IMF Executive Board Concludes 2008 Article IV Consultation with Vietnam

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On March 16, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Vietnam.[1]

Background

Following an extended period of strong economic performance, Vietnam is facing considerable challenges. Growth moderated to 6.2 percent in 2008, from a historical average of 7½ percent. Rapid credit growth fueled by massive capital inflows, coupled with a surge in commodity prices, led to high inflation and large trade deficits in the first half of 2008. While inflation pressures are subsiding with easing food and energy prices, growth is expected to slow further to 4¾ percent in 2009 on the back of weaker domestic and external demand. The current account deficit is projected to decline to 8 percent of GDP, mainly due to lower imports. Near-term risks are on the downside, as the deteriorating global environment could worsen Vietnam's growth prospects and reduce capital inflows, putting pressure on reserves and the exchange rate. A slower pace of economic activity could also heighten banks' vulnerabilities.

Spillover effects from the global turmoil have become more apparent since October 2008. Exports of goods and services, private remittances, and foreign direct investment have all weakened. Risk aversion remained acute, prompting foreign investors to continue reducing their portfolio exposures to Vietnam, particularly in bonds, and the stock market lost two-thirds of its value in 2008. Depreciation pressures on the dong have also resurfaced.

Macroeconomic policies have reversed course as concerns over growth increased and inflation pressures waned. Earlier in 2008, the State Bank of Vietnam (SBV) made considerable efforts to stabilize the overheating economy. In the fourth quarter, the SBV rapidly eased monetary policy by lowering its policy rates by 7 percentage points to 7 percent, and reducing reserve requirements sharply. To alleviate depreciation pressures on the exchange rate, the SBV devalued the dong and widened the dong-U.S. dollar trading band. However, the dong has continued to trade at the weaker end of the band. More recently, the government has announced a broad economic stimulus plan aiming to support growth and protect vulnerable groups.

Fiscal policy has also become accommodative. With spending stepped up in the final quarter, the overall fiscal balance in 2008 is estimated to have recorded a deficit of 4¾ percent of GDP. The original 2009 budget plan (excluding the stimulus plan) indicates a widening of the overall deficit to about 8¼ percent of GDP with a large domestic financing, reflecting lower revenue from oil and recent tax reforms and an increase in off-budget expenditure and net lending. The non-oil primary deficit is projected to rise slightly.

Strains in the banking system emerged in 2008. Banks have high loan-to-deposit ratios and rely heavily on short-term interbank funding, and their profit margins were squeezed by the higher funding costs and caps on lending rates. Smaller joint-stock banks were reportedly most affected, with some obtaining liquidity support from the SBV. Nonperforming loans (NPLs) doubled to 3 percent in October 2008 from the end-2007 level, and some banks are likely to face a substantial increase in NPLs with a slowing economy.

Executive Board Assessment

Executive Directors commended the Vietnamese authorities for the significant progress they have made in stabilizing the economy, which was overheating in 2008. Directors welcomed the recent improvements in inflation and the trade balance. They noted, however, that Vietnam is facing substantial near-term challenges stemming from the sharp deterioration in global economic and financial conditions, and that risks are tilted firmly to the downside. Economic growth is expected to slow in 2009 with capital inflows, exports, and private remittances likely to decline significantly, while the current account deficit will remain large. Slower growth could also heighten banking system vulnerabilities. At the same time, Directors agreed that the medium-term outlook is favorable, with Vietnam remaining an attractive destination for foreign investment.

Directors considered that an accommodative fiscal stance in 2009 to help mitigate the economic downturn is appropriate. They cautioned, however, that in the absence of additional concessional external financing, a large stimulus could further weaken the external position, crowd out private sector activity, and undermine fiscal sustainability. Most Directors encouraged the authorities to revise their budget plan for 2009 in the light of these concerns, and with a view to ensuring that the stimulus measures envisaged are well targeted and effective in supporting aggregate demand.

While welcoming the recent tax reforms, Directors agreed that longer-term revenue and expenditure reforms will be needed to preserve fiscal sustainability. They called for further efforts to broaden the tax base. Also, the structure of expenditures should be reviewed to ensure the efficiency of public investment and the protection of vulnerable groups. Directors welcomed the initiative to revise the state budget law.

Directors advised the authorities to assess the effects of recent monetary adjustment before considering easing further. To strengthen the monetary framework, they recommended improvements in open market operations and liquidity management. Directors took note of the recent devaluation of the dong and the widening of its exchange rate trading band, and in that context, they welcomed the authorities' intention to allow greater exchange rate flexibility, supported by appropriate macroeconomic policies. They noted the staff's assessment that the dong appears somewhat overvalued compared with its estimated medium-term equilibrium level, although the precise degree of the deviation is difficult to ascertain.

Directors considered that the strengthened capital position and improved provisioning practices of Vietnamese banks may provide them with a buffer against the impact of the economic slowdown. Nevertheless, bank loan portfolios could come under pressure as economic growth slows. Directors encouraged the authorities to develop a more comprehensive contingency plan to help the banking sector confront the effects of the global financial turmoil. Directors welcomed the recent efforts to improve bank supervision, but called for further improvement to ensure that bank vulnerabilities are assessed in a timely and effective manner. They encouraged the authorities to advance financial sector reform, in particular, strengthening the operational autonomy of the State Bank of Vietnam.

Directors welcomed the authorities' intention to press ahead with the reform of state-owned enterprises (SOEs), while noting that the equitization process has been postponed due partly to unfavorable market conditions. The planned reforms will help strengthen the performance and governance of SOEs and sustain Vietnam's rapid pace of economic development.

Directors welcomed the steps taken to improve data provision, and emphasized that this —along with an effective public communication strategy—will help bolster investor confidence. They encouraged the authorities to continue to improve the quality and timeliness of data, especially in the areas of the fiscal accounts, SOEs, and banking.

Vietnam: Selected Economic Indicators, 2005–09 [1/]

	2005	2006	2007	2008 Est.	2009 Proj.
Real GDP (annual percentage change) [2/]	8.4	8.2	8.5	6.2	4.8
Saving and investment (in percent of GDP) [3/]					
Gross saving	34.5	36.5	31.8	31.2	25.1
Private	26.7	28.1	26.2	26.1	23.0
Public	7.8	8.4	5.6	5.1	2.1
Gross investment	35.6	36.8	41.6	41.5	33.2
Private	24.1	26.4	30.3	32.2	24.0
Public	11.5	10.4	11.4	9.3	9.2
Inflation (annual percentage change) [2/]					
CPI (period average)	8.3	7.5	8.3	23.1	8.0
CPI (end of period)	8.8	6.7	12.6	19.9	6.0
GDP deflator	8.2	7.3	8.2	21.7	4.8
General government (in percent of GDP)					
Official fiscal balance	-0.1	1.1	-2.2	-1.6	-4.1
Revenue and grants	27.2	28.7	27.6	27.2	24.0
Expenditure	27.3	27.5	29.8	28.8	28.1
Off-budget expenditure and net lending	4.4	2.2	3.1	3.1	4.1
Overall fiscal balance [4/]	-4.5	-1.1	-5.3	-4.7	-8.2
Non-oil primary fiscal balance [4/]	-11.7	-8.8	-11.1	-9.4	-9.7
Money and credit (annual percentage change, end of period) [2/]					
Broad money	29.7	33.6	46.1	20.3	…
Credit to the economy	31.7	25.4	53.9	25.4	…
Interest rates (in percent, end of period) [2/]					
Nominal three-month deposit rate (households)	7.8	7.9	7.4	8.1	...

Nominal short-term lending rate (less than one year)	12.0	11.8	11.8	11.5	...
Current account balance (including official transfers)					
(In billions of U.S. dollars)	-0.6	-0.2	-7.0	-9.2	-7.3
(In percent of GDP)	-1.1	-0.3	-9.8	-10.3	-8.1
Exports f.o.b. (annual percentage change, U.S. dollar terms)	22.5	22.7	21.9	29.5	-15.5
Imports f.o.b. (annual percentage change, U.S. dollar terms)	15.0	22.1	38.3	27.6	-19.9
Foreign exchange reserves (in billions of U.S. dollars, end of period)					
Gross official reserves, including gold [2/]	8.6	11.5	21.0	23.0	20.7
(In months of next year's imports of GNFS)	2.2	2.1	3.0	4.1	3.3
External debt (in percent of GDP) [5/]	32.5	31.4	33.3	29.8	31.9
External debt service (in percent of exports of GNFS)	4.5	4.2	3.8	3.4	4.5
Total public and publicly-guaranteed debt (in percent of GDP)	44.5	44.1	46.3	44.4	47.5
Dong per U.S. dollar exchange rate (end of period) [2/] [6/]	15,907	16,068	16,003	17,486	...
Nominal effective exchange rate (end of period) [7/]	83.6	77.3	73.3	75.4	...
Real effective exchange rate (end of period) [7/]	99.8	96.8	100.5	121.9	...
Memorandum item:					
GDP (in trillions of dong at current market prices)	839	974	1,144	1,479	1,623

Sources: Data provided by the Vietnamese authorities; and IMF staff estimates and projections.
[1/] Figures in 2008-09 are staff estimates and projections unless otherwise indicated. Projections for 2009 do not take into account the recently announced stimulus plan.
[2/] Figures for 2008 are actual.
[3/] The private sector includes state-owned enterprises.
[4/] Includes off-budget expenditure and net lending.
[5/] Includes private debt.
[6/] Interbank exchange rate.
[7/] 2000 annual average=100.