



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

Source: World Development Indicators.

Vietnam's economy continues to recover rapidly from the global crisis. After growing 5.3 percent in 2009, the economy expanded 6.8 percent in 2010—the fastest pace in 3 years. The rapid recovery has been bolstered by robust domestic demand, higher level of investment and strong revival in exports. Foreign direct investments have continued to remain buoyant and remittances have grown at a healthy rate. Exports are growing at 25.5 percent, with export of non-oil sector doing particularly well, having registered 31.5 percent growth in 2010. Improved trade balance and strong private remittance has helped to reduce the current account deficit from 8 percent in 2009 to around 4 percent in 2010. Strong FDI inflow, ODA disbursement and portfolio investment have also helped the capital account to ensure a surplus of about 12 percent of GDP in 2010.

The delayed withdrawal of the fiscal and monetary stimulus despite a robust recovery proved costly for Vietnam. By the third quarter of 2010, inflation started to accelerate, exchange rate premium in the parallel market widened and financial problems in Vinashin, a large, diversified state-owned enterprise with business interest ranging from ship building to security market, came to light. The prices continued to surge through the last quarter of 2010, buoyed by strong domestic

demand, knock-on effects of increased global commodity prices, and weather- and disease-related domestic supply shocks. Sentiment in international capital markets turned particularly bearish after Vinashin defaulted on the first payment of \$60 million on a syndicated loan of \$600 million.

The authorities did make a number of efforts to regain macroeconomic stability (see below), but these measures could not be sustained as the country approached some important political milestones including the XIth Party Congress.

By the time the 2011 Lunar New Year arrived, inflation had climbed to a two year high of 12.2 percent and the dong was under intense pressure, with parallel market rate exceeding 10 percent. Despite improvement in the current account deficit and continued large surplus in the capital account, the level of foreign exchange reserves declined during 2010. Much of the surplus in the balance of payments found its way out of the banking system in the form of errors and omissions, which for the second year in running exceeded \$10 billion. A macroeconomic problem had over time turned into a crisis of confidence, with Vietnamese households and firms moving out of dong into U.S. dollars and gold in fear of rising inflation and considerable policy uncertainty. The time had come for the government to take some decisive actions or yield to the self-fulfilling expectations of its domestic investors.

By early February, there was growing consensus in the government to introduce strong measures to restore macroeconomic stability. The authorities recognized that their attention and focus should be on addressing instability even if this comes at the expense of slower growth in the short term. The government publicly indicated its intention to pursue “tight and prudent monetary and fiscal policy” and approved Resolution 11, which included a wide range of monetary, fiscal and structural policy reforms, intended to cool an overheated economy. A brief summary of the measures is provided in the Box.

Key elements of Vietnam's stabilization policy

Exchange Rate Policy

- The dong was devalued by 9.3 percent against the U.S. dollar and the trading band was narrowed from +/-3% to +/-1%. This is the single largest correction to the exchange rate following the onset of macroeconomic instability in 2007.
- Given a large and rapidly growing quasi-illegal trade in gold, which led to a significant increase in errors and omissions in the balance of payments, the Resolution instructs the central bank to issue a decree on Management of Gold Trading which will centralize gold exports, eliminate trading in gold bars, and prevent cross-border trafficking of gold.

Monetary Policies

- In the last four months, the State Bank of Vietnam has increased the base (refinancing) rate from 8 percent to 11 percent and revised upward the overnight market operation (repo) rate six times—from 7 percent to 12 percent.
- The central bank also announced that the target for credit growth in 2011 will be cut to 20 percent from 39 percent in 2009 and about 30 percent in 2010. This will be the lowest target for credit growth in the last 10 years. Concomitantly, the target for broad money supply growth has been kept at 15-16 percent during 2011—the lowest since the reform program was initiated in 1991.

Fiscal Policy

- The government has announced that it will cut non-salary recurrent expenditure by 10 percent, stop approving new projects in the public sector, including in SOEs, and thereby reduce fiscal deficit to below 5 percent of GDP in 2011 (government definition)—a 1 percentage point reduction relative to 2010 and 0.3 percentage point reduction relative to 2011 budget estimate.⁵²

Banking Sector

- Resolution 11 limits banks' exposure to non-productive activities (which include real estate and security market) to 22 percent of total credit by June 30, 2011 and to 16 percent by December 31, 2011. Non-compliant banks will be asked to double their required reserves ratio and restrict their business activities. The central bank will review compliance at the end of June 2011.

State-Owned Enterprises

- The Ministry of Planning and Investment (MPI) has been asked to review planned loans and investment projects of SOEs to identify those that can be dropped or scaled down. The report from MPI is due to the National Assembly by the end of March 2011.
- Resolution 11 also indicates that the government will accelerate the equitization process and strengthen the governance of SOEs.

Other Structural Measures

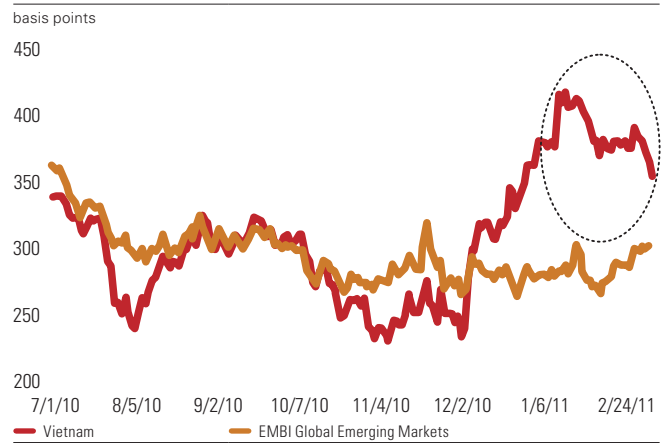
- The government is preparing a Circular to increase disclosure of information and policies affecting monetary management and banking sector.
- Finally, the government is moving from an administrative mechanism for setting the prices of key commodities such as electricity, gas and fuel, to a more market-based mechanism. It has already announced an increase in electricity tariffs by 15.3 percent, and in the price of gasoline (by 18 percent), diesel (24 percent), and kerosene (21 percent). In addition, it will issue a regulation for establishing a market mechanism for pricing electricity.

⁵² Based on IMF's definition, fiscal deficit to GDP ratio will fall from 5.9 percent of GDP in 2010 to 3.8 percent of GDP in 2011 (the later does not include the impact of Resolution 11).

In absence of a persuasive strategy to deal with macroeconomic turbulence, Vietnam's economy has lurched from one episode of instability to another during the last 3 years. The recent policy announcement is an important step in the right direction to break this cycle of boom and gloom and restore the country's image as one of the most attractive destinations of foreign investment in the region. Recently announced measures have been widely discussed and debated within the government and have the broad support of line ministries as well as key finance and budget committees in the National Assembly. The international financial markets have also reacted favorably to the recent announcement, with Vietnam's sovereign spreads steadily declining over the past few days (see adjacent figure). This augurs well for successful implementation.

While the outlook for the next few months remains extremely challenging, the recent policy shift has reduced some of the downside risks. The hike in fuel and electricity prices, rising global commodity prices, and depreciation of the dong, however, would add fresh impetus to inflation in the near-term. But core inflation should start to decline on account of the tighter monetary and fiscal policies. A declining and stable core inflation rate, along with improved external balance, should gradually help to stabilize the foreign exchange market. Through its 2011 budget, and recent government resolution, the authorities have indicated their intention to further consolidate the fiscal accounts and gradually reduce the fiscal deficit to pre-crisis levels. Vietnam's public debt is likely to remain sustainable if the current economic recovery continues to take hold and the authorities maintain a declining path for fiscal deficit. While stabilization policies would slow down growth in the near-term, if successfully implemented, they will help Vietnam to regain its pre-crisis growth potential in the medium-term.

Sovereign bond spread



Source:

Vietnam Key Economic Indicators

	2007	2008	2009	2010e	2011f	2012f
	Year	Year	Year	Year	Year	Year
Output, Employment and Prices						
Real GDP (% change y-y)	8.5	6.2	5.3	6.8	6.3	6.7
Industrial production index (% change y-y)	16.7	13.9	7.6	14.0	13.0	13.5
Unemployment (%) 1/	4.6	4.7	4.6	4.4	4.0	4.0
Consumer price index (% change y-y)	12.6	19.9	6.5	11.8	9.5	6.5
Public Sector						
Government balance, official (% GDP) 2/	-0.7	1.2	-5.1	0.1	-1.0	-1.0
Government balance, general (% GDP) 3/	-2.5	-1.2	-9.0	-4.4	-3.9	-3.8
Public sector debt (% GDP) 4/	44.6	42.9	51.2	52.8	53.4	52.7
Foreign Trade, BOP and External Debt						
Trade balance (billions US\$)	-10.4	-12.8	-8.3	-7.1	-7.4	-7.8
Exports of goods (billions US\$) (% change y-y)	48.6	62.7	57.1	72.2	84.8	99.5
Key export (% change y-y) 4/	2.7	23.1	-40.2	-23.0	-5.0	-5.0
Imports of goods (billions US\$) (% change y-y)	58.9	75.5	65.4	79.3	92.3	107.3
Current account balance (billions US\$) (% GDP)	-7.0	-10.8	-6.1	-4.0	-4.4	-4.5
Foreign direct investment (billions US\$)	6.6	9.3	6.9	7.1	7.2	7.3
External debt (billions US\$) (% GDP)	23.0	30.2	38.8	44.5	49.6	52.9
Debt service ratio (% exports of g&s)	2.8	2.6	4.5	3.2	3.2	3.5
Foreign exchange reserves, gross (billions US\$) 6/ (months of imports of g&s)	21.0	23.0	14.1	12.4	..	..
Financial Markets						
Domestic credit (% change y-y)	53.9	25.4	39.6	28.6	20.0	20.0
Short-term interest rate (% p.a.) 7/	7.8	8.1	10.7	13.0	..	..
Exchange rate (Dong/US\$, eop)	16.003	17.486	18.479	19.498	..	..
Real effective exchange rate (2000=100) (% change y-y)	106.0	125.9	116.1	117.4	..	..
Stock market index (Jul. 2000=100) 8/	927	316	495	485	..	..
Memo: Nominal GDP (billions US\$)	71	90	93	105	115	125

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/ Includes off-budgetary items

4/ Public and publicly-guaranteed debt

5/ Crude oil

6/ Based on IMF International Financial Statistics (IFS) as of September 2010

7/ Three-month deposit, end-of-period

8/ Ho Chi Minh Stock Index