Viet Nam

Bolstered by strong global markets for oil and commodities and buoyant domestic demand, the economy recorded further robust growth in 2004, and the outlook is good for the medium term. However, the economy will bump up against constraints in the longer term unless the Government accelerates reforms among SOEs and banks. Avian flu may become a serious risk factor.

Macroeconomic assessment of 2004

Supported by buoyant consumption and investment, growth maintained its rapid rate in 2004, reaching 7.5%. Private consumption grew by 12.9% and government consumption by 8.0%. Total investment climbed by 24.6% to reach 35.5% of GDP. A little more than half of the investment, 56%, originated from the state sector, while the domestic private sector contributed 27% and foreign investment 17%. Around 27,000 new private enterprises were registered during the first 10 months of the year, with a total capital of $3.4 billion, representing a year-on-year increase of 24% in number and 25% in capital value.

Investment projects and expanding export industries lifted demand for imports, but exports too were buoyant, narrowing the trade deficit to 11.5% of GDP in 2004 from 12.6% in 2003.

On the supply side, industry and services, together accounting for nearly 80% of GDP, were the main sources of growth. The industry sector, which covers manufacturing, mining, construction, and utilities, grew by 10.2% and contributed 3.9 percentage points to GDP growth. Within this sector, the GDP of the domestic private and foreign-invested subsectors grew faster (22.8% and 15.7%, respectively) than the state-owned subsector (11.8%).

Services grew by 7.4% in 2004, driven mainly by wholesale and retail sales, which were up by 9.0%, and transport, postal, and tourism services, up by 8.5%. After a slow start at the beginning of the year due to the outbreak of avian flu, visitor arrivals jumped by 20.5% from the 2003 level, to nearly 3 million. The easing of visa requirements for tourists from Japan and Korea was a factor, prompting an upsurge in tourists from these countries. Overall, services contributed 3.0 percentage points to GDP growth.

The agriculture, forestry, and fisheries sector was the slowest expanding at 2.8%, because of a prolonged drought in many parts of the country and higher prices for imported fertilizers. The share of this sector declined to 20.2% of GDP in 2004 and it contributed only 0.6 percentage point to economic growth. Rice farmers benefited from high domestic and international prices. The shrimp industry grew by 8.5%, supported by domestic demand at a time that antidumping action in the US restricted access to that market.

Strong economic growth helped reduce the number of households in poverty by 300,000 to 1.4 million. This is as measured by the national poverty standard, which puts households below the poverty line if they have consumption spending of less than D80,000–D150,000 (depending on the location) per person per month. The poverty rate was consequently reduced from 11.0% in 2003 to 8.3% in 2004. The poorest regions continued to be the Northwest (16.4% poor), the Central Highlands (13.6%), and the Northern Central Coast (12.7%). Ethnic minorities generally have a high incidence of poverty.

Growth created jobs for an estimated 1.6 million people in 2004, lowering the unemployment rate in urban areas from 5.8% in 2003 to 5.6% in 2004. Unemployment rates were higher in large cities—6.5% in Hanoi and 6.4% in Hai Phong and Ho Chi Minh City. Nearly 65,000 Vietnamese took jobs abroad in 2004, bringing the total to 340,000. These workers' remittances contributed an estimated $1.5 billion, equivalent to 3.5% of GDP, to the national economy.

Government revenues benefited from strong economic growth and from higher world oil prices (Viet Nam is a net exporter of oil), with receipts from the production and export of crude oil exceeding budget targets by 60%. Total budget revenues were 14.5% higher than expected. Expenditures also exceeded the budget level, by 10.9%, as the Government eased its fiscal position, particularly in the fourth quarter of 2004. Some of the increase in spending was caused by avian flu, which required more resources in the health sector and for subsidies to farmers who culled their poultry stock. The fiscal deficit was estimated at 3.8% of GDP, including onlending and excluding grants, or below the Government's target of 5.0%.

In response to the rise in the price of imported petroleum products and to curb likely border leakages due to lower domestic petroleum prices, the Government increased the domestic price of diesel, kerosene, and gasoline in June and again in November. This raised transport costs, including costs of food production and distribution. Food prices also came under upward pressure from the drought, the avian flu outbreak (which raised meat prices), and higher world prices for rice. As a result, the price of food increased by 15.6%. The CPI rose by 9.5% in December and annual average inflation for the year was estimated at 7.7%, up from 3.2% in 2003. However, excluding food, the CPI rose much more moderately at 3.0%.

Credit growth accelerated to 28% year on year at end-2003, and was estimated to have picked up further to 36% in July 2004. The State Bank of Viet Nam kept the prime lending rate steady at 7.5%, and the dong depreciated by less than 1% against the dollar.

Buoyant world prices for oil and commodities were a boon for Viet Nam in 2004, helping boost total export revenues by 30.3% to $26.0 billion.

Table 2.13 Major economic indicators, Viet Nam, 2004–2007, %

Item	2004	2005	2006	2007
GDP growth	7.5	7.6	7.6	7.5
GDI/GDP	35.5	36.1	37.1	37.7
Inflation (CPI)	7.7	5.7	5.2	5.2
Money supply (M2) growth	28.0	28.0	27.0	25.0
Fiscal balance/GDP	-3.8	-4.9	-5.0	-4.8
Merchandise export growth	30.3	11.4	8.9	8.6
Merchandise import growth	26.0	12.0	10.0	10.0
Current account/GDP	-5.7	-5.6	-5.8	-6.6

CPI = consumer price index, GDI = gross domestic investment, GDP = gross domestic product.

Sources: General Statistics Office; Ministry of Finance; State Bank of Vietnam; International Monetary Fund; staff estimates.

Crude oil, which accounted for 22.0% of total exports, recorded a 48.3% rise in value on a 14.1% increase in volume. The country is a significant exporter of rice, coffee, rubber, pepper, cashew nuts, and tea, which all benefited from stronger global prices. The export value of wooden furniture and related products soared by 86% to over $1 billion, mainly because of improved access to the US market. Textiles and garments also performed well in 2004, with exports growing by 17.2% to $4.3 billion. The US remained the main market for textiles and garments, although Canada, EU, and Japan were also major destinations.

Steeper world prices also pushed up the cost of some imports, in particular refined petroleum products, fertilizer, and steel. The total import bill rose by 26.0% to $30.9 billion, resulting in a trade deficit of $4.9 billion. The current account deficit was similar to the 2003 level, but as a share of GDP fell to 5.7%.

In response to an improved investment climate, FDI commitments were strong in 2004, reaching $4.0 billion, or almost one third higher than in the previous year. Net FDI rose from $1.2 billion to $1.7 billion. Foreign exchange inflows were pushed up by official development assistance and by private remittances through official channels. These private remittances rose from $2.6 billion in 2003 to about $3.2 billion in 2004.

Gross international reserves (including gold) rose by $300 million to an estimated $6 billion in

2004, equivalent to about 2.5 months of imports. The ratio of external debt to GDP is estimated at 34% for 2004, down from 38.7% in 2003. Total debt servicing amounts to 6.7% of the total value of exports of goods and services.

Macroeconomic policy developments

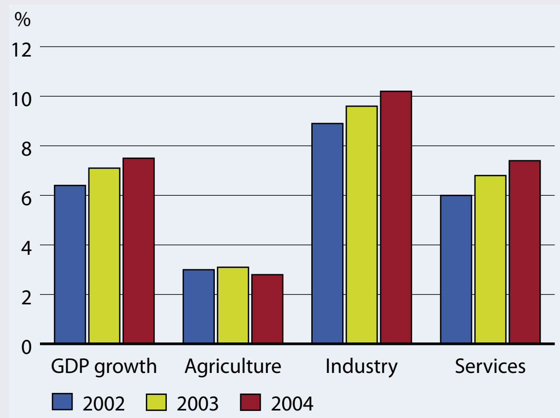
The Government continued to pursue an expansionary fiscal stance. In 2005, the last year of the current 5-year socioeconomic development plan, it is aiming for 8.5% growth to achieve the 7.5% annual average growth envisaged in the plan. At the same time, the authorities recognize the increasingly important role and potential of the private sector. Improvements were made in the business environment in 2004, resulting in increased private investment.

Among the improvements, the Government started to prepare a unified law for all types of enterprises and one investment law for all types of investments by 2006. These changes are expected to simplify procedures, enhance transparency, and promote good corporate governance. Legislation on competition issues, bankruptcy, and land ownership was updated, and decrees were promulgated on the conversion of businesses with foreign investment into joint-stock companies and on allowing foreign investors to own up to 30% of the registered capital of Vietnamese businesses.

The Viet Nam Business Forum's 2004 survey showed that more than two thirds of surveyed foreign businesses plan to expand over the next 3 years. The other third indicated that bureaucracy, corruption, high costs of doing business, and poor enforcement of laws were obstacles to expansion. Half of the surveyed companies noted evidence of improvements in access to financing, in administrative and customs procedures, and in transparency.

Business community representatives, at a meeting in December with government officials, suggested that the authorities focus efforts on further streamlining administrative procedures, curbing corruption, facilitating the introduction of modern technologies and management skills, improving infrastructure, developing capital markets, and allowing the private sector to compete on a level playing field with state enterprises. Such changes would improve the viability

Figure 2.13 GDP and sector growth, Viet Nam, 2002–2004



Sources: General Statistics Office; staff estimates.

of domestic producers as the economy is opened wider to external competition.

Related to the improvements in the business climate is reform of the public administration system, which is important in the context of the transition to a market economy as well as further economic integration with the rest of the world. In addition to further progress in training civil servants and the computerization of state administration, the Government paid long-awaited salary increases to civil servants in December 2004. Low salaries are considered to be one of the root causes of corruption in the civil service.

In response to the accelerating growth of credit, the central bank raised compulsory reserve requirements for dong and US dollar deposits in July 2004. It subsequently increased discount and refinancing rates by 50 basis points to 3.5% and 5.5%, respectively, in January 2005. However, it kept the prime lending rate at 7.5%. In an effort to slow inflation, the Government lowered tariffs on petroleum and steel products (until January 2005) and instructed SOEs not to take advantage of their monopolistic positions to raise prices.

While Viet Nam has made solid progress in its macroeconomic performance and in improving its business climate, it has lagged in removing structural weaknesses, particularly in the SOE and state-owned commercial bank (SOCB) sectors. The Government has grappled with technical problems, such as a lack of legal mandates for the equitization program for SOEs, under which the state retains a large shareholding in an SOE and sells the rest to employees and the private sector. Building a consensus for reform among SOE stakeholders, such as employees and state agencies, is also taking time.

The state seems to be concerned about minimizing social costs and revenue erosion (about 70% of tax revenues come from SOEs). Nevertheless, several decrees were announced to facilitate planned SOE equitization. The social safety net, which compensates SOE employees who lose their jobs during restructuring or equitization, was brought into operation.

In the first 10 months of 2004, 461 SOEs, mainly smaller and provincial-level ones, were partially privatized. As part of its preparation to reform larger SOEs, the Government undertook a performance assessment of 42 of them, mainly manufacturers, which disclosed that about 80% were profitable, albeit with low rates of return on investment. It also drew up plans to group many "government corporations," which are large SOEs that are supposed to be run on a commercial basis, into holding-company structures in an effort to improve their performance. Few advances were made as regards the development of capital markets in 2004, to a degree a result of the drawn-out procedure on partially privatizing SOEs.

All SOCBs have been recapitalized, although they do not yet meet the internationally accepted capital-adequacy ratio of 8%. Amendments to the Law on Credit Institutions became effective in October 2004. Among other reforms, the amendments clarify the separation of policy and commercial lending, strengthen the decision-making autonomy of credit institutions, allow banks to offer loans without collateral, and require independent audits of SOCBs.

On the external trade front, Canada and the EU agreed to eliminate quotas on Vietnamese exports of textiles and garments from 1 January 2005, and the US approved a $1.8 billion quota for Vietnamese garment exports. The Government is pushing ahead with its bid for WTO entry and has said that it will amend or abolish trade- and investment-related laws that are inconsistent with WTO rules. The chances of joining WTO by late 2005 seem to have improved following the successful conclusion of the ninth round of multilateral negotiations in December 2004, as well as bilateral agreements with the EU and Singapore. The final round of multilateral negotiations is scheduled for mid-2005.

The next 5-year socioeconomic development plan (2006–2010) has a target of 7.5–8.0% annual average GDP growth, broken down into 3.0–3.5% in agriculture, forestry, and fisheries; 10.0–15.0% in industry; and 7.2–7.5% in services. The aim is to create 8 million additional jobs and reduce the number of poor households. The plan is expected to achieve the Government's Comprehensive Poverty Reduction and Growth Strategy and Viet Nam Development Goals—the local version of the Millennium Development Goals. Given that the country has achieved rapid economic expansion and poverty reduction over the past decade, the targets seem plausible, provided that the Government ensures that total investment stays at about 35% of GDP, improvements are made in the productivity of capital, and economic growth benefits all sectors of society.

Outlook for 2005–2007 and medium-term trends

Continued robust growth is likely over the forecast period. The export environment looks favorable, with high crude oil prices and an upward trend in global commodity prices, as well as Viet Nam's closer integration into the world economy. Domestic demand is expected to remain strong.

GDP growth is projected at around 7.5% annually over the next 3 years, supported by domestic demand that is forecast to increase by 8.0%, 8.7%, and 8.5%, and export growth of 11.4%, 8.9%, and 8.6% in 2005, 2006, and 2007, respectively.

The Government's target for 8.5% growth in 2005 calls for total investment of about $19 billion, of which about 70% will go to economic infrastructure such as roads, bridges, and power generation. The fiscal position is expected to remain expansionary to cover the cost of reforms and infrastructure. Growth in revenues will be constrained by further cuts in import tariffs, but the buoyant economy and more efficient tax collection will ensure that revenues remain fairly robust. The budget deficit will widen to around 5% of GDP in 2005–2007.

Inflation will likely moderate to 5.7% in 2005 and 5.2% in 2006–2007. The CPI rose by 3.6% in the first 2 months of 2005 from December 2004, mainly caused by higher food prices during the Lunar New Year. For the rest of the year, the CPI is likely to increase at a slower pace.

While key macroeconomic variables are expected to remain reasonably stable, risks to the medium-term outlook come from a further opening of the economy to competition from abroad, uncertainty over market access, falls in commodity prices, rapid credit expansion, inflation, and possible public health scares.

Opening the economy further over the next 2 years in compliance with ASEAN Free Trade Area commitments and WTO accession (assuming it happens) will likely bring more external competition for domestic enterprises. The economically less efficient and state-protected enterprises will have difficulty in adjusting to the more competitive environment. In aggregate, though, the additional market access gained for local products should more than offset the impact on the enterprises that lose domestic market share.

The issue of market access will arise if the planned accession to WTO fails or is delayed. Garment markets are more competitive since the MFA ended, and the country needs to join WTO to secure the favorable treatment accorded to members. Still on trade, the economy is now running a trade deficit, which could widen the current account deficit if foreign exchange inflows are constricted for any reason. Continuing improvement in the business climate will be required to ensure a high level of foreign exchange inflows from FDI, overseas aid, and private remittances.

International commodity prices look likely to remain robust, but if prices instead turn down, consumption spending will be vulnerable as many people depend on income from production of rice, coffee, spices, and other commodities.

High rates of credit expansion could potentially exacerbate inflation and raise the risk of more NPLs, because SOCBs and the state-owned Development Assistance Fund, which provides credit to SOEs, have limited credit risk assessment and management capabilities.

The major public health risk is avian flu, which reappeared late in 2004 in southern parts of the country and spread to many provinces. By late March, 14 human deaths had been recorded in the latest outbreak. No human-to-human infection has been confirmed, but concern is growing that transmission in this manner may occur, which could spark a pandemic. The incidence of HIV/AIDS has increased, too.

In the longer term, as Viet Nam emerges as a fully open economy, its prospects for rapid growth and poverty reduction will be put at risk if progress remains slow in the areas of reforming SOEs and SOCBs, improving capital productivity, and making the economy more competitive.