Viet Nam

This economy now enters its third year of macroeconomic stability with lower inflation, strong external trade and capital flows, and a firmer exchange rate. GDP growth edged up in 2013 and is expected to recover further over the next 2 years. Inflation is forecast to remain relatively subdued. A return to the faster economic growth of previous years is hampered by the cautious pace of reform to banks and state enterprises.

Economic performance

Economic growth picked up slightly to 5.4% in 2013 (Figure 3.31.1), still well below the 7.0%–8.0% pace seen in 2004–2007. Services accelerated to 6.6%, making the biggest contribution to GDP growth. Hotels and restaurants grew by 9.9%, buoyed by an 11% increase in tourist arrivals, and banking and finance expanded by 6.9%, helped by easier credit. Reflecting subdued private consumption, growth in wholesale and retail trade decelerated to 6.5%.

The improved services performance offset a slowdown in industry, which grew by 5.4%. Mining output contracted as coal and crude oil production fell, but manufacturing expanded by 7.4%, driven by exports of manufactures from foreign-invested factories. Construction continued to recover from a slump to grow by 5.8% last year.

Agriculture and fisheries maintained modest growth at 2.7%. Fisheries now contribute 20% of this sector's output, about double their share 10 years ago.

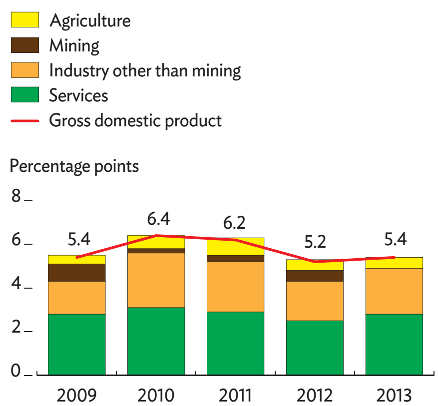
From the demand side, increases in foreign direct investment and off-budget government outlays on infrastructure drove a 5.5% expansion of investment. This was from a low base in 2012, and gross capital formation as a ratio to GDP remained, at 27% in 2013, far below earlier peaks. Weakness in the labor market and lackluster consumer confidence held growth in private consumption to 5.2%. Public consumption rose by 7.3% in line with the government's policy to grow recurrent expenditure. Net exports of goods and services also contributed to GDP growth.

Inflation abated to average 6.6% last year, maintaining a steep decline from 18.6% in 2011 (Figure 3.31.2). Subdued domestic demand, steady food production, and soft international commodity prices contributed to dampening inflation. With food price inflation under control, the government raised administered prices for electricity, fuel, and medical services.

To help struggling businesses and lift growth, the State Bank of Viet Nam (SBV), the central bank, lowered its key policy interest rates

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

3.31.1 Supply-side contributions to growth



Source: General Statistics Office of Viet Nam.
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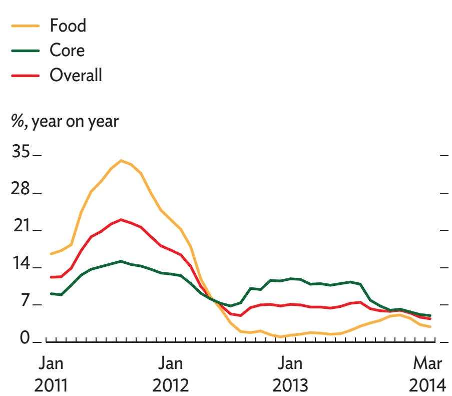
3.31.2 Inflation



Source: General Statistics Office of Viet Nam.
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by 200 basis points in 2013, following cuts of 600 basis points in 2012 (Figure 3.31.3). The SBV also reduced caps on certain deposit and lending rates.

Nevertheless, growth in credit was sluggish until late in 2013, when some banks extended temporary credit to meet a government target of 12.0% credit growth. For the year, credit grew by an estimated 12.5% (Figure 3.31.4). Credit growth remained constrained by uncertainties over the prevalence of nonperforming loans (NPLs), the slow progress of banking reform, and slack demand for credit. Broad money supply (M2) increased by an estimated 18%, above the SBV's 2013 target range of 14%–16%.

The Viet Nam dong was relatively stable through 2013. The currency was supported by easing inflation, strong external accounts, and positive real interest rates. An additional factor was the active sterilization of excess liquidity through the issuance of central bank bills. The SBV devalued the dong by 1% against the US dollar in June to stimulate exports.

Fiscal policy provided support to economic growth, with tax breaks for small- and medium-sized enterprises and increases in recurrent spending (Figure 3.31.5). The budget deficit, as defined by the government, widened to 5.5% of GDP in 2013 from 4.3% in 2012. Off-budget spending likely added to the overall fiscal deficit, though shortcomings regarding transparency in fiscal information make estimates difficult. Tax revenue has been hurt by the sluggish economy over the past 2 years, tax concessions, and reductions in import tariffs.

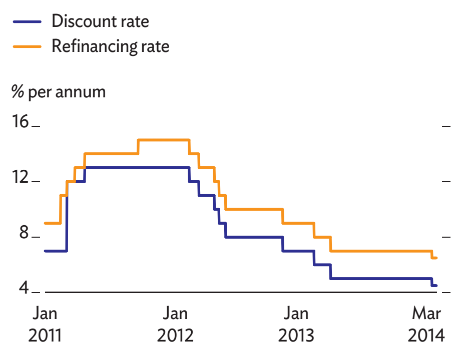
The government responded to revenue constraints by taking steps to improve the efficiency of public investment and by restraining capital spending from the budget. Total capital spending was estimated at 5.8% of GDP in the past 2 years, down from 8.4% in 2004–2011. Capital spending declined from roughly 72% of total spending in 2010 to 40% in 2013, partly because of a government decision to maintain in real terms recurrent spending to social sectors.

In the external accounts, merchandise exports rose by an estimated 15.3% on a balance-of-payments basis, with foreign-invested companies contributing 13 percentage points of this growth. Customs data showed exports of mobile phones jumped by 69% last year, computers and electronics by 36%, and textiles by 19%. Gains in manufactured exports offset declines in the value of agricultural and crude oil exports. Merchandise imports rose by an estimated 15.1%, driven by raw materials and inputs for manufacturing.

A trade surplus of $11.6 billion contributed to a current account surplus estimated at 6.5% of GDP, the third consecutive surplus achieved through growth in merchandise exports, tourism receipts, and remittance inflows. Net inflows of foreign direct investment were down a bit from the previous year at $7 billion, and net financing and portfolio inflows also fell. The balance of payments recorded a surplus estimated at 0.4% of GDP, and international reserves were estimated at 2.3 months of imports of goods and services (Figure 3.31.6).

To mitigate vulnerabilities in the banking sector, the government took several steps that addressed impaired bank balance sheets, insufficient bank capital, and inadequate prudential standards.

3.31.3 Interest rates



Source: State Bank of Viet Nam.
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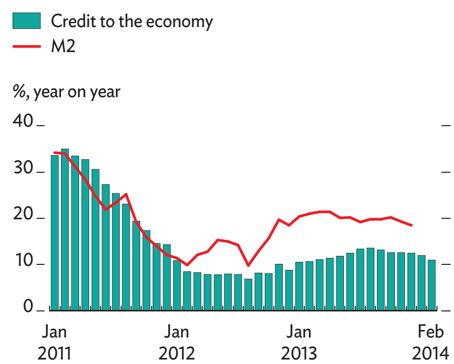
3.31.4 Credit and money supply growth



Sources: State Bank of Viet Nam; ADB estimates.
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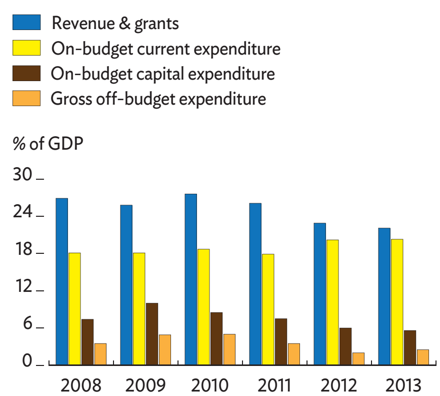
3.31.5 Budget revenue and expenditure indicators



Source: Ministry of Finance.
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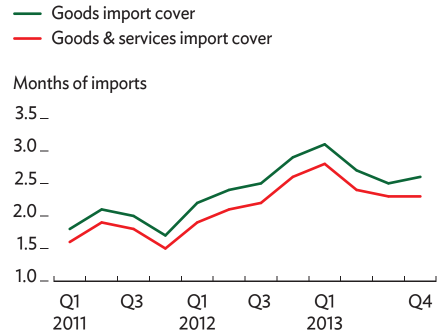
Most notably, it established the Viet Nam Asset Management Company (VAMC) primarily to acquire, restructure, and sell NPLs. By year-end, the VAMC had purchased the equivalent of $1.9 billion in bad debts from 35 banks (estimated at 1.1% of all outstanding loans). As payment, the VAMC issued special bonds of up to 5 years with zero interest, which the banks can use as collateral to access the SBV's refinancing facility.

The SBV reported that the NPL rate had declined to 3.6% of all loans by the end of 2013, owing mainly to transfers to the VAMC, but it added that NPLs could be 9% if restructured loans were included. Rating agency Moody's estimated NPLs could exceed 15% if international accounting and provisioning standards were applied (Figure 3.31.7).

In addition, the government is gradually implementing a program to strengthen state-owned enterprises (SOEs). This plan includes equitizing, or partly privatizing, more state firms and sharply reducing the number of SOEs to 690 by 2015 and 200 by 2020. SOEs have been instructed to divest themselves of risky noncore operations. In June 2013 the government simplified SOE reporting requirements in a move expected to encourage their disclosure of financial information.

3.31.6 Gross international reserves



Q = quarter.

Note: Data exclude government foreign exchange deposits at the State Bank of Viet Nam and the foreign exchange counterpart of swap operations. Imports are on free-on-board basis.

Sources: International Monetary Fund; ADB estimates.

Click here for figure data

Economic prospects

Official statements indicate that the government will act to support economic growth in the next 2 years, though its priority is to maintain macroeconomic stability. The forecasts below assume policy stimulation will be moderate and that the government will make further gradual progress on structural reform to the financial and SOE sectors.

The budget deficit target for 2014 is close to last year's, but the government increased the bond-issuance ceiling, which suggests that it could raise off-budget spending. Growth should get a lift from efforts to accelerate lagging programs as illustrated by a $1.4 billion housing assistance package unveiled in early 2013. Only 4% of this amount was disbursed by February 2014.

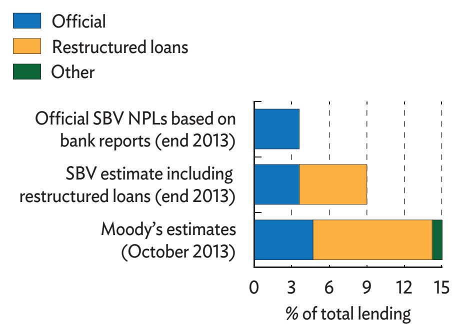
On the monetary side, the SBV further trimmed policy rates by 50 basis points in March 2014, taking the refinancing rate down to 6.5% and the discount rate to 4.5%. It also reduced the caps on certain deposit and lending rates. With policy rates at the lows seen in the last easing cycle, there is limited room for further monetary support. Interest rates could start to turn up next year.

To meet a target of 7% inflation, the SBV set targets of 12%–14% for credit growth, and 16%–18% for growth in total liquidity, all slightly higher than the 2013 targets.

Growth in private consumption will get support from lower inflation, but the labor market remains slack and consumer confidence lackluster. Strong disbursements from committed foreign direct investment, particularly from Japan and the Republic of Korea, will bolster investment in high-tech manufacturing (Figure 3.31.8). On the other hand, private domestic investment will still be dampened by banking system weaknesses.

Prospects for better performances in the US and euro area economies, two of Viet Nam's major markets, suggest that growth in exports can be maintained. Coffee exports should get a lift

3.31.7 Nonperforming loans



NPL = nonperforming loan, SBV = State Bank of Viet Nam.

Sources: State Bank of Viet Nam; Moody's Rating Agency.

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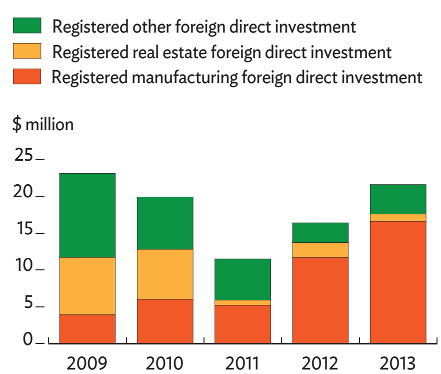
3.31.8 Foreign direct investment by sector



Source: General Statistics Office of Viet Nam.

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from stronger global coffee demand in 2014, and export-oriented manufacturing industries should continue to expand. However, growth in the manufacture of high-tech products also propels imports, because inputs to these factories are sourced largely from abroad.

Data for the first quarter of 2014 show that GDP rose by 5.0%, slightly faster than in the year-earlier quarter. Services expanded by 6.0% in January–March, industry and construction by 4.7%, and agriculture by 2.4%. As a sign of how the year started for manufacturing, the purchasing managers' index for February showed that output continued to grow, but the pace eased to the slowest in 4 months.

Considering these factors, GDP growth is forecast to rise slightly to 5.6% in 2014, picking up further to 5.8% in 2015 (Figure 3.31.9) with economic recovery in the US and the euro area and as progress is made in addressing domestic banking sector weaknesses.

Inflation is expected to average 6.2% in 2014, assuming reasonably stable food production, moderate policy stimulation, and only slight depreciation of the dong (Figure 3.31.10). Inflation eased to 4.4% in March 2014. Changes in assumptions, or unexpectedly large price increases for subsidized goods and services, would generate higher inflation. Inflation is forecast to average 6.6% in 2015 as economic activity picks up.

Trade and current account surpluses are projected over the forecast period, but narrowing from 2013. A relatively stable dong exchange rate since April 2011 has improved perceptions about the currency, but periodic internal flight to foreign currency and gold suggests that sentiment toward the dong remains fragile. Prices for gold that are higher domestically than overseas indicate that investors favor gold as an inflation hedge.

Negative errors and omissions in the balance of payments swelled to an estimated 6% of GDP in 2013, which may reflect large volumes of gold outside the banking system (Figure 3.31.11).

A return to the faster economic growth of previous years is hampered by the cautious pace of reform to the banking system and SOEs. The SBV has stepped up its supervision of bank lending, merged and restructured some of the weaker banks, and eased restrictions on foreign investment in domestic banks. After a year's delay, new loan classification and provision standards intended to close the gap with international norms will come into effect in June 2014.

However, these new standards are less ambitious than originally intended, and further delay affects some key measures such as the requirement to adjust loan classifications based on credit information center data. Also, banks will continue to enjoy flexibility when restructuring overdue loans and the discretion to avoid declaring them as bad debt. Accelerating progress on resolving NPLs is likely to require setting firm targets and timelines for closing the gap between national and international standards.

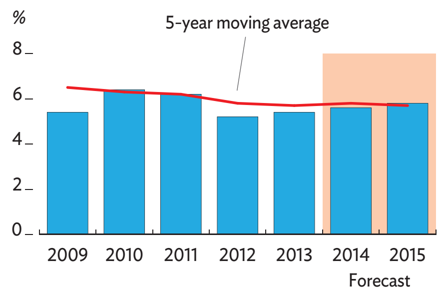
In 2014, the VAMC plans to purchase the equivalent of up to $4.8 billion of bad debt from banks. Among the challenges facing the asset-management company are to build sufficient capacity to undertake complex debt restructuring and to pursue the task with initial capital of only $24 million. Effective mechanisms to price and auction bad debts,

3.31.1 Selected economic indicators (%)

	2014	2015
GDP growth	5.6	5.8
Inflation	6.2	6.6
Current account balance (share of GDP)	4.1	3.0

Source: ADB estimates.

3.31.9 GDP growth



Source: Asian Development Outlook database.

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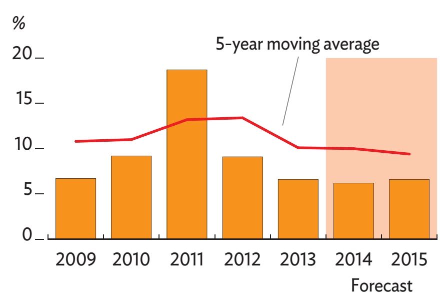
3.31.10 Inflation



Source: Asian Development Outlook database.

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and to auction collateralized assets, have yet to be put in place. Changes are required in the regulatory framework and bankruptcy law to allow the VAMC to handle debt and related collateral in a timely way.

As the banks clean up NPLs they will still need capital injections, but it is unclear how and when they will be recapitalized. Bank recapitalization and SOE reform need to be pursued together with NPL resolution.

On SOE reform, the government aims to partly privatize 432 SOEs during 2014–2015 (Figure 3.31.12). That appears ambitious, considering that only 99 SOEs were equitized during 2011–2013. The domestic stock market has rallied to push the share price index up by 30% from August 2013 to March 2014. But total stock market capitalization remains fairly small relative to the capital needed to ensure a successful equitization program. The government has approved share sales at below par value, which could help set prices that attract investors.

A new constitution for Viet Nam approved by the National Assembly in November 2013 reaffirmed the dominant economic role of SOEs, disappointing business groups and others who hoped the role of the private sector would be more explicitly recognized. In a decision that should improve the accountability and management of SOEs, the government also approved a new procurement law that extends coverage to include SOEs.

In another reform, a new land law that takes effect in July 2014 will improve transparency in land administration. If implemented well, this law will help minimize conflicts and delays in infrastructure projects.

Policy challenge—public–private partnership

The quality of infrastructure in Viet Nam lags behind that of most other major Southeast Asian economies (Table 3.31.2). According to the government, Viet Nam needs to invest $170 billion in physical infrastructure such as electricity and water supply, transportation, and sewerage from 2011 to 2020. Public funding and official development assistance are expected to meet only half this need. The government's capital spending is constricted by a persistent fiscal deficit, which averaged 5% of GDP in 2010–2013.

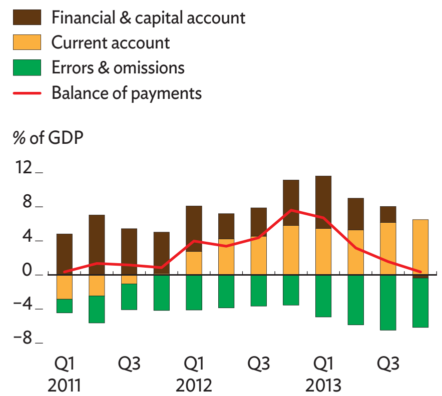
Attracting private investment in infrastructure, mainly through public–private partnership (PPP), could substantially contribute to funding projects and help gain access to international expertise and technology that improves efficiency and service delivery.

So far, however, private investment in infrastructure has been very limited. For a start, the existing regulatory framework is not conducive to facilitating PPP transactions. Also, government agencies have developed their own practices in build-operate-transfer projects, the favored PPP structure, that depart from standard international practice. Most such projects have not been awarded through competitive bidding.

The private sector views the bidding and negotiating process for PPPs in Viet Nam as unpredictable and lengthy. It is further concerned about the adequacy of PPP feasibility studies.

To address these issues, the government established the National Steering Committee on PPPs in 2012, chaired by the deputy prime minister. The committee is an advisory board to the government,

3.31.11 Balance-of-payments indicators



Q = quarter.

Sources: State Bank of Viet Nam; International Monetary Fund; ADB estimates.

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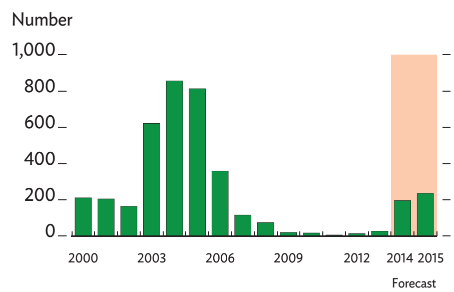
3.31.12 State-owned enterprises equitized



Source: Ministry of Finance.

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3.31.2 Ranking of infrastructure, selected economies

	2013–2014
Malaysia	29
Thailand	47
Indonesia	61
Viet Nam	82

Source: World Economic Forum. 2013. *The Global Competitiveness Report 2013–2014.* http://www.weforum.org not the PPP authority for projects. The Ministry of Planning and Investment established a PPP office that has become the central coordinator of PPP projects.

Last year, the government directed the Ministry of Planning and Investment to draft a decree that would improve the regulatory framework for PPP, replacing earlier PPP-related legislation in favor of a framework that is more user-friendly and easier to administer. The draft decree, now undergoing consultation with government officials, development partners, and the private sector, proposes comprehensive regulation of PPP and includes greater emphasis on competition in the selection of investors. It further introduces principles for sharing risk between private investors and the government.

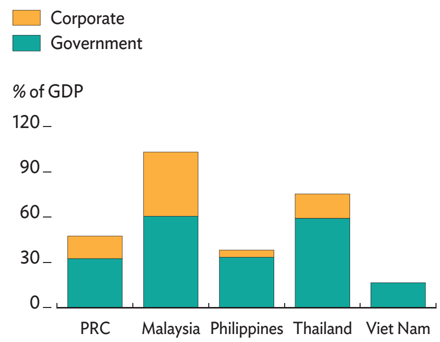
The decree is expected to be adopted by the government later this year. Separately, a new procurement law that will govern selection procedures for PPP investors will take effect in July 2014.

The financial viability of some infrastructure—urban transport, waste water, sanitation, and renewable energy—needs to be enhanced, given the low tariffs the public pays for these services. The government could consider options to provide viability gap funding by, for example, making land available at no cost or through grants to selected projects. Such subsidies should be time-bound and targeted, and backed by explicit government policy, to achieve their declared outcomes regarding, for instance, environmental and social equity objectives.

While the authorities have committed to a level playing field for bidders competing for PPP opportunities, the private sector is concerned about bidding transparency and SOE access to state-directed or preferential financing. A level playing field will require progress on SOE reform, including improved corporate governance. Also important is to ensure greater policy clarity and consistency with respect to private sector participation in the economy, including through PPPs, and continuing government attention to constraints faced by partners involved in PPPs.

Another need is to develop the domestic financial system to improve access to long-term funding for infrastructure through bank loans and debt markets. The Viet Nam capital market remains relatively shallow (Figure 3.31.13). Foreign banks are a potential source of medium- and long-term lending in foreign currencies but require credit enhancements and guarantees, such as those from export credit agencies. Until Viet Nam has a more established track record for PPP, the government may need to provide credit enhancements and underwrite guarantees.

3.31.13 Local currency bond markets, 2013



PRC = People's Republic of China.

Note: Data for the Philippines and Thailand are as of September 2013.

Source: Asian Development Bank. Asian Bonds Online. http://asianbondsonline.adb.org/ (accessed 15 March 2014).

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