Viet Nam

GDP growth quickened in 2010, supported by recovery in exports and an accommodative monetary policy. Inflation hit double-digit rates by year-end, and the currency slid. Moving to restore macroeconomic stability, the authorities in February 2011 unveiled comprehensive measures including tightened fiscal and monetary policies. Partly as a consequence, economic growth is forecast to moderate this year, then pick up next year. Inflation is seen subsiding late in 2011 and further in 2012. The immediate challenge is to follow through on the policy tightening; the longer-term one is to reinvigorate structural reforms.

Economic performance

Growth picked up to 6.8% in 2010 (Figure 3.31.1), supported by recovery in the global economy, the residual impact of domestic fiscal stimulus in 2009, and an accommodative monetary policy. Strong consumption growth of 9.7% stimulated private sector investment.

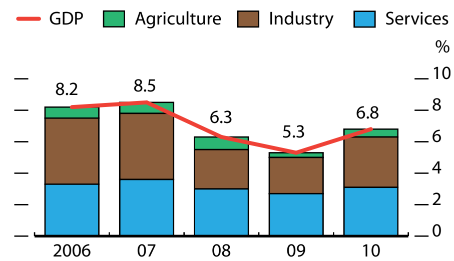
By sector, industry expanded by 7.7% and contributed 3.2 percentage points of total GDP growth. Stronger external demand spurred 8.4% growth in manufacturing, and public infrastructure investment pushed up growth of construction by 10.1%. Services grew by 7.5%, contributing 3.1 percentage points of GDP growth. Wholesale and retail trading climbed by 8.1%, reflecting the expansion in private consumption, and hotels and restaurants picked up by 8.7%, assisted by a steep 34.8% increase in visitor arrivals. Agricultural output was subdued, though, edging up by 2.8% in 2010, owing to flooding in central regions followed by drought in the north.

Faster economic growth helped to reduce urban unemployment, and poverty incidence fell to 10.6% from 12.3% in 2009, based on the official poverty measure.

Inflation accelerated to 11.8% in December 2010, averaging 9.2% for the year, the highest in Southeast Asia. By March 2011, it was running at 13.9% year on year (Figure 3.31.2), with rising food prices and school fees leading causes. Credit grew by 32.4%, above the official target of 25% but slightly slower than 39.6% in the previous year.

Concerns among the general population over loss of purchasing power, together with a slide in the currency—the dong—boosted purchases of gold and US dollars. Foreign currency deposits climbed by 21% in 2010. The currency came under steady depreciation pressure from about midyear, reflected in the spread between the black market rate and the reference rate of the State Bank of Viet Nam (SBV, the central bank); the spread increased to over 10% in January 2011. The SBV devalued the dong by 9.3% in February 2011, and narrowed the trading band for the dollar–dong exchange rate from ±3% to ±1%. During November 2009–

3.31.1 Contributions to growth (supply)



Source: General Statistics Office of Viet Nam. http://www.gso.gov.vn (accessed 14 March 2011).

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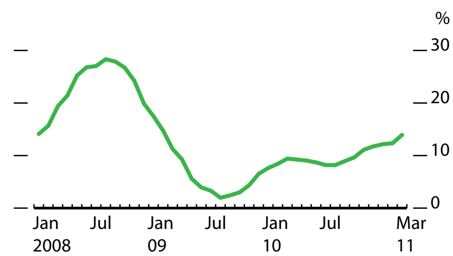
3.31.2 Inflation



Sources: General Statistics Office of Viet Nam; ADB estimates.

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

February 2011, the authorities devalued the dong, in four steps, by a total of about 20% against the US dollar (Figure 3.31.3).

Lack of clarity over the direction of monetary policy further eroded confidence. The SBV started to withdraw monetary stimulus from late 2009, raising its base rate and ending interest rate subsidies and caps, but in 2010 it urged banks to moderate lending-rate rises. With inflation accelerating, the SBV in November 2010 raised policy rates again. That tightening seemed insufficient to counter what was by then double-digit inflation or market expectations of further dong depreciation.

The SBV's capacity to support the dong was constrained by relatively low holdings of foreign exchange reserves, estimated at $12.4 billion at end-2010 (about 1.9 months of import cover—Figure 3.31.4).

A rebound in exports last year, reflecting recovery in global trade, reined in the deficit in merchandise trade to $7.1 billion on a balance-of-payments basis, from $8.3 billion in 2009. Exports rose by 26.4% in US dollars. Customs data showed strong increases in exports of textiles (up by 23%), footwear (25%), and electronics and computers (29%). Crude oil exports fell, however, by 20%, as volumes plunged by 40% owing to depletion of oil fields. Imports rose by 21.2%, reflecting demand for inputs for manufacturing and the country's reliance on imported capital equipment.

Trade with the People's Republic of China (PRC), Viet Nam's largest trading partner, was boosted by a free-trade agreement between the Association of Southeast Asian Nations and the PRC, from January 2010. Customs data show that imports from the PRC increased by 23% to about $18.0 billion and exports there shot up by 49% to $6.3 billion.

After increases in remittances and tourism receipts, the current account deficit contracted to $4.3 billion, equivalent to 4.0% of GDP, its narrowest in 4 years. The overall balance of payments showed a deficit of $1.8 billion in 2010 (Figure 3.31.5).

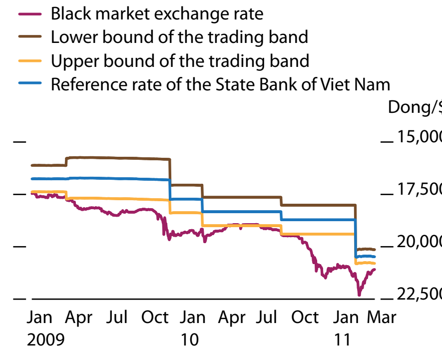
Net foreign direct investment (FDI) inflows rose by about 3% to $7.1 billion in 2010. FDI approvals at $18.6 billion missed the target, however, and were well below 2009's, likely reflecting investor uncertainties over policy direction. FDI approvals for real estate projects fell, but approvals for manufacturing more than doubled.

With most fiscal stimulus measures taken during the global recession expiring at end-2009, the overall fiscal deficit in 2010 narrowed to 8.0% of GDP. In real terms, government expenditure was estimated to be little changed from 2009, but revenue and grants rose by about 10%, reflecting stronger non-oil tax receipts.

Total public debt and publicly guaranteed debt, excluding state firms' contingent liabilities, is estimated to have declined by 1 percentage point to 51.5% of GDP in 2010, still above the government's target ceiling of 50%. Weakness in the stock market over the past 2 years (the VN Index of share prices fell by 2.0% in 2010) has hindered government plans to sell shares in state-owned enterprises.

State-owned Viet Nam Shipbuilding Industry Group (Vinashin) defaulted in late 2010 on a repayment of $60 million relating to a $600 million syndicated loan. Some international credit rating agencies downgraded Viet Nam's ratings, citing the government's contingent liabilities and the macroeconomic stresses.

3.31.3 Exchange rates



Sources: State Bank of Viet Nam; ADB observations.

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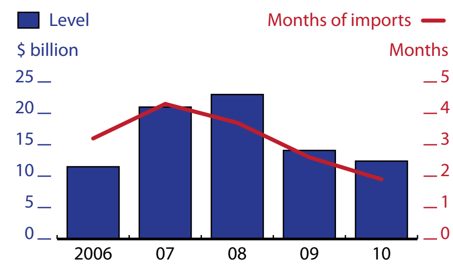
3.31.4 Gross official reserves



Note: Data exclude government foreign exchange deposits at the State Bank of Viet Nam and the foreign exchange counterpart of swap operations.

Sources: State Bank of Viet Nam; ADB estimates.

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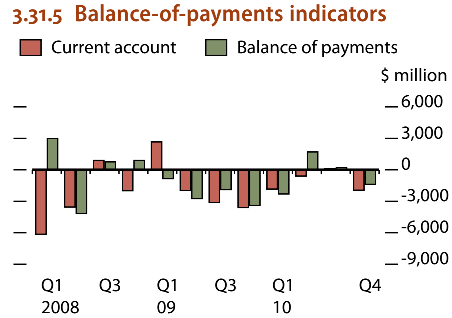
3.31.5 Balance-of-payments indicators



Source: State Bank of Viet Nam.

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The government indicated it would not bail out Vinashin, signaling to other state-owned firms that they would be held accountable if they overextended their borrowing. Vinashin will be restructured over 3 years to put its finances on a firmer footing.

Viet Nam's ranking in the World Bank's *Doing Business 2011* report rose to 78 from 88 the previous year. This reflected significant gains in the ease of starting a business, obtaining construction permits, access to credit, and tax administration. A government drive called Project 30, to reduce bureaucratic procedures for business, also helped.

Economic prospects

The Socioeconomic Development Strategy for 2011–2020, approved by the Communist Party of Viet Nam in January 2011, targets rapid average GDP growth of 7%–8%. In February, however, the government indicated that it was prepared to give a higher priority to stability than growth in the near term, when it committed to restore stability through a package of policies (Resolution 11—Box 3.31.1), notably tighter fiscal and monetary policies in 2011 aimed at curbing inflation and stabilizing the external position. Restoration of solid investor confidence will require sustained and consistent policy actions until inflation is subdued.

The SBV lifted its refinancing rate from 9.0% to 12.0% and its rediscount rate from 7% to 12% in the first quarter of 2011, although it

3.31.1 Selected economic indicators (%)

	2011	2012
GDP growth	6.1	6.7
Inflation	13.3	6.8
Current account balance (share of GDP)	-3.8	-3.6

Source: ADB estimates.

3.31.1 Resolution 11

Resolution 11, issued on 24 February 2011, contains six sets of policy measures to restore macroeconomic stability and maintain social security: tightening monetary policy; tightening fiscal policy; containing the trade deficit; increasing electricity prices while shielding the poor and using a more market-based mechanism for petroleum pricing; strengthening social security; and improving dissemination of policy information.

On 1 March 2011, the SBV issued a directive to implement Resolution 11. It included a credit growth target ceiling of 20% (reduced from an original target of 23%) and a 15%–16% target for growth in M2 money supply in 2011 (down from 21%–24%). Both targets are considerably below the outcomes in 2010, when credit grew by 32.4% and M2 by 33.3%.

To achieve these targets, the SBV instructed banks and other credit institutions to curb credit growth to less than 20%. These institutions were also instructed to limit credit outstanding to "nonproductive" activities such as real estate and marketable securities to 22% of total lending by end-June 2011 and 16% by end-2011.

The SBV intends to penalize institutions that fail to meet these targets by doubling their required reserve ratios. It also is restricting foreign currency lending on imports of specified nonessential goods, including all consumer goods. The SBV aims to limit the import of gold to a few firms and to eventually prohibit trading in gold bars in the parallel market. These actions are intended to reduce speculative foreign exchange and gold transactions and so help to stabilize the dong.

On the fiscal side, the Ministry of Finance revised the 2011 budget deficit target to below 5.0% of GDP (down from an original 5.3%). Ministries and line agencies were told to withhold 10% of nonessential current expenditure (excluding salaries and wages) for the rest of this year.

The budget revenue target for 2011 was revised up by 7%–8%. The government aims to collect higher taxes through improved tax administration enforcement. It also intends to closely scrutinize all investments made by public agencies and state-owned firms.

The Ministry of Industry and Trade is developing a plan to contain the trade deficit. It will try to improve the efficiency of export production, while restricting certain imports.

Strengthening social security involves measures to shield vulnerable groups from the impact of the increase in electricity tariffs, as well as other targeted support.

The Ministry of Information and Communication has been directed to disseminate timely information on policy actions.

maintained the base rate at 9.0%, below the inflation rate (Figure 3.31.6). The refinancing rate was further increased to 13.0% on 1 April 2011. The higher rates increased the cost to commercial banks of borrowing dong from the central bank. The SBV is aiming to balance the need to tighten policy with the likely impact on firms that already face high dong-denominated borrowing rates of close to 20%.

Proposed policy actions include both market-based instruments and administrative controls. Such controls will likely have some temporary impact, but may not be effective further out. For example, controls on gold trading usually lead to increased illicit trading. They also create market distortions.

The forecasts assume that the government will follow through with the policy tightening until macroeconomic stability is restored. That will slow consumer spending and domestically financed investment.

Forecasts also take into account developments in the first quarter of 2011. Preliminary data show that GDP rose by 5.4% year on year in January–March 2011, slowing from 7.3% in the fourth quarter of 2010. Agriculture increased by 2.0%, industry by 5.5%, and services by 6.3%. Solid expansion in the first quarter was seen elsewhere: industrial production at 14.0%, retail sales at 9% in real terms, international visitor arrivals at 12%, and merchandise exports on a customs basis at 44%. For the whole year, crude oil production is projected at 15 million metric tons, similar to 2010.

Against this background, GDP is forecast to grow by 6.1% in 2011 (Figure 3.31.7). Growth is expected to pick up to 6.7% in 2012 as a more stable economic environment stimulates consumption and investment.

Inflation is projected to remain high through 2011, peaking at about 16% year on year in the third quarter and averaging 13.3% (Figure 3.31.8). Underpinning high inflation (which averaged 10.3% in the first quarter of the year) are a lagged pass-through of currency depreciation and hikes in price-controlled electricity (by 15.3%) and fuel (by about 30%) in March, as well as the base effect of low inflation in April–September 2010.

Sustained policy tightening will damp domestic demand and help to stabilize the dong exchange rate. Bringing year-on-year inflation down to single digits by end-2011 will require the average month-on-month rate to be below 0.4% for the rest of the year.

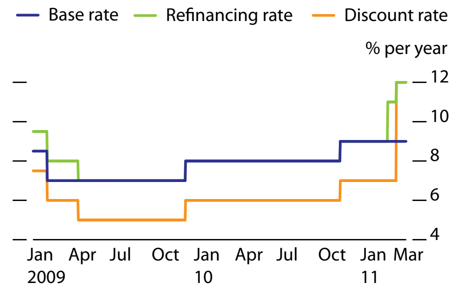
A deceleration in world trade from the rebound rates of 2010 alongside the impact of policy tightening on imports will contribute to slower growth in external trade this year. After inflows from tourism and remittances, the current account deficit is forecast at 3.8% in 2011 and 3.6% in 2012 (Figure 3.31.9).

The more stable macroeconomic situation should stimulate FDI in the forecast period. The overall balance of payments is expected to improve.

Risks to the outlook center on implementation of Resolution 11. Insufficient policy tightening or premature easing—or perception of easing—of policies would keep inflation high for longer and could lead to a deterioration of the external accounts. Such an outcome could require another round of policy tightening in a year or two.

Another domestic risk relates to state-owned enterprises. Vinashin needs to negotiate a debt rescheduling. Further evidence of debt distress among this or other state-owned firms would hurt investor confidence.

3.31.6 Interest rates



Source: State Bank of Viet Nam.

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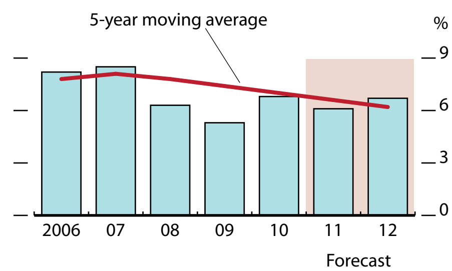
3.31.7 GDP growth



Source: Asian Development Outlook database.

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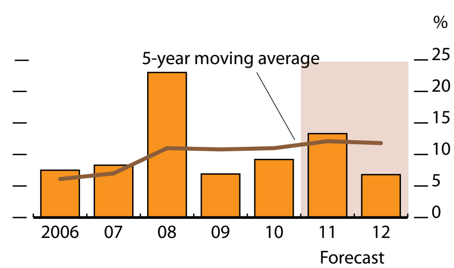
3.31.8 Inflation



Sources: General Statistics Office of Viet Nam; *Asian Development Outlook* database.

Click here for figure data

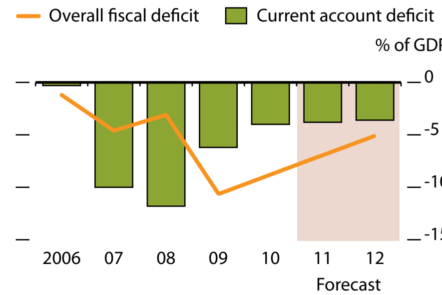
The large increase in the domestic credit stock, of about $100 billion during 2007–2010, raises concerns over banking asset quality, as does bank exposure to real estate and state-owned enterprises.

US dollar borrowing jumped in early 2010 as borrowers took advantage of new regulations that allowed firms earning dong revenue to borrow in US dollars (at lower rates than in dong). But such borrowing comes with a currency risk, and after the currency devaluations some firms might now face much bigger debt in dong terms.

There is also a risk that the supply of manufactured components from Japan for Viet Nam's export industries, or exports to that market, could be disrupted by the impact of the 11 March earthquake for longer than currently anticipated.

Overall, though, the change in policies this year has reduced domestic risks. The medium-term outlook remains favorable, with the proviso that macroeconomic stability is restored and maintained. Viet Nam remains an attractive destination for foreign investors, and is well positioned to benefit from economic developments in the PRC. Rising labor costs there will divert some FDI to other developing Asian economies, and growing domestic PRC consumption will increase its demand for imports.

3.31.9 Current account and fiscal balance



Source: Asian Development Outlook database.

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Development challenges

Much has been achieved in lifting the economy to lower-middle-income status in 2010 and in reducing poverty over two decades. High inflation, especially for food, puts poverty-reduction gains at risk, however. The immediate challenge is to restore stability in the economy by fully implementing the policy directives of February 2011.

Maintaining price stability and economic growth in the longer term requires further improvements in efficiency, particularly in the state-owned sector; development of the financial system; and heavy investment in infrastructure and education to address supply-side bottlenecks.

State-owned firms are a drag on the economy. They absorb many of the available resources but their efficiency is much lower than among private firms. Hence a better performance from them would stimulate economic growth and release budget resources for more productive uses. Regardless of ownership, putting them on a commercial footing, exposing them to competition, and holding them financially accountable—particularly for noncore activities—would improve their efficiency.

Further reforms are needed to safeguard the financial system (the SBV took the important step of raising minimum capital requirements in 2010). Supervision of banks would be strengthened if the capacity of the SBV to provide regulatory oversight were upgraded and if a risk-based supervision framework were adopted (shifting from a compliance-based approach). A move toward international standards for bank provisioning would also strengthen banks' stability.

Finally, timely publication of economic and financial data would help to build public and investor confidence.