Outlook On Vietnam Revised To Positive From Stable; Ratings Affirmed

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SINGAPORE (Standard & Poor's) Oct. 18, 2005--Standard & Poor's Ratings Services today revised its outlook on the long-term ratings on Vietnam to positive from stable. At the same time, the 'BB-/B' foreign currency sovereign credit ratings, and 'BB/B' local currency ratings were affirmed.

"The positive outlook takes into account measured progress in legislative reforms in support of ongoing trade liberalization, and bilateral and multilateral agreements," said Standard & Poor's credit analyst Agost Benard. This reflects the ruling Communist Party's commitment to transformation toward a market economy and to increased international integration. Vietnam's positive medium-term economic potential is also underpinned by high domestic savings, a diverse and competitive export sector, and fast-growing private enterprises.

Standard & Poor's expects reforms to continue along this path, where a traditional cautious pace due to fear of adverse political and social consequences is balanced against the impetus provided by a strong ambition to maintain high real growth through an export-led growth strategy, in which early WTO accession, in particular, is deemed a key step.

These factors should ensure the continued inflow of foreign direct investments of US$2.0 billion-US$2.5 billion a year. Combined with Overseas Development Assistance inflows of about U$2 billion, strong flow of unrequited transfers--projected at U$3 billion in 2005--and a low external debt service burden, Vietnam is expected to maintain a comfortable external liquidity position.

The country's ratio of gross financing requirement to current account receipts plus usable reserves is projected at 97.2% in 2005, while its interest paid to total external debt is less than 2%, both ratios indicating strong external viability compared with most peers in the 'BB-' rating category. Its external debt level, projected at 47% of 2005 current account receipts, is one of the lowest among similarly rated countries. The government accounts for about 80% of the external debt, which was obtained on concessional terms, with long maturity and stable amortization profile.

The strong growth and favorable external position, in turn, provide Vietnam some latitude to further reduce the prevailing distortions in its domestic economy, which constrain its credit rating at the current level by perpetuating inefficiencies in resource allocation and the high contingent liabilities to the state.

Although Vietnam has enjoyed a fair degree of political stability compared with its peers, this relies on a highly centralized control and decision-making process that lacks transparency. The consequent slow progress in dealing with structural, institutional, and legal deficiencies contributed to the country's protracted transition process from a centrally planned economy, and continues to limit the sovereign rating. Vietnam's per-capita GDP stood at US$555 in 2004, which is the lowest among sovereigns in the 'BB' category, and is well below that of other rated

transition economies. The government intends to maintain ownership of public enterprises in many sectors, and the restructuring of nonfinancial public enterprises and state banks is hampered by weak administrative capacity, the undeveloped legal framework, and resistance from vested interests.

An area of enduring institutional deficiency impairing economic decision making and the assessment of Vietnam's credit fundamentals is the shortcomings in the quality, availability, timeliness, and transparency of economic data--encompassing its fiscal operations, national income, balance of payments, and foreign reserves. Independent audit of the central bank remains a bone of contention for the authorities, making verification of foreign reserves impossible.

The ratings are also constrained by weak and opaque public finances. Although the government's reported general deficits were reasonably contained at an average 3.2% of GDP over the past five years, quasi-fiscal and off-budget activities used as policy tools remain prevalent in Vietnam. As a result, potentially significant contingent liabilities to the state remain hidden. The general deficits are expected to be maintained at the above level, where diminished nontax revenues due to trade liberalization are likely to be countered by rising oil and gas-related revenues.

"Vietnam's public sector debt, including general government and nonfinancial public enterprises, remains relatively low at an expected 54% of GDP in 2005," noted Mr. Benard. Nonetheless, Vietnam's key challenge in public finance is to expand its tax base by capturing revenue from the larger and faster growing nonstate sector.

Another constraint on the sovereign rating on Vietnam is its limited monetary policy flexibility, stemming from the absence of central bank independence and its conflicting mandate. This is reflected in the central bank's lack of timely and appropriate response to rising inflation and excessive credit growth.

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