

VIETNAM

Population	86.2 million
Population growth	1.2 percent
Surface area	329,310 sq.km.
Capital	Hanoi



Source: World Development Indicators.

Vietnam navigated the global financial crisis better than could have been anticipated, given the high ratio of exports to GDP and the overall openness of its economy. Real GDP grew by 5.3 percent in 2009, led by a surge in construction due to a large extent to the sizeable stimulus program set by the government between late 2008 and mid-2009. A large budget deficit, rapid credit growth and moral suasion on state-owned enterprises resulted in a doubling of total investment in 2009, pushing up the investment rate to 42.8 percent of GDP. The state sector accounted for about a third of the total. The recovery has consolidated in recent months, with real GDP posting 6.9 percent growth in the last quarter of 2009 year-on-year, and growth of 6 percent is plausible for the first quarter of 2010.

Reliance on domestic demand to support economic activity resulted in pressures on the balance of payments. At a fundamental level, the external position of Vietnam is sustainable. Exports decreased by 9.7 percent in 2009, the first decline since the beginning of reforms two decades ago. Imports contracted by 14.7 percent, which brought the current account deficit down to about 7.8 percent of GDP, compared to 11.9 percent in 2008. Inflows of foreign direct investment are estimated to have declined by a relatively modest 13 percent in a difficult year. For 2009, the capital account surplus roughly offset the current account deficit. However, unusually large errors and omissions item in the balance of payments by about 10 percent of GDP, and the dollar trading outside the dong band in parallel markets, indicate a lack of confidence in the dong. Throughout 2009, households and domestic enterprises (including large state-owned economic groups) have been betting on a devaluation of the dong.

Meanwhile, inflation shows sign of accelerating. Prices rose 6.5 percent in 2009 as a whole, down from 19.9 percent in 2008. However, on a monthly basis inflation started accelerating in the last quarter of 2009. There is a strong seasonality in the months around the Lunar New Year, which makes it difficult to isolate a trend. However, higher international commodity prices, the devaluation of the dong, and the adjustment of energy prices to align them with international comparators are bound to result in higher inflation rates. The inflationary pressure is even more visible in asset markets, with the stock market index being on an upward trend for months in a row, and land prices escalating. These developments suggest that the limits of the expansionary policy stance adopted by government since 2008 are being reached. With the global economy doing substantially better now than it did in 2009, the time to gradually phase out Vietnam's stimulus program is rapidly approaching.

In the last quarter of 2009 there was a gradual rebalancing of macroeconomic policy towards ensuring macroeconomic stability. The acceleration of inflation, a spike in the domestic price of gold, and a widening gap between the parallel and the official exchange rates, made it obvious that the expansionary stance was not sustainable for much longer. Excessively low interest rates had also made government bond issuances unattractive. In spite of a substantial increase in fast disbursing ODA, and the drawdown of government deposits in commercial banks, financing the budget deficit was becoming increasingly difficult. This policy rebalancing has continued well into 2010, and may be pursued further in the coming months. The speed at which this could occur will very much depend on the assessment of the current situation. There has been limited appetite to raise policy rates, but this pro-growth stance may be softened if new data on consumer and price data make it clear that inflation is back and some turbulence could be expected in the coming months.

The new policy stance was reflected in a lower target for credit growth in 2010 (25 percent, as opposed to an actual increase of 37.7 percent in 2009), the discontinuation of the short-term interest rate subsidy program, fiscal adjustment in the order of 2-3 percentage points of GDP, and two smaller devaluations of the dong, in November 2008 and February

2009. The target for real GDP growth in 2010 is an easily attainable 6.5 percent. Keeping the inflation rate below 7 percent, as requested by the National Assembly, will be more challenging. The tighter monetary stance brought the parallel exchange rate closer to the official band, and led to a substantial but only temporary correction in the stock market. More recently, the government allowed credit institutions and borrowers to negotiate the terms of their lending, which amounts to the abolition of the lending cap on interest rates. This cap had been introduced during the over-heating phase of the economy, but in the current circumstances it squeezed the profitability of commercial banks.

The balance of payments may continue to be a challenge for the authorities going in 2010, but in the wake of the Lunar New Year it is still difficult to infer any trend from the available data. While waiting for more clarity on the prices front, the government is taking steps towards strengthening the banking system. Minimum capital requirement should be met by end-2010, and plans to do so much be submitted before March 2010, and a framework to support the bankruptcy, merger and absorption of the banks that cannot be meet the new minimum requirements are being put in place. In early 2010, the Prime Minister instructed seven of the largest state-owned corporations to surrender the foreign exchange holdings to credit institutions. In turn, those credit institutions will ensure that the corporations have enough access to foreign exchange to settle their payments.

The government is expected to reduce the size of the budget deficit gradually. The budget plan for 2010, which translates into an overall fiscal deficit of about 6.2 percent of GDP, entails a substantial contraction compared with 2009, but still an expansionary stance compared with previous years. Vietnam's debt is likely to stay sustainable if the current economic recovery continues and the authorities revert to a budget deficit in the order of 3 to 4 percent, as had been the case in previous years. The government is expected to finance this deficit with a combination of increased fast-disbursing ODA and bond issuance. A second international bond was issued, for \$1 billion in January 2010. With a 10-year maturity and a 6.75 percent coupon rate, it was sold at discount to yield at 6.95 percent or 332.7 basis points over U.S. Treasury

bonds. The issuance was 2.4 times over-subscribed. While Vietnam's return to international capital markets can be considered a success, the yield of the bond is about 100 basis points higher than for the recent bonds issued by Indonesia and the Philippines. In the recent past, the risk premia for these two countries have been higher than for Vietnam.

Steps have been taken to discourage speculation by Vietnamese investors. Gold trading floors will be closed by March 31, 2010. Gold speculation by local investors had led to worrying price spikes, affecting market sentiment. While trading in gold will not be forbidden, the lack of an easily observable price should reduce the volatility of expectations. But a tight credit policy will be necessary as well. Unless interest rates in dong are increased (and become roughly comparable to the inflation rate), investors and exporters will be reluctant to drawdown their foreign currency holdings, which means that the parallel market for foreign exchange could continue trading outside the official band. Discussions about possible price controls do not reassure the markets. However, there are indications that the rebalancing of the policy stance is working, and a growing interest in Vietnam by international asset managers and portfolio investors is already perceptible.

Vietnam: Key Economic Indicators

	2005	2006	2007	2008	2009e	2010f
	Year	Year	Year	Year	Year	Year
Output, Employment and Prices						
Real GDP (% change y-y)	8.4	8.2	8.5	6.2	5.3	6.5
Industrial production index (% change y-y)	17.1	16.8	16.7	13.9	7.6	12.5
Unemployment (%) 1/	5.3	4.8	4.6	4.7	6.5	5.0
Consumer price index (% change y-y)	8.8	6.7	12.6	19.9	6.5	9.0
Public Sector						
Government balance, official (% GDP) 2/	-0.1	1.1	-2.2	-1.1	-6.2	-3.8
Government balance, general (% GDP) 3/	-4.5	-1.1	-5.3	-4.5	-9.7	-6.2
Domestic public sector debt (% GDP) 4/	44.5	44.0	46.5	41.4	46.5	47.5
Foreign Trade, BOP and External Debt						
Trade balance (millions US\$)	-2,439	-2,776	-10,360	-12,782	-8,307	-7,820
Exports of goods (millions US\$)	32,447	39,826	48,561	62,685	57,096	64,115
(% change y-y)	22.5	22.7	21.9	29.1	-8.9	12.3
Key export (% change y-y) 4/	30.3	12.1	2.7	23.1	-40.2	13.0
Imports of goods (millions US\$)	34,886	42,602	58,921	75,467	65,403	71,935
(% change y-y)	15.7	22.1	38.3	28.1	-13.3	10.0
Current account balance (millions US\$)	-560	-163	-6,992	-10,705	-7,192	-7,320
(% GDP)	-1.1	-0.3	-9.8	-11.9	-7.8	-7.2
Foreign direct investment (billions US\$)	1.9	2.4	6.7	9.3	8.4	8.8
External debt (billions US\$)	17.2	19.1	23.8	29.6	33.2	37.1
(% GDP)	32.7	31.5	33.4	33.0	36.0	36.5
Debt service ratio (% exports of g&s)	5.4	5	4.6	3.9	5	5.7
Foreign exchange reserves, gross (billions US\$)	8.6	11.5	21	23	15.2	17.5
(months of imports of g&s)	11.3	12.5	16.6	14.4	10.9	11.4
Financial Markets						
Domestic credit (% change y-y)	31.7	25.4	53.9	25.4	37.7	25
Short-term interest rate (% p.a.) 6/	7.4	7.9	7.8	8.1	8.5	8.5
Exchange rate (Dong/US\$, eop)	15,916	16,055	16,010	16,450	17,664	..
Real effective exchange rate (2000=100)	93.7	97.3	98.4	110.9	113.1	..
(% change y-y)	4.4	3.9	1.1	12.7	2.0	..
Stock market index (Jul. 2000=100) 7/	308	752	927	316	494.8	..
Memo: Nominal GDP (millions US\$)	52,917	60,913	71,034	90,705	93,513	

Sources: Vietnam Government Statistics Office, State Bank of Vietnam, IMF, and World Bank staff estimates.

e = estimate

f = forecast

1/ Urban areas.

2/ Excludes off-budgetary items.

3/ Excludes off-budgetary items.

4/ Includes guaranteed and off-budgetary items.

5/ Crude oil.

6/ Three-month deposit, end-of-period.

7/ Ho Chi Minh Stock Index