate. The capital account is expected to be in surplus and the overall external position to be close to balance—provided that confidence about medium-term macroeconomic stability is restored—leaving official reserves little changed.

In 2011, an expected quickening of growth in exports, tourism, and remittances will pull the current account deficit back to about 5.5% of GDP (Figure 3.31.11). Capital inflows should also pick up as the global recovery gathers momentum. The overall balance of payments is expected to be in surplus in 2011, lifting official reserves.

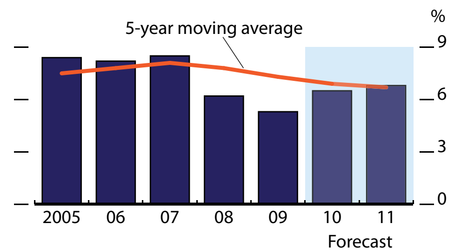
Domestic risks to the outlook are mostly on the downside. If monetary and fiscal policies are not tightened adequately, inflation could spurt above the forecast rate and the current account deficit would deteriorate (GDP growth in 2010 would likely exceed the forecast). Such circumstances might well require an abrupt tightening of policies in 2011, pulling GDP growth below the forecast. Two episodes of high inflation

3.31.1 Selected economic indicators (%)

	2010	2011
GDP growth	6.5	6.8
Inflation	10.0	8.0
Current account balance (share of GDP)	-7.6	-5.5

Source: ADB estimates.

3.31.9 GDP growth



Source: Asian Development Outlook database.

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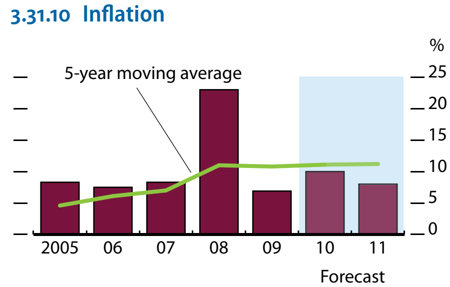
3.31.10 Inflation



Source: Asian Development Outlook database.

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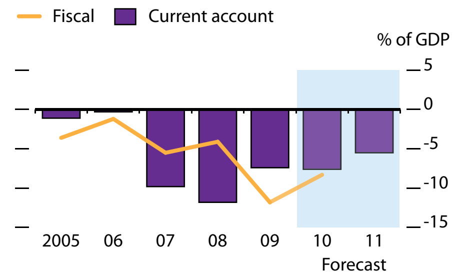
within 3 years (it averaged 23% in 2008) would also erode business and consumer confidence, and hinder poverty reduction.

There have been some official proposals to use administrative measures such as price controls and import restrictions to curb inflation and devaluation pressures. Controls might limit price rises and imports, although they, too, might damage foreign investor confidence (and would likely lead to shortages).

3.31.11 Fiscal and current account deficits



Source: *Asian Development Outlook* database.

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Development challenges

The end of subsidies on short-term loans and expected tightening of monetary policy will squeeze some borrowers and could lead to a rise in nonperforming loans, adding to stresses in the banking system. It will be necessary, therefore, to manage the slowdown in growth of credit and money supply through an orderly rise in interest rates, rather than a shortage of liquidity in the banking system. In this context, the elimination of caps on interest rates on medium- and long-term loans was a step in the right direction.

Shortages of foreign exchange in the formal market, which undermine confidence in the currency, fuel inflation, and hurt investment, should be addressed through a combination of tighter monetary policy and increased exchange-rate flexibility.

Over the medium term, it will be important to improve the legal and institutional framework for monetary policy. Maintaining price stability should be the primary goal of monetary policy, and the SBV should be given enough operational autonomy to pursue this goal effectively.

Large strides have been taken to raise the efficiency of the economy and ease supply-side constraints to growth, but more needs to be done on this front. Infrastructure bottlenecks, deficiencies in the legal and regulatory framework for the private sector, and shortages of labor skills remain.

It is estimated that investment in infrastructure over the next 10 years will cost the equivalent of 11% of GDP each year. Only about half could be met from the budget. Clearly it would be helpful to create policy and legal frameworks that encourage private sector participation in infrastructure through public–private partnerships.

Improvements in economywide efficiency also require greater efforts to restructure state-owned enterprises, which employ a substantial proportion of available resources in this economy but do not always use them efficiently.