

VIETNAM

Vietnam's growth reached 8.5 percent in 2007, making it the third consecutive year above the 8-percent benchmark. Fears that the WTO accession (early in 2007) would adversely affect agriculture and retail trade failed to materialize. The business climate continued to improve, with the investment rate reaching 40.4 percent of GDP. Growth was increasingly driven by the private sector, with 59 thousand new enterprises registering during the year, 26 percent over the year before. Foreign direct investment (FDI) commitments almost doubled, to \$20.3 billion, whereas stock market capitalization reached 43 percent of GDP by end 2007, compared to 1.5 percent two years earlier. Non-oil exports grew by 27 percent, bringing total exports to 68 percent of GDP by year end. International reserves increased by over \$ 10 billion to \$21.6 billion, equivalent to 30.2 percent of GDP or 3.3 months worth of imports. Business surveys consistently show a large majority of respondents foreseeing continued expansion in 2008.

The economy shows signs of overheating. Inflation accelerated from 6.6 percent (year on year) in December 2006 to 15.7 percent by February 2008. To some extent, this reflects the rapid increase in international prices, especially for food, oil, and construction materials. With the dong loosely pegged to the dollar and a very open economy, changes in world prices are rapidly reflected in domestic prices. Higher domestic oil prices also reflected the removal of government subsidies to local distributors, a sound policy on fiscal grounds.

The current account of the balance of payments recorded an unusually large deficit in 2007 in the range of 9.3 to 9.7 percent of GDP.¹ Imports surged by almost 40 percent, with growth especially strong for capital goods (56.5 percent) due mainly to imports of commercial aircraft and oil refinery equipment. Growth was also strong for intermediate goods (40 percent) used in the production of garments and footwear, chemical products, plastic and livestock.

Asset prices also climbed rapidly in 2007—stocks in the first half of the year and real estate in the second. When the State Bank of Vietnam (SBV) capped lending for the purchase of securities, and the number and size of companies listed expanded rapidly, the stock market fever receded. But the fever moved to the real estate market, where rapid increases in property prices have raised the prospect of a potentially dangerous bubble.

Overheating is not the result of excessive government spending. Indeed, the overall budget deficit for 2007 stood at around 1 percent of GDP. This preliminary figure does not represent a significant departure in relation to previous years. The overall fiscal balance was larger at around 5 percent of GDP, including the issuance of government bonds for education, infrastructure and the re-capitalization of State-Owned Commercial Banks (SOCBs).

On the other hand, there was rapid acceleration in credit growth, from 25.4 percent in 2006 to 50.6 percent by November 2007. This frenetic pace raises concerns about the quality of the portfolios of banks. Lending by joint stock banks grew by a remarkable 95 percent, but state-owned commercial banks were more cautious, increasing lending by only 25 percent to improve the overall quality of their loan portfolio prior to equitization.

The expansion in credit was underpinned by growth in base money predominantly due to the build-up of record foreign exchange reserves. Reserves accumulated as authorities purchased

¹ It is difficult to provide a precise figure for the current account deficit, due to limitations in data..

foreign exchange to prevent (or perhaps slow) the appreciation of the dong in the face of growing capital inflows. SBV widened the trading band for the dollar from ± 0.25 percent to ± 0.5 percent in January 2007, then to ± 0.75 percent in December and again to ± 1 percent in March 2008. The dong had stayed virtually stationary against the dollar over 2007 but then started to appreciate in the first months of 2008.

Towards the end of 2007 and in early 2008 the central bank took dramatic contractionary measures resulting in a severe lack of liquidity. It stopped foreign currency purchases, increased reserve requirements, forced placement of SBV bonds with banks, and stopped rolling over reverse repos. This led to a sharp spike in overnight interest rates that peaked at 40 percent.

More recently, in early March 2008, the authorities announced a new policy package containing a mixture of monetary and fiscal measures designed to cool the economy while minimizing the effect on growth. Its success will very much depend on how it is implemented in practice, and how well the authorities are able to adjust policies in light of changing circumstances.