

Viet Nam

The economy maintained a rapid rate of growth in 2006, supported by robust exports, rising consumption spending, and strong investment. Inflation also stayed high. Membership of the World Trade Organization (WTO) from January 2007 has added impetus to development and market-oriented reforms. Provided that further progress is made on structural reforms, further brisk economic growth is projected this year and next.

Economic performance

The economy expanded by an estimated 8.0% in 2006 (against a government-estimated figure of 8.2%), above its trend rate of the past 5 years. Demand was strong for the country's exports of commodities, crude oil, and manufactures. Private investment and private consumption recorded robust growth, too. Growth in private consumption was supported by rising incomes and inward remittances of about \$4 billion. Retail sales of goods and services increased by 20.9% in 2006 (about 13% after adjusting for inflation; Figure 2.29.1).

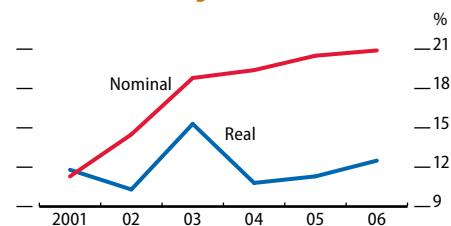
Investment levels remained high at an estimated 39.4% of GDP in 2006. Private investment was encouraged by further simplification of administrative procedures for businesses and moves toward equal treatment between state enterprises and the private sector and between domestic and foreign enterprises. The domestic private sector accounted for 33.6% of total investment in 2006 (Figure 2.29.2). That proportion is up sharply from 22.6% 5 years earlier. Foreign direct investment (FDI) commitments rose to \$10.2 billion last year, the highest since the country opened to investment in 1986.

On the production side, the industry and services sectors contributed more than 90% of total GDP growth in 2006 (Figure 2.29.3). Industry expanded by a robust 10.4%, slightly below the year-earlier pace. The manufacturing and the utilities subsectors maintained strong growth (12.4% and 11.6%, respectively; Figure 2.29.4). But mining production barely grew because of a fall in the volume of crude oil production from 18.5 million tonnes in 2005 to 17.0 million tonnes in 2006. Planned development of several new oil fields in coming years is expected to lift production.

Services, on the back of buoyant performances of trade, tourism, transportation, communications, and finance, grew by an estimated 8.2% (Figure 2.29.5). Surging demand for mobile phones is helping drive the expansion. As sales soared, the number of telephones per 100 people rose to about 31 in 2006 from 19 in 2005, and is expected to exceed 50 by the end of 2009.

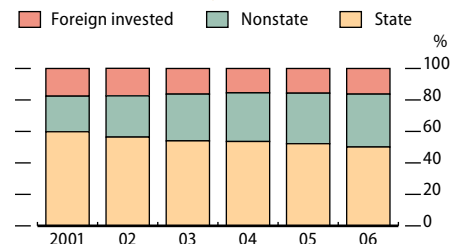
Production in agriculture rose by 2.9% last year, below average for recent years, because of floods and typhoons. Rice output fell, partly due a decrease in acreage planted. Agricultural land is being converted into

2.29.1 Retail sales growth



Sources: General Statistics Office of Viet Nam, available: <http://www.gso.go.vn>; CEIC Data Company Ltd., downloaded 16 February 2007.

2.29.2 Investment by ownership



Source: General Statistics Office of Viet Nam, available: <http://www.gso.go.vn>, downloaded 16 February 2007.

industrial parks, which is reflected in the changing economic structure: agriculture's share of GDP declined to 20.4% in 2006 from 24.5% in 2000. Production of tea, coffee, and natural rubber was buoyed by high export prices. Strong external demand also underpinned growth in the fisheries subsector.

Exports performed strongly in 2006, rising by 23.0% in nominal US dollar terms. The ratio of exports to GDP increased from about 46% in 2000 to 66% in 2006, indicating the openness of economy even before Viet Nam joined WTO in January this year. The structure of exports is becoming more diversified—commodities such as crude oil, rice, marine products, and coffee remain important, but the share of manufactured products is rising. Exports of clothing, electronics, and wood products each expanded by at least 20% in 2006.

Robust domestic demand, particularly from investment projects, lifted imports by a third, widening the trade deficit to \$4.5 billion. Vigorous expansion in both private remittances and tourism receipts helped limit the current account deficit to \$1.3 billion, or 2.1% of GDP. Buoyant FDI inflows supported the balance of payments, resulting in a rise in gross international reserves to \$11.4 billion, equivalent to 3.5 months of imports (Figure 2.29.6).

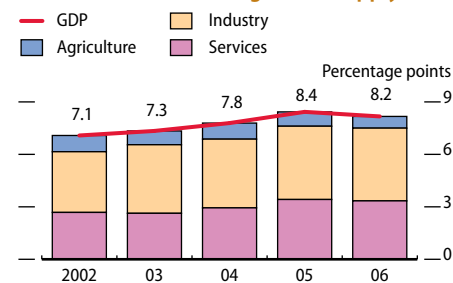
Inflation continued to run high, exceeding 7% on average during 2006 for the third year in a row (Figure 2.29.7). Rising food prices were one cause; increases in administered prices of domestic fuels and in transport charges were others. In February 2007 inflation was 6.5%, and is expected to stay around this level through the year. For employers, rapid growth in demand for workers and professionals pushed up payroll costs. The minimum salary of civil servants was increased by 30% in October 2006, a component of reforms to the civil service. Administered domestic fuel prices were raised in April and in August 2006, by a cumulative 18.5%, and then reduced twice by a cumulative 12.5%. Subsidies have been largely eliminated for gasoline and kerosene, and the Government plans to eliminate fuel subsidies completely next year. The International Monetary Fund has estimated that subsidies, mainly on diesel fuel, were still equivalent to 1.3% of GDP in 2006.

Moving to curb inflation, the State Bank of Viet Nam set a 2006 year-end target of 20% growth in credit, compared with rapid growth of 40% in 2005 (though actual credit growth was about 24% late in 2006; Figure 2.29.8). The slower rate of credit growth in 2006 was attributable to more cautious lending by state-owned commercial banks, which were following new prudential standards.

Officially, the authorities follow a managed float of the dong. The currency depreciated in nominal terms against the US dollar by about 1% in 2006 (Figure 2.29.9). In a step toward more flexible exchange rate management, the central bank widened the daily trading band for the dong against the US dollar, from 0.25% to 0.5%.

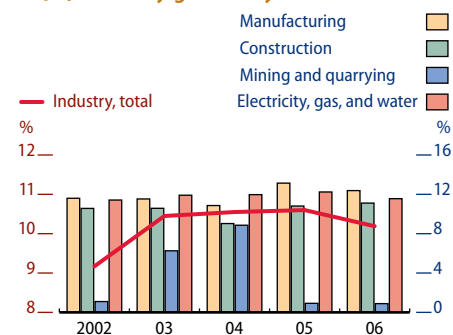
The overall fiscal deficit was high in 2006 at 5.0% of GDP as the Government pursued the building of infrastructure. Fiscal revenues surpassed the planned target by 10%, attributable to higher oil income (29% of the total), improvements in tax administration, and a growing number of tax-paying businesses in the formal sector (Figure 2.29.10). Receipts from value-added tax have increased significantly in recent

2.29.3 Contributions to growth (supply)



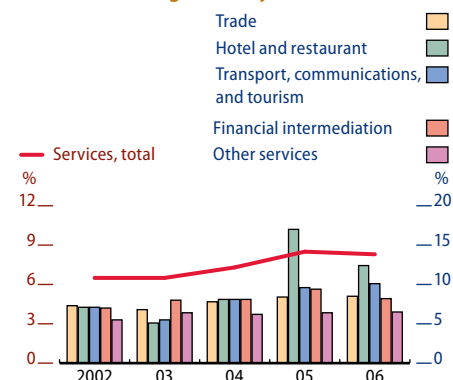
Sources: Asian Development Outlook database; General Statistics Office of Viet Nam, available: <http://www.gso.go.vn>, downloaded 16 February 2007.

2.29.4 Industry growth by subsector



Source: CEIC Data Company Ltd., downloaded 16 February 2007.

2.29.5 Services growth by subsector



Source: CEIC Data Company Ltd., downloaded 16 February 2007.

years. Strong revenue growth is critical to funding the state's 30% share of the estimated \$140 billion investment required to achieve targets set out in the socioeconomic development plan for 2006–2010. Off-budget expenditures rose from 1.2% of GDP in 2004 to an estimated 2% of GDP in 2006. These are used mainly for investment in infrastructure and education. Investment in infrastructure now exceeds 9% of GDP and is expected to reach 11% in coming years. The off-budget expenditures are subject to National Assembly scrutiny, as is budgetary spending. Public and publicly guaranteed debt was an estimated 45.5% of GDP in nominal terms at end-2006. External debt was estimated at 32% of GDP. Moody's upgraded the country's B₃ foreign-currency sovereign rating outlook to positive from stable.

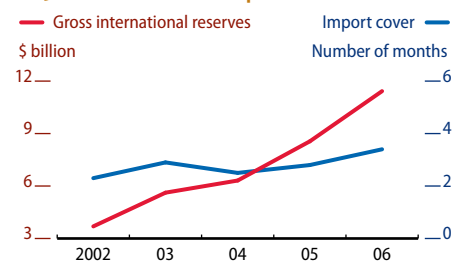
The growth of the private sector has been a significant feature of Viet Nam's economic development over the past decade. The nonstate sector accounted for more than half of GDP in 2006. Preliminary estimates show that private businesses generated almost 90% of the 7.5 million jobs created during the 5 years to 2005. Most of the 1.6 million new jobs Viet Nam needs to create annually from 2006–2010 are expected to be generated by the private sector. However, shortages of skilled labor have become apparent. The industrial park and export processing zone authority for Ho Chi Minh City has stated that the city's vocational schools can only supply about 15% of the 500,000 workers that the city's industry will likely need through 2010.

In the policy arena, the Government in May 2006 outlined a strategy for banking reform. The State Bank of Viet Nam is to be converted into a modern central bank with a mandate (and capacity) to manage monetary policy and supervise financial institutions. State-owned commercial banks are to be restructured in an effort to improve their performance, and are to be "equitized," or partly privatized, by 2010. The Viet Nam Foreign Trade Bank (Vietcombank) will be partially privatized in the second half of this year. A stock market boom has enabled many joint-stock commercial banks to raise equity capital and so increase their capital-adequacy ratios. Several domestic banks also took major international banks as strategic partners.

The securities market expanded beyond expectations in 2006. The number of listed companies rose to 193 from 41, and total market capitalization increased by almost 20 times from 2005 levels, to \$14 billion, or 22.7% of GDP. The main index of share prices soared from 307.5 at end-2005 to 751.8 12 months later, and climbed further to 1,138 points at the end of February this year (Figure 2.29.11). There are concerns that speculators using funds borrowed from banks may face repayment difficulties if stock prices dropped precipitously, and big fund flows could cause problems for the implementation of monetary and foreign exchange policies. With this in mind, the central bank warned commercial banks of the risk of increasing securities-backed loans and requested commercial banks to report on such loans.

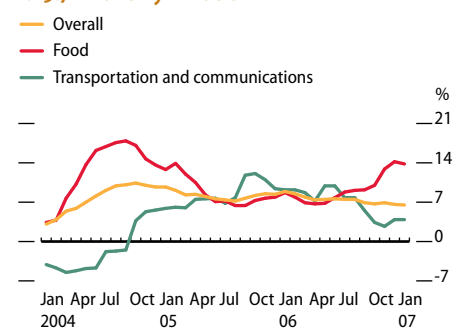
Moves were made to improve corporate governance and market regulation. A law on securities and securities markets was approved, and came into force in January 2007. It provides a legal base for investor protection and market transparency, including disclosure requirements for publicly held companies. The maximum foreign ownership in listed

2.29.6 Reserves and import cover



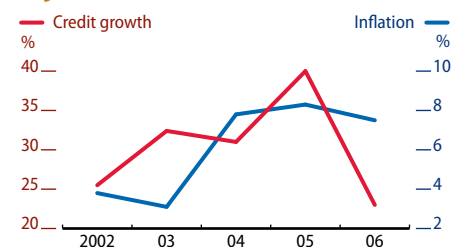
Source: International Monetary Fund, *International Financial Statistics* online database, downloaded 7 February 2007; staff estimates.

2.29.7 Monthly inflation



Source: General Statistics Office of Viet Nam, available: <http://www.gso.gov.vn>, downloaded 19 February 2007; International Monetary Fund, *Vietnam: Statistical Appendix*, November 2006.

2.29.8 Prices and credit



Sources: International Monetary Fund, *International Financial Statistics* online database, downloaded 7 February 2007; staff estimates.

companies was lifted from 30% to 49%. The stock market boom also encouraged more state-owned enterprises (SOEs) to issue shares to investors. Subsidiaries of several major SOEs in areas such as hydropower made successful initial public share offerings. The prime minister in December approved a list of state firms to be equitized during 2007–2010, including major ones such as Viet Nam Airlines.

Economic prospects

Prospects for the economy are predicated on the assumption that WTO accession will maintain the momentum for structural reforms. Commitments given to liberalize the financial sector should speed up bank restructuring. Anticipated reforms to state banks, partnerships between foreign and domestic banks, and the boost to equity capital for joint-stock commercial banks likely will mean a strengthened banking system, a broader range of products for customers, and better access to finance, particularly for small and medium enterprises.

Similarly, the pace of reform in SOEs should be stimulated by additional competitive pressure that these firms will face as more international businesses enter the domestic market. The stimulus of the successful initial public offerings in 2006 and the record of SOEs improving their operating performances after equitization are expected to lift the pace of equitization, particularly of large SOEs. The country has also committed under its WTO membership terms to allow foreign ownership of services firms.

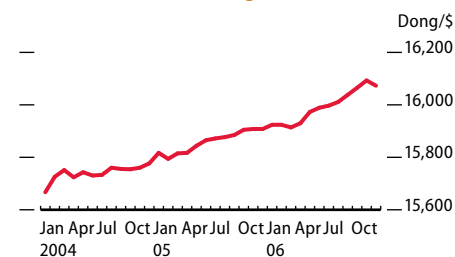
On these assumptions, the economy is predicted to grow by 8.3% in 2007 and 8.5% in 2008. Growth will be underpinned by strong private consumption, private investment, and FDI. Total investment as a share of GDP is projected to be about 40% in the next 2 years. Industry (projected to expand by 10.5%) and services (8.5%) will continue to drive overall growth (Figure 2.29.12). The Government aims to lift spending on infrastructure toward 11% of GDP in the medium term, from about 9% now, which will spur construction activity.

WTO accession also provides greater opportunities for exporters as the country becomes eligible for most-favored-nation treatment by WTO members and is no longer subject to quotas. This will benefit competitive industries such as clothing, wood products, footwear, and marine products. Exports are projected to maintain strong growth of around 18% this year and next. Robust consumption and investment demand will keep import growth high, and the trade account is estimated to be in deficit by 4.7% GDP in 2007, and 3.8% GDP in 2008 (Figure 2.29.13). However, buoyant inward remittances and tourism receipts are likely to mean small current account surpluses in the forecast period.

Fiscal policy will remain expansionary, with additional outlays on public sector wages and on infrastructure. Improved tax administration and the expansion of the formal sector of the economy will broaden the tax base. The impact on revenues of tariff cuts in compliance with WTO commitments will be slight: average tariffs come down just 4 percentage points to 13.4%, and this happens over 5–7 years. The fiscal deficit is projected to remain around 5%.

The political leadership has stepped up efforts against corruption,

2.29.9 Nominal exchange rate



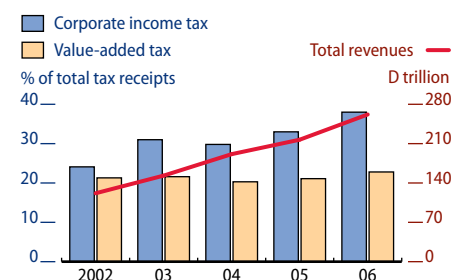
Source: International Monetary Fund, *International Financial Statistics* online database, downloaded 12 March 2007.

2.29.1 Selected economic indicators

	2007	2008
GDP growth	8.3	8.5
Inflation	6.8	6.3
Current account balance (% of GDP)	0.2	1.3

Source: Staff estimates.

2.29.10 Selected components of total revenues



Sources: International Monetary Fund, *Vietnam: Statistical Appendix*, November 2006; staff estimates.

and a committee headed by the prime minister was established to coordinate the campaign. A decision by the Communist Party in January 2007 to streamline its organization and to strengthen the transparency of enterprises under the defense and police ministries suggests a commitment by leaders to improve the performance of the public sector. The Government has this year made public administration reform a high priority.

Domestic risks to the projections include a possible backtracking in the Government's commitment to implementing reforms and controlling corruption, which would discourage investment. This risk currently appears low. Power shortages remain a problem, given an estimated 15% annual growth in demand. Power sector investment needs are large (\$2.5 billion–3.5 billion) a year. Hydropower accounts for 56% of power supply, but this leaves the country vulnerable to droughts. A failure to meet energy demand and to reduce reliance on hydropower could undermine growth.

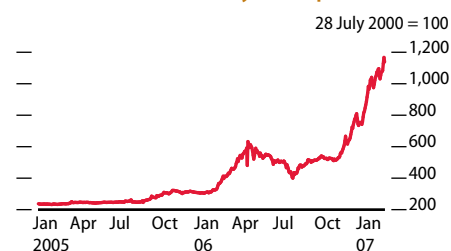
Development challenges

The socioeconomic development plan for 2006–2010 seeks high rates of economic growth (7.5–8.0% annual average) based on an investment-to-GDP ratio of about 40%. Investment levels already are high; the challenge now is to improve the efficiency of investment. Studies suggest little improvement in the productivity of capital in recent years. Worse, public investment is sometimes used inefficiently. The rising proportion of domestic and foreign private investment in total investment (it was 46% in 2001–2005) should improve the productivity of capital, and the restructuring of SOEs should do the same in the public sector. However, SOE reforms need to be accelerated, especially now that WTO entry will allow more foreign firms to operate in the country.

Related to the productivity issue is the shortage of skilled workers. This has been cited in surveys as the third most important constraint faced by manufacturers, after access to finance and to land. The education system is not up to the task at this time, with generally out-of-date curricula, a lecture-centered method of teaching, and research activities separated from teaching.

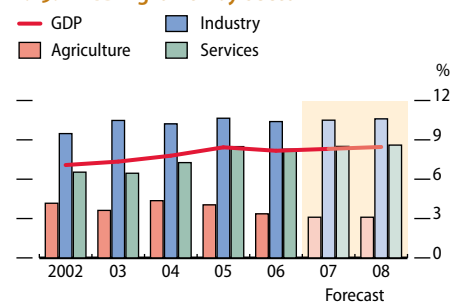
Another challenge is to maintain controlled development of the stock market in the face of the boom in share prices. A sudden reversal and capital outflows could jolt the economy. While the supply of securities has been increasing, demand has been even stronger, given limited outlets for savings. Investor education and better corporate disclosure would seem part of the answer. On the macro level, a timely and comprehensive set of data on capital flows is needed to guide policy making and to facilitate market functioning.

2.29.11 Ho Chi Minh City stock price index



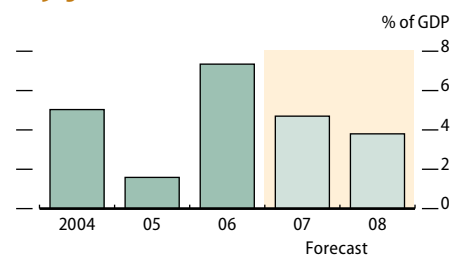
Source: CEIC Data Company Ltd., downloaded 20 March 2007.

2.29.12 GDP growth by sector



Source: General Statistics Office of Viet Nam, available: <http://www.gso.gov.vn>, downloaded 16 February 2007; staff estimates.

2.29.13 Trade deficit



Sources: International Monetary Fund, *Vietnam: Statistical Appendix*, November 2006; staff estimates.