Viet Nam

Buoyant investment and consumption drove robust economic growth in the first half of 2007. A surge in imports, partly investment-related, widened the trade deficit more than expected in *Asian Development Outlook 2007* (*ADO 2007*). GDP growth forecasts for all 2007 and for 2008 are maintained at rapid rates of 8.3% and 8.5%, respectively. The wider trade gap now points to current account deficits in both years. With stronger than expected inflation (and upward revisions to the forecasts), the Government has taken steps to contain the price pressures.

Updated assessment

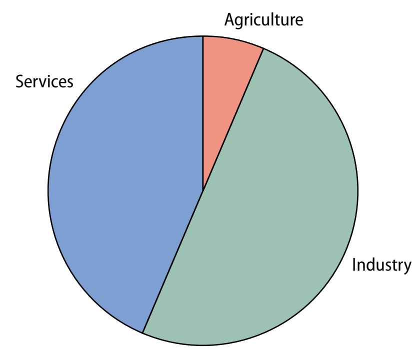
A half percentage point faster than the year-earlier period, the economy accelerated to 7.9% growth in January–June 2007, with nearly all of it coming from industry (3.9 percentage points) and services (3.4 percentage points) on the production side (Figure 3.9.1). Private industry expanded by 20.5%, more than double the pace of state enterprises. Among subsectors, manufacturing grew by a robust 12.3%, but mining (showing minimal growth) suffered from a 7.4% contraction in crude oil production as output at the White Tiger oil field, the biggest in Viet Nam, declined. In services, trade and finance grew by 10.4% and the hotels and restaurants subsector, benefiting from buoyant consumption and increased tourism, rose by 12.7%.

Agriculture, hit by drought, avian flu, and livestock diseases, put in a weaker performance in the first half than a year earlier, to contribute only 0.5 percentage points to aggregate expansion. This sector still accounts for about 55% of total employment, however.

On the demand side, strong investment and consumption were the main drivers. Investment grew by 14% in the first half, stimulated by Viet Nam's entry into the World Trade Organization (WTO) in January 2007 and by improvements in the business environment. Much of investment's growth is from the domestic private sector, whose share of overall investment increased to about 35% in the first half of 2007 (up from 23% in 6 years). As part of efforts to maintain improvements in the business climate, a "single window" at the Department of Planning and Investment has been set up in some cities to streamline procedures and reduce the time needed for starting a business.

Foreign direct investment (FDI) approvals in the first 7 months of this year rose by about 55% to $6.4 billion and seem headed for a record $13 billion for the full year. An increasing share is going into property (in anticipation of rising demand for offices and commercial buildings) and into tourism. Consumption growth was supported by wage increases, particularly for skilled workers who are in short supply, and remittances from Vietnamese living abroad. Retail sales of goods and services in nominal terms rose by an estimated 23% in the first half of 2007, slightly above the pace of a year earlier (Figure 3.9.2).

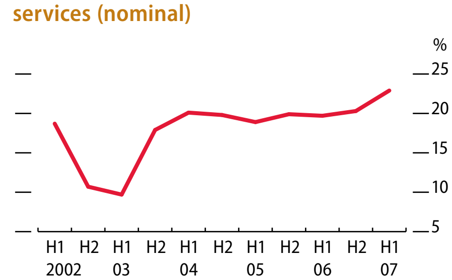
3.9.1 Contributions to growth (supply), first half 2007



Source: CEIC Data Company Ltd., downloaded 31 August 2007.

Click here for figure data

3.9.2 Growth of retail sales of goods and services (nominal)



Sources: General Statistics Office of Viet Nam, available: http://www.gso.go.vn; CEIC Data Company Ltd.; both downloaded 31 August 2007.

Click here for figure data

Since GDP usually picks up in the second half of the year, mainly because budget disbursements accelerate, economic growth for all 2007 is forecast to be 8.3%, unchanged from the *ADO 2007* projection.

Buoyant investment led to a steep 30.4% increase in merchandise imports in the first half of 2007, about double the year-earlier rate. Imports of capital goods surged by 46.5%, and imports of raw materials and intermediate goods were also vigorous (Figure 3.9.3). Growth in merchandise exports, in contrast, slowed to 19.4% from 25.7% (Figure 3.9.4). The value of crude oil exports fell by 10%, largely because of the drop in oil production. Seafood exports, one of the biggest export categories, were hurt by concerns in some overseas markets about contamination of shrimp by antibiotics. Other export categories performed robustly, though: coffee exports more than doubled as global coffee prices increased, and textiles and clothing rose by 25.9% after the abolition of quotas following WTO accession. Exports of wooden furniture, which have grown rapidly in the past couple of years, rose by 23%.

As a result of these trends in the first half, the trade deficit widened sharply to $4.8 billion, equivalent to about 16% of GDP, from $2.0 billion in the year-earlier period. Concerns were, though, largely assuaged by the composition of imports: much of their increase reflected capital goods and other inputs for export production (the clothing industry, for example, imports almost 70% of its inputs). Moreover, the external position is supported by rising remittances and tourism receipts. With the deterioration in the trade gap, Viet Nam is now forecast to have a current account deficit equivalent to 5.0% of GDP this year, revised from a small surplus expected in *ADO 2007*.

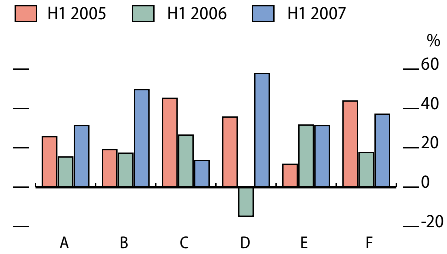
Strong FDI inflows and a rise in portfolio investment contributed to a surplus in the overall balance of payments. The State Bank of Viet Nam, the central bank, accumulated additional foreign exchange reserves of $7 billion in January–July to reduce upward pressure on the currency. The Government in January 2007 widened the dong's daily trading band against the dollar from 0.25% to 0.5%, allowing for more flexibility in monetary policy.

The impact on money supply of FDI and portfolio inflows was only partly offset by central bank sterilization operations, leading to a liquidity buildup. Credit soared by 35% in the first 6 months, above the central bank's full-year target of 25%. High levels of liquidity, plus heavy domestic demand and some food supply issues, pushed inflation up to 8.6% in August, taking the average inflation rate for the first 8 months of this year to 7.4% (Figure 3.9.5). Food prices rose, driven by outbreaks of avian flu and a pig disease that caused meat shortages.

Administered energy prices went up, too. The Government, phasing out energy subsidies, raised prices of electricity (by 7.6%), and coal (20%) early in the year and subsequently abolished a subsidy on gasoline (keeping subsidies for kerosene and diesel). Largely as a result, gasoline prices rose by 7.6% in the first 8 months. The heightened inflation pressures have prompted an increase in the full-year forecast to 7.8% from 6.8% in *ADO 2007*.

The authorities have taken several steps to contain price pressures. The State Bank of Viet Nam increased issuance of bills to drain excess liquidity and in June it raised the reserve-requirement ratio for banks

3.9.3 Merchandise import growth (total and major categories)

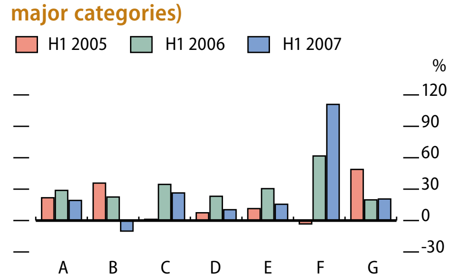


A = Total imports; B = Machinery and spare parts; C = Petroleum; D = Steel productsr; E = Fabrics; F = Electronic products.

Source: CEIC Data Company Ltd., downloaded 31 August 2007.

Click here for figure data

3.9.4 Merchandise export growth (total and major categories)

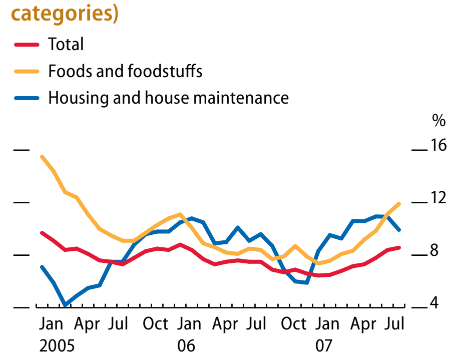


A = Total exports; B = Crude oil; C = Textiles and clothing; D = Footwear; E = Fisheries products; F = Coffee; G = Computer and electrical components.

Source: CEIC Data Company Ltd., downloaded 31 August 2007.

Click here for figure data

3.9.5 Inflation (total and high inflation categories)



Source: CEIC Data Company Ltd., downloaded 31 August 2007.

Click here for figure data

from 5% to 10%. The Ministry of Finance in August lowered import tariffs on 18 groups of commodities to assist in the inflation-fighting effort. Tariff rates on food and construction materials were cut by at least half. As part of this effort, the Government in July had already dropped a plan to increase wages across the public sector.

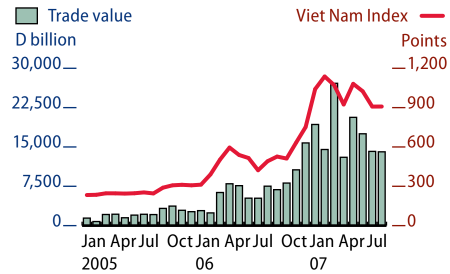
Fiscal policy remains expansionary as the Government invests heavily in infrastructure. This has led to a widening fiscal deficit and an increasing public debt. The overall fiscal deficit is expected to reach 5.0% of GDP in 2007.

In policy developments, Viet Nam lowered its average tariff rate from 17.4% to 14.5% under its WTO commitments, and the average rate is scheduled to come down further over the next few years. The increased competitive pressures from deepening integration with global markets have emphasized the need to reform state-owned enterprises (SOEs). The Government plans to equitize (partly privatize) an additional 1,500 SOEs, out of the remaining 2,100, by 2010. Among moves already made, state-owned Bao Viet Insurance Corporation, the largest insurance company, issued shares through an initial public offering in June 2007, and others are lining up to do this. In addition, the state's holdings in fully and partly owned SOEs are being transferred from ministries and provincial governments to the State Capital Investment Corporation, which is likely to reduce the involvement of ministries in the management of the enterprises.

A WTO commitment to open banking to foreign ownership is underlining the urgency of reforming state-owned commercial banks as well. The Government encouraged this in April by raising the stake that foreign banks and investors can hold in Vietnamese banks, from 10% to, in most cases, 15%. Two state-owned banks—Vietcom Bank and Mekong Housing Bank—plan to make initial share offerings, but volatility in the stock market has caused some slippage of the schedule.

The stock market boomed through 2006, with the Viet Nam Index of share prices climbing by 144%. In the first 10 weeks of 2007, the index rose by a further 50%, but has since dropped by about 20% from the record set in March (Figure 3.9.6). Stock market capitalization of listed companies has increased to the equivalent of about 28% of GDP this year, from just 5% in 2005. The central bank, concerned that banks might be taking on excessive risk exposure to stocks and about the impact on inflation of rapid credit growth, in June called on banks to limit lending for share purchases to a ceiling of 3% of total loans by end-2007.

3.9.6 Ho Chi Minh City stock trading center



Source: CEIC Data Company Ltd., downloaded 31 August 2007.

Click here for figure data

Prospects

The outlook for next year assumes that WTO accession will further integrate the economy into global business networks, encourage FDI, and help maintain the momentum for domestic reforms, which are generally improving the business environment. Investment is forecast to grow by about 15% in 2008, similar to this year, taking it to 41% of GDP. Robust consumption will be underpinned by rising wages for skilled employees and by remittances.

Led by strong growth of two of its components—manufacturing and construction—industry is expected to grow by 10.6% in 2008. Higher

3.9.1 Selected economic indicators (%)

	2007		2008	
	ADO 2007	*Update*	*ADO 2007*	*Update*
GDP growth	8.3	8.3	8.5	8.5
Inflation	6.8	7.8	6.3	6.8
Current acct. bal. (share of GDP)	0.2	-5.0	1.3	-4.7

Source: Staff estimates.

value-added products, including computers and electronic goods for export, constitute an increasing share of manufacturing output. In construction, projects under way or planned include major hotels and resorts, as well as high-end office and apartment buildings in Hanoi and Ho Chi Minh City. Public sector construction will emphasize the building of roads, ports, and power generation facilities.

Services, spurred by consumption and tourism, as well as the gradual opening of some subsectors to foreign participation, is projected to grow by 8.6% next year. Subsectors likely to expand fastest are banking and finance, trade, transport and telecommunications, and tourism. Agriculture is projected to pick up to 3.1% in 2008, slightly faster than this year's weaker than usual pace. On these influences, GDP growth for 2008 is projected to edge up to 8.5% (Figure 3.9.7), in line with the *ADO 2007* forecast.

Trade benefits from WTO accession are expected to keep export growth brisk in 2008, at 22%. Clothing exports will build on the gains made from the ending of quotas on Vietnamese garments. In addition, the shrimp industry has improved its quality control, and this should lift exports.

Import growth is seen staying high, reflecting the continued need for capital goods (to support investment spending) and for export-related inputs. The current account deficit is projected at 4.7% of GDP in 2008 (Figure 3.9.8), similar to that in 2007 but marking a revision from a small surplus forecast in *ADO 2007*. Inflows of FDI, portfolio investment, and aid are seen maintaining a surplus in the overall balance of payments.

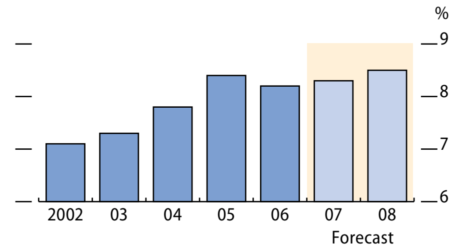
Strong domestic demand and high levels of liquidity related to the balance-of-payments surplus will likely see little dissipation of strong inflation pressures. Average inflation for 2008 is forecast at 6.8%, easing from 2007's rate but revised up from 6.3% in *ADO 2007* (Figure 3.9.9). The fiscal stance is expected to remain expansionary, with an estimated fiscal deficit of 5.0% of GDP.

Pressing challenges involve reining in inflation, addressing bottlenecks in infrastructure (particularly electricity and ports), and tackling skilled-labor shortages. Demand for electricity is growing by 17% annually, overtaxing the system, and leading to power outages. Just over half the power supply comes from hydropower, which is vulnerable to drought. Consequently, six new FDI-funded thermal power plants are planned, at a cost of $8.5 billion. They are currently awaiting government approval.

Given the heavy investment required in infrastructure, and the constraint imposed by a 5% budget deficit, greater private participation in infrastructure would help accelerate the program and reduce the strain on the public debt, which has grown rapidly to about 45% of GDP. The encouragement of private participation in building power facilities in the past 2 years is a welcome step in this direction.

A business forum in May 2007 identified difficulties in finding skilled labor as a key constraint in doing business in the country. Deficiencies in the education system are largely to blame for this bottleneck, and recognizing this, the authorities are taking some steps to change the education system, including encouraging privately operated schools and universities. Removing the 3% limit on the number of foreign employees in an enterprise would also help.

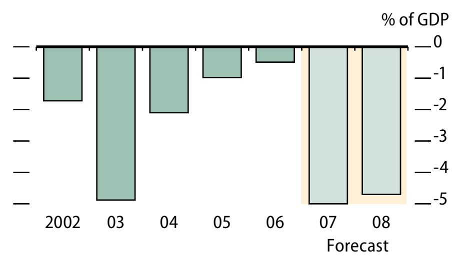
3.9.7 GDP growth



Sources: Asian Development Outlook database; staff estimates.

Click here for figure data

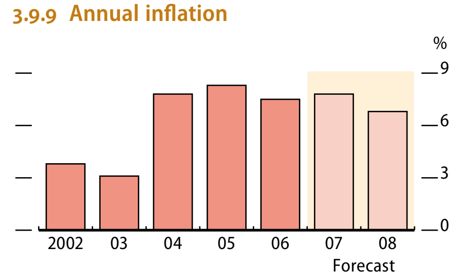
3.9.8 Current account balance



Sources: Asian Development Outlook database; staff estimates.

Click here for figure data

3.9.9 Annual inflation



Sources: Asian Development Outlook database; staff estimates.

Click here for figure data