Vietnam economy: Stimulus report card
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Abstract (Summary)

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Full Text

(1300 words)

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FROM THE ECONOMIST INTELLIGENCE UNIT

The Vietnamese government was initially slow to appreciate the scale and the likely impact of the global financial crisis, but its efforts to mitigate and contain the adverse effects of the crisis on the domestic economy were surprisingly ardent when it eventually acted. The stimulus has helped to support GDP growth and has enabled Vietnam to escape the worst of the global downturn. However, it has also fuelled rapid credit growth and has amplified concerns about both the country's fiscal accounts and the government's ability to keep inflation in check.

Headline measures

The government stated that it planned to spend around D143trn (US$7.7bn) on stimulating the economy. Its policy approach to maintaining economic growth comprised four broad components: supporting key sectors (primarily small and medium-sized enterprises, or SMEs); stimulating investment; reducing poverty and ensuring social stability; and adopting a flexible approach to monetary and fiscal policy.

One of the key components of the stimulus programme was a 4-percentage-point interest-rate subsidy on new dong-denominated short-term bank loans to provide companies with working capital. On the tax front, the government drew up a revised corporate-tax scheme in an effort to help firms through the downturn. The government gave SMEs a 30% reduction in their corporate income tax for the fourth quarter of 2008 and throughout 2009. In addition, the corporate income-tax rate was lowered from 28% to 25% (including for firms that benefited from the 30% tax reduction). The government also implemented a personal income-tax holiday in January-June 2009.

The monetary-policy response was also significant. On February 1st the State Bank of Vietnam (SBV, the central bank) reduced its benchmark interest rate from 8.5% to 7%. By law, banks may not set their lending rate at more than one-and-a-half times the benchmark rate, so the maximum loan rate was reduced from 12.75% to 10.5%. The SBV also cut the discount and refinancing rates by 150 basis points, to 6% and 8% respectively. The SBV insists that the turmoil in the global financial system has not directly affected Vietnamese banks. However, the global crisis has had an impact on the country's banking sector to the extent that there has been a rise in non-performing loans. The government's control of all of the major banks means that it would have to provide financial support if any of them came under pressure.

What do these mean?

The lack of transparency in Vietnam's fiscal accounting means that it is difficult to ascertain the exact size of the stimulus programme. It is unclear how much of the D143trn is new money, how much has actually been spent, and indeed whether the target includes the four broad components or the interest-rate subsidy. There is likely to have been some duplication of spending plans, and some of the announced measures involved spending that had been brought forward. At face value the D143trn represents a stimulus package equivalent to almost 9% of GDP, but this overstates the actual boost to the economy.

Macroeconomic impact

While the government's stimulus efforts were effective in keeping GDP growth in 2009 at a relatively high estimated level of 5.3%, they have also fuelled imbalances that are now harming the domestic economy. The government had hoped that the interest-rate subsidy scheme would stimulate economic activity, but it appears that some businesses used the scheme to refinance or restructure their existing debts--certainly this was not the scheme's intended use. The interest-rate subsidy, combined with relatively low official lending rates in 2009, also resulted in a surge in domestic credit that has undermined recent progress in taming inflationary pressures. Total lending under the subsidy programme reached the equivalent of US$23.2bn in 2009, according to the SBV.

By late November, Vietnam's efforts to promote economic growth while keeping inflation under control reached a crucial turning point. The SBV announced that it would devalue the local currency by over 5% against the US dollar. The central bank also announced that it would narrow the band within which the dong is allowed to fluctuate on a daily basis against the US dollar to 3%, from 5% previously. At the same time, the SBV said that it would raise its main policy interest rate, the prime rate, by 1 percentage point to 8%. Prior to the devaluation, the dong had been under downward pressure. Demand for US dollars had risen strongly, driven by the widening merchandise trade deficit and rising domestic inflationary expectations

It is unclear how effective the new policies will be in reducing speculative pressure on the dong (and thus staving off further devaluations). In theory raising the benchmark interest rate should provide support for the dong. It should also help to restrain credit growth. According to the IMF, year-on-year credit growth stood at an incredible 46.4% in August; it is likely to have accelerated further since then. Raising the base interest rate will allow Vietnam's commercial banks to raise their lending interest rates. This should curtail growth in the money supply, and inflationary pressures should diminish as a result. Moreover, some of the excess dong liquidity in the market should be mopped up as higher interest rates attract deposits.

Business and sectoral impact

The interest-rate subsidy has helped firms by providing working capital. The stated aim of the subsidy was to support companies in maintaining production levels and to protect jobs. All companies except those operating in a relatively short list of "negative sectors" (including stockbroking, consumer imports and property development) were eligible for the subsidy. Commercial banks and finance companies were in effect obliged to provide the subsidy on short-term loans.

Another component of the government's economic stimulus package was a credit-guarantee scheme to support commercial bank lending to SMEs. The state-owned Vietnam Development Bank (VDB) guaranteed loans up to 100% of their value. Yet owing to red tape and stringent requirements, guarantees were reportedly difficult for firms to obtain. According to the VDB, in the first three quarters of 2009 only 813 guarantees were authorised under the programme.

Exit strategy

Despite a lack of clarity about how much of the stimulus will be incorporated into the annual budget and how much will be off-budget, the government's budget deficit widened dramatically in 2009. Indeed, the budget deficit (excluding on-lending) expanded to an estimated 9.1% of GDP in 2009. The Economist Intelligence Unit forecasts that the deficit will remain large in 2010-11. There are serious concerns about how the government will finance its deficit, particularly given that it is already borrowing heavily to fund off-budget stimulus programmes.

The government terminated the interest-rate subsidy scheme for short-term lending at the end of 2009. However, discounted medium- and long-term financing, and loans for production materials in the agricultural sector, will continue to be made available in 2010. The new rate of corporate taxation is expected to remain in place. The government will also remain committed to spending heavily on infrastructure and social welfare, although it will be difficult to determine how much of this should be considered part of the fiscal stimulus package and how much would have been spent regardless of the economic slump. Most of the other stimulus measures--including the personal income-tax holiday and loose monetary policy--have already ended and it is unlikely that they will be reinstated.

Vietnam's devaluation strategy suggests that the country's leaders are beginning to pay more attention to the potential risks of their aggressively pro-growth policies. A number of market observers, both inside and outside Vietnam, have expressed concern over these policies. The head of the Asian Development Bank, Haruhiko Kuroda, said recently that he expected Vietnam, as one of the region's better-performing economies, to tighten monetary policy. The IMF has also urged the Vietnamese government down the same path in order to slow credit growth and reduce the risk of rising inflation.