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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/52-3

2:30 p.m., June 19, 2019

3. Vietnam—2019 Article IV Consultation

Documents: SM/19/135 and Correction 1; and Correction 2; and Supplement 1; SM/19/143; and Correction 1

Staff: Gulde, APD; Mourmouras, APD, Duttagupta, SPR

Length: 51 minutes

Executive Board Attendance

D. Lipton, Acting Chair

Executive Directors	**Alternate Executive Directors**
	G. Gasasira-Manzi (AE), Temporary
	H. Razafindramanana (AF)
G. Lopetegui (AG)	
	N. Heo (AP)
	B. Saraiva (BR)
Z. Jin (CC)	
	A. Arevalo Arroyo (CE), Temporary
	P. Mooney (CO), Temporary
	C. Just (EC)
	A. Castets (FF)
S. Meyer (GR)	
	P. Dhillon (IN), Temporary
	M. Psalidopoulos (IT)
	Y. Saito (JA)
	M. Daïri (MD)
	D. Fadhel (MI), Temporary
	M. Tolici (NE), Temporary
	J. Sigurgeirsson (NO)
	L. Palei (RU)
	R. Alkhareif (SA)
A. Mahasandana (ST)	
	P. Trabinski (SZ)
	J. Freeman (UK), Temporary
	P. Pollard (US), Temporary

S. Bhatia, Acting Secretary
H. Malothra, Summing Up Officer
A. Lalor, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
Asia and Pacific Department: A. Banerji, D. Corvino, A. Gulde, A. Mourmouras, J. Turunen. Legal Department: J. Pampolina, J. Swanepoel. Strategy, Policy, and Review Department: R. Duttagupta. World Bank Group: K. Sjetnan. Senior Advisors to Executive Directors: Z. Abenoja (ST), S. Evjen (NO), A. Tolstikov (RU). Advisors to Executive Directors: S. David (AP), J. Garang (AE), U. Latu (ST), R. Lopes Varela (AF), R. Pandit (ST),

A. Urbanowska (SZ), D. Vogel (AG), S. Yoe (ST), K. Lok (CC), V. Lucas (GR), A. Sode (FF).

3. VIETNAM—2019 ARTICLE IV CONSULTATION

Ms. Mahasandana and Mr. Abenoja submitted the following statement:

Introduction

On behalf of the Vietnamese authorities, we would like to thank the IMF's Article IV mission team for the candid and constructive policy discussions as well as for their objective and comprehensive assessment. The authorities were encouraged by staff's positive assessment of the Vietnamese current economic situation, and took note of variance in views, particularly on Vietnam's external position in 2018.

In the context of rising trade tensions, heightened uncertainties and downside risks in the global economy, the Vietnamese economy in 2018 and early 2019 remained resilient, supported by strong macroeconomic fundamentals. Appropriate policy framework together with sound and timely policy responses will help ensure sustained economic growth in 2019. Our authorities remain vigilant against near-term risks and continue to be committed towards sound policies and upgrading institutions of macroeconomic management in order for Vietnam to successfully navigate its transition to upper middle-income status by 2030.

Latest economic developments and outlook

Our authorities remain committed to macroeconomic stability and private sector-led growth. They agree with staff's assessment that solid growth with low inflation will continue even as credit and monetary policies are becoming more prudent. In 2018, the economy remained strong and resilient with GDP growth of 7.1 percent, slightly above the 6.7 percent target, supported by robust external performance, firm domestic demand and a rebound in industrial production and construction. The momentum continued in the first quarter of 2019. The broad-based expansion is fueled by healthy growth in incomes and domestic consumption and by strong trade, tourism and remittances. Manufacturing is surging, the trade surplus has widened, and direct investment inflows remain strong. Headline inflation averaged 3.54 percent with core inflation of 1.48 percent in 2018. In Q1 2019, inflation increased slightly to 2.63 percent (ayoy), due to fuel and administrative services price increases but remains below the authorities' 4.0 percent target.

For 2019, the authorities project the economy to sustain its strong growth momentum driven by sound economic fundamentals, including gains in productivity, and more effective investment, particularly public investment. The authorities believe that the growth target of around 6.8 percent is achievable Headline inflation for 2019 is projected to be well-anchored at around 3.7 percent, below the target of 4.0 percent, and core inflation at 1.7 - 2.0 percent (yoy). This would be supported by a wide-range of administrative measures and structural reforms to streamline administrative and licensing procedures and to further ease the domestic private sector’s access to land and credit that would help level the playing field and boost potential growth.

The authorities concur with staff that downside risks to growth outlook have risen. As a small and highly open economy, global trade tensions and elevated trade policy uncertainty will likely weigh on the Vietnamese economy through trade, financial and expectations channels. Fully aware of these risks, the authorities, therefore, has been pursuing reforms and policies to reduce vulnerabilities and build buffers. The fiscal adjustment will be accelerated and its quality improved to help narrow infrastructure and social spending gaps and meet the coming challenge of rapid aging. Further modernization of monetary framework will be pursued while the supervision of the banking sector will be upgraded. The recapitalization of banks will continue while the adoption of Basel II standards is scheduled for 2020. The management of SOEs will be further strengthened to allow for privatization of government-owned companies in non-strategic sectors. Data provision and dissemination will also be further enhanced. Additional efforts are needed to improve governance and fight corruption, including through greater fiscal transparency and better public investment management, as well as a stronger AML/CFT framework and execution.

Fiscal policy

The Vietnamese authorities remain committed to significant fiscal consolidation. The state budget deficit is expected to stabilize at 3.46 percent of GDP in 2018, lower than the target. A strong economy and better tax administration helped buoy 2018 revenues, while tight disbursement of public investment contained spending. Gross public and publicly guaranteed debt declined to 58.4 percent of GDP at end of 2018 and is expected to further fall below 50 percent of GDP by end-2024. Growing reliance on non-debt creating deficit financing, including privatization, lengthening of debt maturities, and low long-term interest rates are all expected to help contain debt service costs. The authorities agree with staff’s assessment that Vietnam currently has some fiscal space given the downward sloping debt path and continued strong fundamentals and the quality of fiscal consolidation should be further improved.

For 2019, the authorities are committed to contain public debt of around 61.3 percent of GDP and budget deficit of less than 3.6 percent as targeted. To do so, the authorities plan to implement fundamental tax reform to broaden tax bases and reduce informality of incentives. In 2019, the authorities will be taking necessary measures to preserve strong revenue mobilization in the context of declining ODA and oil revenues. These would include the envisaged broad review of tax policy, tax base widening, and revision of tax laws (VAT, excises, and CIT). In this regard, the authorities appreciate the Fund's technical assistance to support the authorities' efforts in reviewing the current tax laws and strengthening tax administration. On the expenditure side, the authorities confirm that urgently needed public investments would be increased while rationalizing the public sector wage bill and improving public investment efficiency. The reforms recommended by the recent PIMA mission will be carefully considered for implementation at an opportune time.

The authorities' medium-term fiscal strategy aims to contain the budget deficit to 3.8 percent of GDP by 2020. The strategy involves drawing up a fiscal strategy to deal with the longer-term fiscal challenges related to rapid population aging which is projected to set in around 2030-35, and the adoption of high-quality, sustained measures that are balanced between revenues and expenditures while safeguarding public investment and social protection spending.

Public debt management has improved significantly with a more diversified maturity profile for T-bond issuances to allow for more active cash management and facilitate money market development. The authorities agree with staff's advice that more active cash management would help minimize net borrowing costs by avoiding unnecessary idle cash balances. Cash balance of around 9 percent of GDP as stated in the staff report includes not only cash balance of State Treasury but also the extra-budget funds (equitization, cumulative sinking fund etc.) and financial reserves of provincial government, which are required by law to be held at the Treasury. The authorities fully recognize the benefit of sweeping cash resources at the SOCBs into the State Treasury's single account at the SBV to consolidate and manage government's cash resources, thus minimizing its borrowing costs. Therefore, the authorities are considering Fund TA advice together with alternative models and approaches for designing a TSA that takes into account country specificities as well as preconditions and desirable sequencing for its successful implementation.

Monetary and exchange rate policy

In 2018, credit growth has declined to below 14 percent, lower than the SBV's 17 percent ceiling. Credit growth is expected to decelerate further in 2019. The authorities believe this is appropriate from both perspectives of monetary and financial stability since it helps contain excessive foreign exchange movements and close the credit gap while remaining supportive of growth objectives. Administrative allocation of credit will be retained for an extended period of time. When all banks are able to adopt Basel II standards and supervisory and regulatory preconditions are met, further relaxation or gradual phasing out of credit ceilings can be considered in order to move to a monetary policy framework based on indirect instruments.

The authorities welcome staff's view that the SBV has skillfully maintained orderly market conditions while ensuring ample liquidity amidst heightened volatility in 2018. During the year, the SBV allowed for greater two-way exchange rate flexibility within the current band to absorb shocks, including from volatile capital flows. The gradual reserve accumulation continued, as conditions allowed, with fully sterilized interventions. As a result, the depreciation has been less than those seen in some other emerging markets, only 2.2 percent against the U.S. dollar.

The authorities remain strongly committed to having a flexible exchange rate as a primary shock absorber and reiterate that market intervention was never intended to resist trend appreciation. However, as a small and highly open economy, external developments will continue to affect investment behavior, and periods of heightened capital flows and exchange rate volatility are inevitable. The authorities believe that prolonged periods of excessive exchange rate volatility could disrupt orderly financial market activity and eventually spill over to the real economy. Therefore, the authorities' key consideration is to ensure that levels of volatility are not excessive to preserve orderly market conditions, maintain public confidence and promote overall financial stability.

On the external balance assessment, the authorities observed that the different approaches yield opposite results. Moreover, authorities reiterate that the large current account surplus in recent years is attributed to Vietnam's structural factors which could not be fully explained by the EBA-lite model. As the structural adjustment takes time to materialize, the authorities emphasize that external rebalancing should not be borne solely by an exchange rate adjustment. A well-designed and appropriate mix of policies and measures should be pursued flexibly in line with changing economic circumstances specific to the country to achieve not only external rebalancing but also economic and financial stability. The current account surplus has been adjusting in the right direction and will continue to decline over the medium term. It is noted that the ongoing public investment and number of structural reforms would help strengthen domestic demand and moderate the current account surplus going forward.

Financial sector

The banking sector's performance has improved significantly in recent years and bank recapitalization is on track. The authorities agree with staff that bank earnings have risen in response to a shift to retail lending and consumer finance. The share of non-interest incomes related to corporate bond issuance, credit card, and cash transfer has increased and contributed to profitability. As large firms issue more corporate bonds, banks have increased credit to SMEs recently, thus improving SMEs' access to credit. Fintech helps banks to expand their customer base while fostering financial inclusion.

The resolution of legacy loans was also significantly stepped up, aided by the strong economy. NPL ratios have been declining and banks have aggressively resolved NPLs with the Vietnam Asset Management Corporation (VAMC). The SBV coordinated with institutions and the VAMC in aggresively implementing solutions stipulated in the 2016 – 2020 Masterplan of Restructuring of Credit Institution System and the National Assembly's Resolution No 42 on Piloting NPL Resolution, ensuring that the implementation is on track and in line with NPL resolution's and control's objectives, roadmap and plan, while preventing risks to the banking system's stability.

Strengthening bank capital is a top priority. As the January 1, 2020, deadline for implementing Basel II rules, approaches, the authorities formulated a bank-by-bank strategy for recapitalizing large state-owned commercial banks (SOCBs), using private money where possible and allowing SOCBs to retain earnings and equitization proceeds as needed. The authorities are fully aware that while there is progress in NPL resolution, NPL ratios remain high and there is a risk that it could be interrupted by a downturn in the economy. Bank balance sheets are still vulnerable to shocks and could be a risk to macroeconomic stability. Therefore, the authorities consider bank recapitalization, especially for SOCBs, a top priority and should be accelerated.

The authorities are of the view that vulnerabilities in the non-banking sector, if not properly contained, could have adverse impact on economic and financial stability. As rightly pointed out by staff, the authorities agree that there should be greater coordination and cooperation among key financial regulators in jointly addressing the bouts of volatility. Therefore, the authorities intend to form a multi-agency financial stability committee chaired by a Deputy Prime Minister to discuss system-wide risks and policy measures on a regular basis. The SBV is making substantial progress in improving its Financial Stability Report, and will consider to disseminate its main conclusions across key agencies so that it could better inform policy decisions. Going forward, the authorities will remain vigilant to changes in the financial landscape from Fintech developments and potential challenges arising from cybersecurity issues.

Structural Reforms

The authorities consider reform and modernization of macroeconomic frameworks and institutions a key priority. The Vietnamese government is committed to private sector-led growth and has shifted to a model that emphasizes the state’s enabling function over public production. Regulatory quality and ease of doing business have improved. The legal framework for SOEs was revamped with the creation of an independent State Capital Management Committee (SCMC) to oversee all large SOEs to improve accountability and efficiency, while leaving management and regulation with line ministries and regulatory bodies.

Moving forward, the authorities will focus on modernizing institutions of macroeconomic management, strengthening the supervision and management of the banking sector and SOEs and allowing 100 percent foreign ownership in areas not critical to national security; modernizing regulation, reducing the concentration of land in state hands, and strengthening data provision and dissemination.

Governance and AML/CFT

The authorities are strengthening its governance and anti-corruption efforts. The 2018 anti corruption law strengthens the system for assets declaration and is in line with best practices to enhance its effectiveness. Additional reform priorities for the future include greater fiscal transparency and stronger public investment management.

The authorities have conducted the National Risk Assessment (Assessment) on money laundering and terrorism financing for 2012 – 2017 period. The Assessment has identified the overall ML risk of the country as "higher medium" and the overall FT risk as "low". Based on the Assessment, the authorities have issued Decision No. 474/QD-TTg dated April 30, 2019 adopting the National Action Plan (Plan) to address deficiencies and risks associated with AML/CFT framework for the period of 2019-2020 as identified in the Assessment. The Plan aims at strengthening the effectiveness of AML/CFT regime in Vietnam, addressing any related risks and deficiencies identified in the National Risk Assessment, adopting FATF standards, and preparing for the upcoming APG assessment. The Plan also includes outreach activities on AML issues, training and regulatory capacity building, as well as closing regulatory gaps by November 2019.

Conclusion

The authorities will continue to implement their reform agenda to help realize the country's full growth potential. However, the authorities are also mindful of the considerable challenges that lie ahead and realize that sustainable results would take time to materialize. The authorities are fully committed and determined towards steadfast implemention of necessary structural reforms and policies that will continue to improve the investment climate and sustain economic growth, while providing buffers against external and domestic shocks. Growth will be made more inclusive and made more resilient with continued focus on fiscal prudence, well-grounded monetary management and financial stability, improved competitiveness of SOEs, and sound banking system. The depth of these reforms and the pace of their implementation would be appropriately calibrated to achieve the desired outcomes while minimizing unintended consequences.

Finally, the authorities are cognizant that these efforts need to be supplemented by support from multilateral institutions and other countries. In this light, our Vietnamese authorities would like to express their appreciation to the Fund in providing policy advice and invaluable technical support, and look forward to continued cooperation in the years to come.

Mr. Daïri submitted the following statement:

We thank staff for an informative set of papers and Ms. Mahasandana and Mr. Abenoja for their helpful buff statement. We broadly agree with the staff appraisal and emphasize the following points.

In a global environment characterized by mounting uncertainties and trade conflicts, Vietnam's economy continues to showcase resilience and impressive growth, reflecting. implementation of sound macroeconomic policies and far reaching structural reforms in recent years. Vietnam has become a destination of choice for FDI inflows. GDP growth—amongst the highest in the ASEAN region—is broad-based and inclusive, contributing to a marked reduction in poverty headcount to only 5 percent from nearly 60 percent three decades ago. We commend the authorities for these remarkable achievements and encourage them to leverage the economy's strong fundamentals to embark on a more ambitious reform agenda to tackle the short-term risks identified in the Risk Assessment Matrix (RAM), reinforce macroeconomic and financial stability, and further modernize the economy and boost potential growth. Vietnam's domestic sector lags behind the highly integrated FDI sector. Could staff elaborate on the authorities' strategy, in particular with regard to SOEs' reform and privatization?

Gradual fiscal consolidation and the authorities' proactive efforts to limit new public guarantees have helped reduce public debt and should continue. The budget deficit has been reduced, including from improved revenue mobilization, and public and publicly- guaranteed debt (PPG) is projected to decline to less than 50 percent of GDP in 2024 from a high of 60 percent of GDP in 2016. With looming challenges from population aging and climate change, we welcome the authorities' commitment to further fiscal consolidation and encourage them to give due consideration to broadening the revenue base, streamlining expenditure, and improving PFM, consistent with staff recommendations. Could staff elaborate on the authorities' views regarding the proposal to lower the fiscal anchor (the statutory PPG debt limit) from 65 to 50 percent of GDP?

Vietnam would benefit from continuous, prudent, financial liberalization. Important progress has already been achieved to modernize the monetary policy framework, contain credit growth, reduce NPLs, and strengthen bank's capital base, thus reducing financial vulnerabilities. We encourage the authorities to continue on this track, and also consider removing bank-by-bank credit caps to promote market-based credit allocation. As pointed out by staff, further plans to liberalize the financial system should be considered once the banking system is better capitalized and more progress is achieved in improving bank supervision and strengthening the macroprudential framework.

We welcome the authorities' commitment to flexible exchange rate policy, with intervention limited to smoothing excessive volatility. We agree with the authorities that staff assessment under EBA leads to diverging outcomes depending on the methodology used, which may make reaching a conclusion more difficult. We also support their view that external current account surplus has been declining and that ongoing structural reforms along with increased public investment will contribute to further rebalancing.

Structural and governance reforms remain critical to promoting private sector-led growth. The authorities are encouraged to give due consideration to staff recommendations to remove the remaining barriers to investment and address shortcomings in governance, transparency, and the AML/CFT framework. We are encouraged by the authorities' intention, as indicated by Ms. Mahasandana and Mr. Abenoja, to streamline administrative and licensing procedures for investment and to further ease domestic private sector's access to land and credit.

Finally, we welcome Appendix VII on the Fund's capacity development (CD) strategy in Vietnam. We support the extensive Fund technical assistance being provided to help modernize the monetary and financial sectors, strengthen fiscal systems and institutions, and improve data quality. We welcome staff comment on the extent to which the CD strategy takes into account the authorities' own strategy and priorities, a point emphasized by the Executive Board during the last review of the Fund's CD strategy.

With these remarks, we wish the authorities further success.

Mr. Saito and Mr. Minoura submitted the following statement:

We thank staff for their comprehensive reports and Ms. Mahasandana and Mr. Abenoja for their informative statement. We commend Vietnamese authorities for maintaining macroeconomic stability, resilient real economic growth and low inflation despite rising trade tensions and emerging market's volatility in 2018. While staff estimate a small positive overall impact on Vietnam from trade tensions reflecting gains in US market share from trade diversion, negative impacts through the regional manufacturing supply chain and confidence effects should be monitored carefully. In addition, the authorities have faced several challenges such as large fiscal needs for infrastructure, social spending and dealing with aging society and climate change. As we broadly agree with the thrust of staff's appraisal, we will limit our comments to the following points.

Fiscal policy

We welcome that the authorities have implemented significant fiscal consolidation and reduced public and publicly guaranteed (PPG) debt to 55.6 percent of GDP at the end of 2018 by 4 percent from its 2016 peak. Nevertheless, while the recent consolidated fiscal policy has enabled Vietnam to create some fiscal space, the authorities need to create more fiscal space to deal with longer term fiscal needs. We encourage the authorities to continue fiscal consolidation by adopting fundamental tax reform and rationalizing the public sector's employment.

We also note that it is essential for the authorities to prepare for aging. In this regard, we appreciate staff's detailed analysis on some possible reform plans for current pension system in Appendix IV such as inflation indexation, increase in retirement age, reduction in benefits, etc., and would appreciate it if staff could elaborate on their view on appropriate combinations and sequencing of those measures.

Monetary and Exchange rate policy

We agree with staff that modernization of monetary policy and gradual shift to inflation targeting (IT) are appropriate, enabling Vietnam to reduce the necessary amount of foreign reserves. We encourage the authorities to continue the modernization of the monetary policy framework, with the support by the TA from IMF. Noting that the authorities see the shift to IT will take between six and eight years, we welcome staff's views on timeframe suggested by the authorities and more detailed explanation on necessary reforms and their sequencing before shifting to IT.

We note of staff's view that the Vietnamese external position is substantially stronger than warranted by fundamentals, reflecting domestic distortion and residual dualism. We support the authorities' view expressed in Ms. Mahasandana and Mr. Abenoja's buff that external rebalancing should not be borne solely by an exchange rate adjustment as the structural adjustment takes time to materialize. We encourage the authorities to continue their efforts to reduce distortion that inhibits investment to reduce the external imbalance.

Financial Sector policy

The reduction of Non-Performing Loans (NPL) and the improvement of banks' profitability is welcoming. Having said that, we take note that there are still many tasks to be done such as adoption of Basel II standard and removal of bank-by-bank credit caps to enable credit allocation based on market mechanism. At the same time, as staff rightly point out, it is necessary to monitor the risk caused by Vietnamese banks' shift to retail lending. In this regard, we would like to know staff's view on the needed response by the authorities to address the risk.

We also note that recapitalization of State Owned Commercial Banks (SOCBs) is an urgent task for the authorities to build strong banking sector. We encourage the authorities to continue their effort to finalize the plan of recapitalization. We take note of staff's recommendation that fresh capital should be injected by government funds to recapitalize SOCBs. We would like to know budgetary implication of the recapitalization through injection of government funds.

Structural reform

We welcome the authorities' commitment to improve the accountability and efficiency of SOEs. At the same time, we concur with the staff that further enhancement is necessary for improvement of accountability and governance. We encourage the authorities to continue these efforts with support from IMF and Financial Action Task Force.

Mr. Geadah and Ms. Fadhel submitted the following statement:

We thank staff for the comprehensive reports and Ms. Mahasandana and Mr. Abenoja for the useful buff statement. Vietnam's growth remains strong, broad-based, and private sector-driven, despite rising trade tensions and volatility in emerging economies. Moreover, growth has been inclusive, which helped to reduce poverty, making spending on health and education an important aspect of Vietnam's growth model.

We welcome the authorities' commitment to fiscal consolidation, through measures to strengthen tax policy and administration and to streamline current spending. Fiscal consolidation efforts will benefit from measures to address fiscal accounting and reporting weaknesses, as well as from the new Public Investment Law which will soon be considered by the National Assembly. The introduction of GFSM standards will help to address partial data coverage and long reporting lags in fiscal accounting, and we positively note ongoing TA in that area. We see merit in staff's recommendation to lower the statutory PPG debt ceiling.

Financial discipline has advanced with tighter credit limits, including progress in resolving NPLs, the shift to retail banking, and the imminent adoption of Basel II requirements, as well as the strategy to recapitalize large SOCBs. We welcome the authorities' plans to further lower credit growth and for market-based credit allocation, which will improve the efficiency of credit allocation. We also note their intention to address elevated real estate and consumer lending and look forward to a stronger macroprudential framework. Further addressing data gaps in corporate, real estate, and private external debt will improve macrofinancial risk management. Continuing to modernize the monetary framework should remain a priority.

Ongoing efforts to strengthen economic institutions and fight corruption are important. We welcome the new anti-corruption legislation and work by the Financial Action Task Force Asia Pacific Group, with support from the IMF. New technologies and digitalization of the economy will bring economic and social dividends. However, there is a need to strengthen regulatory and economic institutions to help mitigate potential risks from the digital economy and cybersecurity. We commend the authorities on their increasing focus on climate change adaptation and green growth and encourage them to keep this issue a priority.

Ms. Levonian, Ms. McKiernan and Mr. Mooney submitted the following statement:

We thank staff for their report and Ms. Mahasandana and Mr. Abenoja for their informative buff statement. The real economy in Vietnam appears to be resilient. Public finances are being consolidated, bank capital rules have been strengthened, and the authorities have made significant progress in tackling corruption. Nevertheless, Vietnam faces risks in the form of trade policy uncertainty, domestic reform implementation and, in the longer term, an aging population. We agree with the thrust of staff's assessment and offer the following points for emphasis.

We welcome recent increases in environmental and excise taxes. However, we agree with staff that a more fundamental tax reform is required to broaden the base and we encourage authorities to carry out a wide-ranging tax policy review encompassing both direct and indirect taxation. Like staff, we commend the authorities for lowering Vietnam's PPG debt in recent years and would welcome the introduction of specific fiscal measures to ensure timely implementation of deficit targets while raising the quality of fiscal consolidation. We positively note the reduction in inflation from high double-digits to 3 percent, as illustrated in the SIP.

We welcome the adoption of Basel II standards and the associated ongoing strengthening of the banking sector. We commend the progress to date in terms of reducing NPLs and encourage the authorities to ensure that this positive trajectory continues. In relation to the AML/CFT framework, we welcome the National Action Plan to strengthen the framework and encourage authorities to address the remaining legislative gaps.

We positively note authorities' efforts to tackle corruption, particularly the revamped 2018 anti-corruption law. We agree with staff that further progress is required in the areas of fiscal transparency and public investment management. Finally, we welcome the introduction of environmental protection charges for wastewater and emissions to promote green and sustainable economic development.

Mr. Lopetegui and Mr. Vogel submitted the following statement:

We thank the staff for the reports and Ms. Mahasandana and Mr. Abenoja for their helpful buff statement.

Reforms pursued over the years have allowed Vietnam to grow rapidly. The economy opened up to the world, with more private sector participation, growth was appropriately distributed, public finances consolidated, and in preparation for the future, access to technology and digitalization has expanded. Nonetheless, we note that Vietnam will have to face important risks and challenges, which include substantial transformations in terms of economic orientation and institutional reforms.

We welcome Vietnam's inclusive growth attained in recent years, which is reflected, among other things, in an impressive reduction of poverty, an expansion of public health care coverage, and improvements in education, as noted in paragraph 13. Fiscal sustainability is essential in order to maintain these achievements. In this regard, we note in the Selected Issues Paper ("Spending needs to reach sustainable developments goals") that financing for additional public spending for Sustainable Development Goals is limited, among others, due to declining official development assistance. Thus, reforms in the tax system and revenue administrations, as well as improvements in public financial management, should be priorities, as rightly advised by staff.

We have some reservations regarding staff's assessment of the country's external sector. First and foremost, we would like to highlight the large levels of errors and omissions, as reported in Table 2, which raise substantial doubts about the accuracy of measurement of balance-of-payment flows. This is an issue that should be appropriately highlighted, and in this regard, we welcome the forthcoming revisions to national income and balance-of-payments' data. With the current account—as currently measured—posting surpluses in the order of 2 percent of GDP over the past years, perhaps it is too categorical to conclude that "the external position is substantially stronger than warranted by fundamental and desirable policies". While we recognize that distortions inhibiting investment would help reduce the external surplus, staff also notes that foreign direct investment in Vietnam has been (and is projected to be) buoyant. On the other hand, we would agree that making the exchange rate more flexible within the band should reduce a possible excess surplus in the current account, and we are not fully convinced that international reserves, above 20 percent of GDP, are low. Vietnam features a large level of imports and exports to GDP, and the possibility that both co-move in the face of shocks, which would in turn, make international reserves less necessary—other things equal—to absorb external shocks. We would appreciate staff's comments on all these issues.

We are encouraged by the authorities' firm decision to resolve non-performing loans and recapitalize banks. The reforms related to the financial system mentioned in the staff report, including the introduction of Basel II requirements, seem to go in the right direction. We fully share the staff's recommendation that liberalization should go hand in hand with the creation of a modern macro-prudential system to replace the administrative allocation of credit.

We are encouraged by Vietnam's preparation for the digital economy. The report eloquently illustrates the country's progress in this regard, including the impressive advances in terms of connection speed and internet users. This progress should contribute to some issues highlighted in the report, like high levels of cash transactions, lack of registrations of property and land use.

We share staff's comments that Vietnam's steps to strengthen economic governance and fight corruption are welcome. Vietnam still ranks low in indices of transparency. We are encouraged by the priorities highlighted by the authorities regarding the simplification of taxation and administrative procedures, making land use regulations more transparent, and revising enterprise law, among other initiatives reported in paragraph 45. Progress on strengthening the AML/CFT framework and its implementation would also be welcome.

With these comments, we wish Vietnam and its people every success in their future endeavors.

Mr. Just and Mr. Reininger submitted the following statement:

We thank staff for their insightful reports on Vietnam, and Ms. Mahasandana and Mr. Abenoja for their comprehensive buff statement.

The Vietnamese economy has had an impressive performance of private-sector led, non-inflationary and inclusive growth for several years, with a 10-year high of 7.1 percent achieved in 2018. The ongoing transition from agriculture to manufacturing and services as well as the comprehensive overhaul of policy approach contributed to this success. Faced with external risks in the short term and challenges related to aging and climate change in the longer run, it is all the more important that the authorities maintain the positive reform momentum and keep abreast of the rapid global digital innovation. We agree with the thrust of the staff's appraisal and add the following comments for emphasis.

Continue fiscal consolidation while improving its quality. We commend the authorities for reducing the fiscal deficit, thereby contributing to lower public debt, while we also note that slower public investment and the authorities' reluctance to recapitalize state-owned commercial banks (SOCBs) have contributed to this decline. Going forward, we encourage the authorities to implement a tax policy review and establish registries for land and property and to contain expenditures other than social spending and infrastructure investment. As for changes in the pension system, we understand that high informality makes expansion of coverage difficult, but even more so we see the need to ensure that vulnerable groups are adequately protected in old age. In this context, we are skeptical that basing pension calculation on the five years before retirement instead of lifetime employment would address this challenge sufficiently, given the limited coverage. Staff comments are welcome.

On fiscal reporting, if integration of the social security is not feasible in the short term, we encourage the authorities to include at least other extrabudgetary funds (EBFs) into the GFSM representation soon.

Continue pursuing a cautious gradual approach to changing the monetary framework while accumulating further reserves and preparing the banking sector. We commend the authorities for successfully conducting their monetary and exchange rate policy under the current framework. We support the authorities' policy of gradual reserve accumulation as the current level is relatively low compared to peers. More generally, we consider the envisaged sequencing of addressing banking sector weaknesses, developing the macroprudential toolkit and liberalizing the credit allocation mechanism as pre-conditions for major adjustments in the monetary framework.

Continue strengthening financial market policies by containing credit growth, committing to Basel II adoption by 2020 and establishing clear macroprudential rules.

We welcome the recent progress in containing credit growth and resolving part of the legacy NPL stock, and encourage the authorities to adopt Basel II standards by January 2020 without exceptions and, hence, to step up their efforts to have the SOCBs adequately prepared and capitalized. We note that several prudential measures to constrain real estate and consumer lending as well as short-term funding have already been taken, and we welcome the authorities' request for IMF TA on financial stability to strengthen the macroprudential framework, including by introducing borrower-based measures. In this context, we note that dollarization appears to be a widespread phenomenon in Vietnam and wonder whether this relates only to the liabilities side or also to the assets side, including lending to households, and whether appropriate limits on net foreign currency positions are in place. Staff comments are welcome.

Continue with ongoing structural reforms and improvement of governance. We welcome the important amendments to the land law, the enterprise law and the securities law envisaged by the authorities and highlight the need to require broader application of IFRS both in the banking and in the enterprise sector, including SOEs. The Fund's TA will be beneficial to enhance data provision aligned with international standards, particularly for the sectoral international investment position, the banking sector, SOEs and the real estate market. As for governance, we underscore the pivotal role of registries for land and property beyond tax policy purposes also for implementing the amended anti-corruption law. Moreover, regarding the authorities' AML/CFT efforts, we encourage them not to hesitate in closing also the legislative gaps concerning customer due diligence for politically exposed persons.

Mr. Rosen and Ms. Svenstrup submitted the following statement:

We thank staff for their comprehensive report, including the Selected Issues Papers, and Ms. Mahasandana and Mr. Abenoja for their helpful buff Statement.

Vietnam continues to experience strong growth thanks to the authorities' ongoing commitment to wide-ranging market reforms. Fiscal consolidation is on track, the authorities are making progress to strengthen and deepen financial markets, and efforts to address governance challenges are progressing. Nonetheless, we agree that more effort is needed to build a modern sustainable economy and enhance buffers to respond to shocks. Further exchange rate flexibility is critical to facilitate smooth adjustment to shifts in the external environment. We broadly agree with staff's policy recommendations and offer a few comments for emphasis.

We appreciated staff's well-integrated discussion of Vietnam's external position and agree that it is substantially stronger than warranted by fundamentals. While we recognize there may be a need for some reserve accumulation over time, we urge the SBV to avoid excessive intervention and allow for movements in the exchange rate that reflect economic fundamentals, including gradual appreciation of the real effective exchange rate to help reduce external imbalances. We also agree with staff that removing barriers to domestic investment – such as improving access to credit and land use – along with allowing greater flexibility within the band would help to reduce external imbalances in the near term. We also encourage the SBV to continue efforts to strengthen its monetary policy framework, laying the groundway for an eventual inflation targeting regime, which will also facilitate the shift away from management of the exchange rate and reduce the need for precautionary reserves.

The SBV has appropriately tightened monetary and credit policies, although further effort is needed to reduce credit growth targets. We agree that an eventual move to market-based credit allocation mechanisms would help to boost productivity. We urge the authorities to accelerate NPL resolution and bank recapitalization in an effort towards full implementation of Basel II by January 2020.

The authorities' commitment to fiscal consolidation is helpful to ensure that PPG debt remains on a downward trajectory. We agree that further consolidation efforts should focus on increasing the efficiency of spending and broadening the tax base, so as to protect growth and create more space for development expenditures. Efforts to improve public debt management are welcome to reduce borrowing costs and improve sustainability, including scrutiny of public guarantees. We welcome the new Public Investment Law. Recognizing large public health and infrastructure investment needs, we urge the authorities to implement PIMA recommendations to increase the efficiency and accountability of public spending.

We strongly welcome the authorities' efforts to strengthen economic institutions, tackle corruption, and improve governance, which will be important to enhance confidence and ultimately private sector investment. We also support efforts to improve the functioning of SOEs by requiring them to release financial statements and hire external auditors. Could staff provide more context on the status of operations and effectiveness of the State Capital Management Committee? We also encourage the authorities to continue to strengthen the AML/CFT framework and execution in line with FATF standards.

Finally, we welcome the forthcoming revisions to national income and balance of payments data. It is imperative that the authorities continue to make progress to enhance data transparency and accuracy. This is a critical part of the economic modernization process and is necessary to underpin stronger investor confidence and private investment. We appreciate Fund technical assistance in this area.

Mr. Gokarn and Ms. Dhillon submitted the following statement:

We thank the staff for the well written papers and Ms. Mahasandana and Mr. Abenoja for their informative buff Statement.

Despite trade tensions and volatility in emerging economies, Vietnam's economy has continued to show fundamental strength, supported by robust domestic demand and export-oriented manufacturing and tourism. Vietnam has made sound progress in reducing poverty and maintaining macroeconomic stability. Vietnam's medium-term outlook projects growth at a sustainable pace. Being a small and highly open economy, vulnerabilities remain from the external setting, trade and global financial conditions. We are encouraged that the authorities continue to be committed to sound policies to navigate their transition to upper middle-income status by 2030. As we broadly concur with the thrust of the staff appraisal, we would like to limit our comments to the following.

On the fiscal front, a balanced mix of revenue and expenditure measures will form the crux of consolidation and build on the gains attained. We commend the authorities for implementing significant fiscal consolidation, including better revenue administration, prudent spending and debt containment. The resulting fiscal space can be effectively used for public investments, protecting social spending and filling the spending gap created by declining official development assistance. In this context, could staff elaborate on the areas and the scale of financing impacted by the altered ODA levels? We align ourselves with the staff suggestion for focusing on revenue augmentation complemented with tax reform and quality spending for infrastructure. Beyond this, an appropriate policy mix to address challenges arising from aging and climate change should be mainstreamed.

On the monetary stance, we appreciate the moderate tightening of monetary and credit policies and the prudential measures to contain real estate and consumer lending. We support staffs call for realistic assessments of the constraints imposed by dollarization and improved data for risk management. Reassuringly, the modernization of the monetary framework is also under way and the authorities have underscored that the shift to inflation targeting would take between six and eight years. Given that there is an ongoing TA, is staff supportive of this timeline to shift to inflation targeting?

Continuous strengthening of the banking sector with a sustained resolution of NPLs and strong supervision would be crucial for stability. Retail banking, improving SMEs’ access to credit, progress with bank recapitalization and the organic emergence of a capital market, are all efforts undertaken by the authorities and deserve praise. Authorities have reaffirmed their commitment to bank restructuring, including recapitalization of the banks through retained earnings and reaching out to foreign strategic investors. Could staff offer more insights on strategy and sequencing planned for the recapitalization of banks?

Positive acknowledgement by the authorities to deepen the structural reforms and modernize the frameworks and institutions is reassuring. Prioritized efforts on anti-corruption measures and for strengthening the anti-money laundering framework and asset declaration require specific attention. Alongside, an enabling environment for boosting investment, including action on land ownership, and digitalization would reap substantive dividends and sustain economic growth. Finally, we would stress on continued efforts for building transparency and data availability from a governance standpoint.

With these comments, we wish the authorities the best in their future endeavors.

Mr. Heo and Ms. Preston submitted the following statement:

We thank staff for an insightful set of reports and selected issues analysis and Ms. Mahasandana and Mr. Abenoja for their informative buff statement. Vietnam has a strong track record, with three decades of economic reforms transforming one of the world's poorest nations to a lower middle-income country. As one of the world's fastest-growing economies, trade has provided enormous benefits for Vietnam. We encourage the authorities to continue with domestic reforms efforts to consolidate hard-won gains and position the economy to successfully navigate the future challenges arising from climate change, large infrastructure needs and rapidly aging demographics. We agree with the staff appraisal and note the large degree of agreement between the staff and authorities. We offer the following comments.

Remarkably, Vietnam remains well positioned to benefit from global trade, even in light of current tensions. In addition, staff set out that international firms have been moving facilities to Vietnam in recent years in response to the rising costs in China. Vietnam remains well placed to benefit from shifts in investment, especially should trade tensions accelerate this trend. We would welcome further elaboration from staff as to the longer-term policy implications for the authorities and potential regional spillovers of a shift in supply chain orientation. Notwithstanding this, we recognize the authorities' efforts to build resilience and reduce vulnerabilities in light of continued global trade tensions and risks associated with elevated policy uncertainty. We also commend the authorities on their efforts to establish a number of free trade agreements that should help drive future productivity.

We welcome recent improvements in the fiscal position that have put debt on a downwards path, signaling a strong commitment to fiscal sustainability. It will be important to continue fiscal consolidation efforts, absent any adverse shocks. As outlined in the buff statement, we welcome the authorities' commitment to accelerate and improve the quality of the fiscal consolidation to help narrow infrastructure and social spending gaps and meet the coming challenge of rapid aging. We note staff advice to lower the statutory debt ceiling to 50 percent of GDP as this will create additional fiscal space. We are interested in how lowering the statutory ceiling, in and of itself, helps to create fiscal space. Can staff elaborate on the mechanics of this? Are staff expecting that the ceiling would be breached (and the consequences of this would be minimal) should shocks materialize in future?

Full compliance with Government Financial Statistics is necessary to ensure reliable estimates of the general government position and importantly inform future policy choices. IMF technical assistance in this area is welcome. Can staff explain in more detail the practice of carry forward revenue and spending as it applies in Vietnam and their associated concerns?

Given the current exchange rate regime, staff recommend both nominal appreciation of the currency and the further accumulation of international reserves. How should the authorities strike the right balance between these objectives? What key steps or milestones do staff envisage in the transition to inflation targeting and a fully flexible exchange rate regime over the next few years? We also welcome a continued focus on financial market deepening, a necessary foundation for increased resilience and flexibility. Can staff comment about the prospects for privatization of state-owned banks over the longer term?

Important reforms are needed to strengthen private investment, improve the efficiency of public investment and tackle domestic trade barriers including non-tariff barriers. We agree with staff that the strong economy provides an opportunity to enhance resilience to shocks, proceed with more ambitious modernization initiatives, and continue with governance reforms. We welcome the authorities continued commitment towards sound policies and strengthening of institutions in order for Vietnam to successfully navigate its transition to upper middle-income status by 2030.

Mr. Sigurgeirsson and Mr. Evjen submitted the following statement:

We thank staff for the good report and Ms. Mahasandana and Mr. Abenoja for their informative buff statement. The outlook for the Vietnamese economy continues to be positive with growth of about 7 percent with contained inflation, although there are downside risks related to global trade tensions and possibly slowing growth among trading partners. Longer-term challenges remain, including population aging, climate change, digitalization, high-rates of non-performing loans, recapitalization of SOCBs, improving governance, and combating corruption. We broadly support staff's assessment and recommendations and would like to highlight the following points for emphasis.

We commend the authorities for their course of fiscal consolidation in recent years. The countercyclical fiscal tightening has reversed the rapid rise in public debt and helped create fiscal space. We encourage the authorities to continue building fiscal space to address risks associated with SOEs and to meet longer-term challenges associated with aging and climate change. We support the plan to strengthen tax policy and administration and contain current spending. At the same time, social spending should be protected. We note that privatization of SOEs has been on the reform agenda and would appreciate staff's view on the progress.

We welcome the progress on the modernizing of the monetary policy framework with a shift from exchange rate stability to price stability as the nominal anchor. This should enhance resilience by allowing for greater exchange rate flexibility. We note positively that capacity development provided by the Fund is expected to play a key role through a multi-year project.

Further strengthening of the financial sector is needed. Although large quantities of non-performing loans are being resolved, the level is still high and should be carefully monitored. We welcome the progress in recapitalizing banks and encourage further improvement so that all banks will meet the Basel II rules by the January 2020 deadline. We welcome that the Central Bank has stepped up prudential measures such as a cap on bank's short-term funding. We agree that strengthening the macroprudential framework, including through implementing loan-to-value and debt service-to-income requirements for mortgages and consumer loans may prove useful when dealing with potential credit risks. Finally, the authorities should finalize their plans to recapitalize systemic SOCBs which at the current stage are facing significant capital shortfalls.

Despite progress in recent years, additional efforts are needed to improve governance and fight corruption. We are encouraged by the numerous measures taken since 2016, including a revamped anti-corruption law and linking of databases on taxation, AML, and in other areas. We recognize that it is too early to see the effects of these efforts on corruption. At the same time, we agree with staff that additional efforts will be needed to ensure further progress in improving governance and combating corruption. We welcome the National Action Plan to strengthen the AML/CFT framework and execution in line with FATF standards.

Finally, we encourage the authorities to consent to the Fund's publication of the Article IV-report.

Mr. Meyer, Mr. Doornbosch, Mr. Psalidopoulos, Mr. Tolici, Mr. Di Lorenzo and Ms. Lucas submitted the following statement:

> We thank staff for the concise set of papers and Ms. Mahasandana and Mr. Abenoja for their informative buff statement. We commend the Vietnamese authorities for their continued economic and development performance of the last 30 years, reflected in a remarkable fivefold increase in GDP per capita and the reduction of poverty rate from more than 60 percent to less than 5 percent. While their prudent macroeconomic management, reinforced by the social-development agenda, strengthened the resilience of the economy, the external and internal downside risks are increasing. Weaker external conditions, rising trade policy uncertainties and tighter credit conditions will likely result in a soft landing of growth toward the economy's potential growth rate. We encourage the authorities to make further progress with fiscal consolidation, modernizing the monetary policy framework, enhancing the macroprudential framework, fighting corruption and reforming the state-owned enterprises to increase the economy's resilience and boost long-term economic potential. Since we broadly share the thrust of the staff appraisal, the following comments are provided for emphasis.
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> Continued fiscal consolidation is critical to keeping the public debt on a declining path and at the same time to further improving the quality of the fiscal adjustment. We commend the authorities for implementing a fiscal consolidation that resulted in a decrease of the state budget deficit from 5.5 percent in 2014-2016 to about 4.6 percent of GDP in 2017-18 and in the decline of Public and Publicly Guaranteed debt from 59.6 percent in 2016 to 55.6 percent of GDP in 2018. Despite the recent reforms, fiscal risks stemming from contingent liabilities of the state-owned enterprises, banks and the social security system remain elevated and should be addressed without delay. Further efforts are needed to broaden and diversify the tax base, strengthen and modernize revenue mobilization and advance with expenditure rationalization and prioritization in order to create the fiscal space needed for dealing with the longer term social and development challenges (e.g. ageing, climate change, achieving SDGs goals). We echo staff's call for stronger public investment management. In that regard, considerations could be given to private funding via PPP, as suggested by PIMA, while remaining vigilant to risks. To successfully tackle the development issues, the authorities may need multi-annual technical assistance in public finance management from the international institutions and development partners, in addition to the Fund TA on fiscal data and statistics. Staff comments are welcome.

We welcome the authorities' plan for modernizing the monetary policy framework. We support the establishment of the inflation rate as the monetary policy nominal anchor, and eventually moving to an IT framework as this would enhance macroeconomic stability and resilience. The Counterfactual Policy exercise for FX flexibility (Appendix V, pg. 56) suggests that systematic FX interventions under the pegged regime have contributed to stabilizing the nominal FX rate, inflation and output growth. However, we concur with staff that enhancing FX flexibility is a key step for modernizing the monetary policy framework and moving toward the inflation targeting regime. This policy change will allow the authorities to better adjust against external shocks and enable the State Bank of Vietnam (SBV) to build additional forex reserves, which currently stand at 76 percent of the ARA metric, significantly below regional peers and the standard metric of imports coverage. We note the SBV's multiple objectives and the lack of both political and operational independence. As these are crucial prerequisites for an effective inflation-targeting regime, we encourage the authorities to address these limitations by clarifying the SBV mandate, as well as by empowering the central bank to conduct monetary policy without government interference. Appropriate central bank communication and proper sequencing of the monetary policy modernization process with financial sector macroprudential measures are essential.

With respect to the banking sector, we welcome the current reform steps and urge the authorities to implement them fully. We take positive note of the reduction of the level of NPLs and encourage the authorities to make further progress. The adoption of Basel II could be used as an opportunity to strengthen the banking sector as a whole. Consideration should be given to replace administrative allocation of credit with market-based mechanisms.

Structural reforms focused on strengthening economic governance, private sector development and business climate improvement are warranted to increase the resilience of the economy and foster long-term sustainable growth. We concur with staff that for the private sector to take the lead role in promoting investment and supporting inclusive and sustainable growth, the authorities must take swift measures to reduce the state footprint, strengthen the fight against corruption and accelerate administrative reform. We encourage the authorities to continue their efforts to equitization, divestment and reform of SOEs while removing regulatory barriers to foreign ownership of public companies. The establishment of an independent State Capital Management Committee to improve SOE's accountability and efficiency is a welcome step in this direction. Further efforts are needed to improve land access procedures and facilitate private sector access to credit. We encourage the authorities to reform tertiary and vocational education to reduce the skills mismatches and prepare the labor force for the digital economy.

Mr. Mouminah, Mr. Alkhareif and Mr. Keshava submitted the following statement:

We thank staff for the well-written set of reports and Ms. Mahasandana and Mr. Abenoja for their helpful buff statement. We are in broad agreement with staff's analysis and policy recommendations and would limit our remarks to a few issues.

We welcome the current economic momentum, supported by strong fundamentals, prudent economic management, and wide-ranging reforms. Looking ahead, we encourage the Vietnamese authorities to sustain the reform momentum for the private sector-led expansion, reduce vulnerabilities, and build buffers against the background of heightened external risks. We are pleased by the notable progress in poverty reduction and achieving inclusive growth. In this connection, the authorities should persevere with their efforts to implement the 2030 Agenda to attain the Sustainable Development Goals.

The plan to continue gradual fiscal consolidation is a step in the right direction to create more fiscal space. To this end, we welcome the focus on further strengthening tax policy and administration and containing current spending and we look forward to continued progress. The growing reliance on non-debt creating deficit financing, lengthening of debt maturities, and low long-term interest rates are also encouraging to help enhance resilience. Considering the large infrastructure spending needs, the authorities should consider PIMA recommendations at the earliest to help enhance the level and efficiency of investment. On PPPs, we take positive note of the authorities' plans to limit risks related to PPP procurement and management.

The multi-year plan to modernize the monetary framework is noteworthy. Here, we consider that a cautious approach is appropriate as credit growth targets are gradually phased out with banks transitioning to Basel II capital standards starting in January 2020. We would welcome staff elaboration on the planned intermediate steps before switching to inflation targeting (IT), which is expected to take several years. As regards the staff's assessment of external position to be substantially stronger than warranted by fundamentals and desirable policies, we take positive note in the buff statement that the current account surplus has been adjusting in the right direction and will continue to decline over the medium term. We also note that the ongoing public investment and structural reforms would help strengthen domestic demand and moderate the current account surplus. On the reserve coverage, we echo staff recommendation to continue gradual reserve accumulation as reserves are only 76 percent of the ARA metric at end-April 2019. In the financial area, we look forward to the authorities' plans to recapitalize state-owned commercial banks.

Finally, structural reforms should continue to reinforce broad-based growth. In this regard, priorities include further addressing the remaining barriers to investment, streamlining regulatory and licensing requirements, improving governance, and strengthening the AML/CFT framework.

With these remarks, we wish the authorities further success.

Mr. Jin and Ms. Lok submitted the following statement:

We thank staff for the comprehensive set of reports and Ms. Mahasandana and Mr. Abenoja for their informative buff statement. We are pleased to note that Vietnam continued to achieve impressive, broad-based growth despite rising trade tensions and heightened uncertainties in the global economy. Nevertheless, the country's economic outlook is facing downside risks both externally and domestically. We encourage the authorities to stay vigilant and maintain sound macroeconomic policy management to achieve long-term, sustainable, and inclusive growth. We broadly agree with staff's appraisal and would like to confine our comments as follows.

The authorities have made notable progress in fiscal consolidation in recent years, which resulted in the lowering of gross public and publicly guaranteed debt. Going forward, we encourage the authorities to continue to pursue quality fiscal adjustments to create additional space that can allow them to flexibly respond to different growth scenarios. Measures to strengthen tax policy and administration and contain current spending are certainly welcome steps. We take positive note from the buff statement that a fundamental tax reform to broaden the tax base and reduce informality of incentives is in the planning. Meanwhile, the sizeable social and infrastructure spending needed for attaining the Sustainable Development Goals (SDGs) underscores the importance of spending and investment efficiency. To this end, we encourage the authorities to continue to strengthen Vietnam's fiscal institutions as well as overall public financial and investment management.

We welcome the authorities' strong commitment to exchange rate flexibility and intervening in the market only for maintaining orderly market conditions. The modernization of the monetary framework and shift to inflation targeting should be approached with care, in a well-sequenced manner at an appropriate pace. On the external sector, we take comfort from the fact that the current account surplus is set to decline over the medium term, and ongoing reforms would support this trend. Noting the fact that the EBA-lite model does not fully account for Vietnam's specific structural characteristics, we encourage staff to exercise care when interpreting and communicating model estimates.

Conditions in the banking sector has improved and we support the efforts by the authorities on multiple fronts to strengthen discipline and resilience. The establishment of the multi-agency National Financial and Monetary Advisory Council would help facilitate coordination and enhance information sharing across agencies, thereby contributing to efforts in mitigating and tackling system-wide risks, including those arising from the non-bank sector. Further plans to liberalize the financial system should be carried out carefully and with necessary preconditions in place, such as a well-capitalized banking system, a sound prudential supervisory framework, a strong set of macroprudential tools, and sufficient capacity for financial stability assessment. We encourage staff to assist the authorities to develop the relevant capacity where needed.

On the structural front, we welcome the authorities' emphasis on modernization and their commitment to support private-sector led growth. With a large internet and digital-savvy population, Vietnam is well-placed to harness the opportunities from technological innovation. To fully reap the benefits of the transition into a digital economy, it is important for the authorities to create an enabling environment while being mindful of potential risks. Meanwhile, building on the progress achieved in recent years, the authorities should step up their efforts in improving governance and fighting corruption. Continued work on strengthening the AML/CFT framework is also critical. Further improvements to data and statistics would also help better inform the authorities' policy decisions. Noting the significant boom of FDI inflows in recent years, could staff comment on the absorptive capacity of Vietnam, especially given the already low unemployment rate which stood at around 2.2 percent in 2018?

With these remarks, we wish the authorities every success in their policy endeavors.

Mr. Trabinski, Mr. Skopiec and Ms. Urbanowska submitted the following statement:

We thank staff for their candid set of reports and Ms. Mahasandana and Mr. Abenoja for their helpful buff statement. We broadly concur with staff's assessment of the economic outlook and the balance of risks, and we would like to offer the following comments.

Vietnam's growth has remained resilient, supported by strong fundamentals. The economy continues to experience a broad-based expansion, backed by robust domestic demand. Additionally, inflation remains subdued, there are no apparent signs of overheating, and the external position is strong. We welcome the authorities' commitment to macroeconomic stability and a steadfast implementation of necessary structural reforms. This said, the country faces important challenges. External risks primarily related to weaker-than-expected global growth, and uncertainty on trade policy remains a source of vulnerability. Domestically, banking sector fragilities continue to pose risks to financial stability, while in the long-term unfavorable demographics could put notable pressure on the pension system.

Gradual countercyclical fiscal tightening seems warranted. We welcome the authorities' commitment to fiscal adjustment, resulting in public debt reduction and the creation of fiscal buffers. Nevertheless, further consolidation is needed in light of the aging population and climate-related vulnerabilities. To further safeguard public finances and ensure fiscal sustainability, a more fundamental tax reform is needed. We support the revenue measures to reverse the downward trend, as proposed by staff. The provision of Fund TA is welcome in this regard. On the expenditure side, increased public investments and improvement in investment quality remains critical, as does safeguarding social spending. We thus welcome the recently undertaken PIMA, and we encourage the authorities to follow through on its recommendations. Additionally, enhancing public sector accounting and reporting will be key.

We welcome the SBV's plans to modernize the monetary policy framework. Allowing for greater exchange rate flexibility would help reduce the external imbalance by facilitating nominal appreciation. However, the shift to inflation targeting requires several preconditions to be met, in particular replacing administrative allocation of credit with market-based mechanisms, reducing the level of dollarization, and further liberalization of the financial system. Fund TA should facilitate the transition. Financial liberalization should be preceded by strengthening the macroprudential framework and bank supervision. We agree that the plans to adopt Basel II standards provide an opportunity to restructure and consolidate the banking sector.

Further structural reforms are needed to reduce barriers to investment and support inclusive growth. Improving the business climate by creating a level-playing field for both domestic and foreign companies would boost growth and allocate resources more efficiently. The authorities should focus on reducing land ownership concentration and the creation of a high-quality infrastructure. Moreover, strengthening governance and combating corruption will be essential to increase the efficiency of public spending and support private sector development.

Mr. Guerra and Ms. Arevalo Arroyo submitted the following statement:

We thank staff for the comprehensive set of papers and Ms. Mahasandana and Mr. Abenoja for their helpful buff statement. Sound fundamentals and strong commitment by the authorities have contributed to the resilience and rapid inclusive growth of the Vietnamese economy. Nevertheless, rising trade tensions and heightened uncertainty pose important risks to the outlook. Fiscal sustainability, strengthening of the banking sector and deepening of the financial markets, as well as broader-based growth and structural reforms will be required for sustainable growth in the medium term.

We welcome the ongoing fiscal consolidation efforts and the commitment to bring public debt to a downward path, but the quality of the adjustment should be improved. Implementation of tax reforms and increase revenue mobilization will be necessary. We take positive note that PIMA recommendations are reflected in a new Public Investment Law and that the authorities are drafting a law to limit the risks related to procurement and management of PPPs. We agree with staff that public debt management requires further improvement and flexibility. Can staff comment on specific measures that the authorities will take in this regard in the medium term?

We agree with staff on the need to modernize the monetary policy framework by anchoring monetary policy to a credible, strict IT regime and granting operational independence to the SBV. In this regard, the gradual introduction of increased exchange rate flexibility will be key to the modernization efforts. We welcome work by staff in Appendix V in this regard. We agree with staff that in the near term there is scope to allow greater exchange rate flexibility within the three percent band and that this will be helpful to reducing the external imbalance. Moreover, clearly establishing operational independence by amending the SBV law is critical for the modernization efforts. We take positive note of the staff’s call for a realistic assessment given capacity constraints imposed by dollarization and the need of a well-capitalized banking system. We also welcome that this process is undertaken with technical assistance from the Fund. Can staff comment if the authorities have a specific timeline for the modernization of the framework and how it would be sequenced?

We welcome progress on the reduction of excessive credit growth, NPL resolution and bank recapitalization, but potential risks remain. Although NPLs are on a downward trend, monitoring should continue in case of a potential shock that could interrupt this decrease. We agree with staff that the deadline for the implementation of Basel II should be regarded as an opportunity to restructure the bank sector and liberalize the financial system. However, liberalization should be carefully sequenced, ensuring adequate capitalization of banks and strengthening of the macroprudential framework, bank supervision, and capacity to undertake financial stability assessments. We take note, as stated in the buff statement, of the authorities' intention to form a multi-agency financial stability committee.

Reducing the role of the public sector in the economy and advancing SOE reform should be priorities to improve the business climate and boost private sector led growth. Vietnam should take advantage of the positive reform momentum to implement an ambitious structural reform agenda to address economic distortions, reduce the state footprint, and improve governance.

We welcome the work and priorities of the capacity development strategy to modernize the monetary and financial sectors, strengthen fiscal policy, improve governance, and enhance transparency of data. We thank staff for the very useful Appendix VII in this regard.

Mr. Mozhin and Mr. Tolstikov submitted the following statement:

We thank staff for a set of well-written papers and Ms. Mahasandana and Mr. Abenoja for their helpful buff statement. The Vietnamese economy continues to grow at a robust pace despite the volatile global environment. Prudent economic policies have been key to macroeconomic stability, non-inflationary growth and increasing FDIs. Still high public debt is set on a declining path. Impressive progress has been made in reducing poverty over the past decades. Sustained implementation of sound economic policies and structural reforms would further increase resilience of growth and reduce risks.

We welcome the countercyclical fiscal consolidation implemented in recent years, which led to some reduction in public debt-to-GDP ratio to

55.6 percent by end-2018. However, this level is still high for an emerging market country and further efforts to improve fiscal management are needed. On the revenue side, the focus should be on broadening tax base, reducing tax exemptions, and improving revenue administration. On the expenditure side, further reduction of the public sector wage bill and measures aimed at improving spending efficiency are needed to create fiscal space for high quality capital spending as well as social protection.

Administrative tightening of the credit growth limits and curbing of the credit-led property boom were appropriate in order to address vulnerabilities in the financial system accumulated in the previous years. Going forward, the authorities should continue to gradually modernize their monetary policy framework, transitioning from administrative to market-based credit allocation in order to boost efficiency and productivity. This process should be carefully executed and has to be supported by creation of a modern macro-prudential system.

We see merit in the advice to gradually increase flexibility of the exchange rate regime, as this will increase resilience to external shocks and facilitate transition to inflation targeting over the medium term. Taking into account still relatively low level of international reserves, there is a need to further increase reserve buffers. We note that Vietnam's external position is assessed by staff as substantially stronger than warranted by fundamentals and exchange rate as undervalued. At the same time, external sector assessments remain imprecise. For example, the methodology which shows undervaluation could overstate the CA gap as it does not account for the segmentation of the FDI sector from the rest of the economy. On the other side, the equilibrium real exchange rate approach points to a substantial currency overvaluation.

The strengthening of the banking sector soundness and resilience should continue, including further efforts to reduce the level of impaired loans. The adoption of the Basel II standards is a welcome step. The implementation of the Basel II rules will incentivize the efforts for recapitalization of systemic state-owned commercial banks in order to meet the 2020 deadline.

Vietnam has substantial room to improve and modernize economic institutions. Reforms of the SOE sector should be accelerated with the aim to establish a level-playing field between enterprises of all forms of ownership. Further efforts are needed to enhance the business environment, improve governance, and fight corruption. We also agree that Vietnam's economy could benefit from embracing the opportunities presented by the ongoing developments in the Fintech area.

With these remarks, we wish the authorities further success.

Mr. Raghani, Mr. N'Sonde and Mr. Lopes Varela submitted the following statement:

We thank staff for the set of papers on Vietnam and Ms. Mahasandana and Mr. Abenoja for their informative buff statement.

We welcome Vietnam's strong economic performance achieved over the past years, which has enabled considerable strides in poverty reduction. In 2018, real GDP grew by 7.1 percent, inflation remains below the 4 percent target, the fiscal stance has strengthened and public debt has declined. We also note that the external position is strong. The country's medium-term growth prospects are favorable. However, we note that significant risks remain, including economic slowdown in the main partners and uncertainty related to global trade. Going forward, we encourage the authorities to pursue their policy efforts to strengthen macroeconomic stability and implement structural reforms to enhance the economy's resilience and achieve more broad-based growth.

We share the thrust of staff assessment and policy recommendations and would like to make the following comments for emphasis.

Continued commitment to fiscal consolidation, improvement in the quality of adjustment, and enhancing of public debt management are essential to ensuring long-term fiscal soundness. Fiscal adjustments efforts over the years have helped reduce the fiscal deficit and the government debt. Moving forward, maintaining gradual fiscal consolidation to preserve fiscal sustainability is appropriate. We concur with the need to quickly enact planned fiscal measures, including the review of tax and expenditure policy, to help provide needed fiscal space for social and infrastructure spending needs. Moreover, sustained efforts to rationalize the wage bill, increase the efficiency of infrastructure investment, and tackling the rising healthcare costs is warranted. In addition, we urge further improvement in public debt management to help strengthen debt viability.

Monetary and prudential policies remain appropriate. We take note of the intention to modernize their monetary framework and to shift to an inflation targeting regime. The Fund TA in this regard is of paramount importance. Furthermore, we appreciate staff analysis in the Selected Issues

Paper on the optimal inflation target, notably the takeaway that further strengthening monetary transmission should precede any decision to lower the current inflation target. In addition, we encourage the authorities to make progress towards greater exchange rate flexibility, limit foreign exchange interventions to contain excessive volatility while building international reserves to withstand shocks. We welcome the planned tightening of the risk weights for real estate lending and prudential measures. Nevertheless, we agree that further efforts may be needed to contain rising real estate prices, including through higher credit allocation caps to certain banks to preserve stability in the sector.

Progress made recently in addressing the legacies of high bank credit-to-GDP, and NPLs is commendable but more is needed to preserve financial stability. The still elevated NPLs warrant continue attention and the SBV should step up efforts to ensure compliance with relevant prudential norms. There is also a need to follow up on recommendations to strengthen the macroprudential framework and ensure adequate data to support growth prospects. The ongoing efforts to complete the work on the Basel II framework by January 1, 2020 and recapitalize the State-owned Commercial Banks (SOCBs) are essential to enhance the resilience of the financial sector.

Further structural reforms are needed to address impediments to private investments. The government's commitment to ambitious structural reforms and to modernize economic institutions is welcome. However, reforms to create a more favorable environment for private sector involvement, reduce the concentration of land owned by the state, transform the provision of the pension system to address challenges stemming from the population aging, and speed up regulatory and the licensing process for business would contribute to sustainable and inclusive growth. We value the informative Appendix VI on Priorities for Improving the Business Climate, and we would appreciate additional information on the progress achieved with the privatization of SOEs. We commend the authorities for their efforts to improve governance and fight corruption, as highlighted in Ms. Mahasandana and Mr. Abenoja's buff statement and urge them to increase fiscal transparency, strengthen public investment management, enhance the judiciary and legal frameworks, and reinforce the AML/CFT system along the lines recommended by staff. TA from the Fund and other partners in these areas would be critical.

With these remarks, we wish the Vietnamese authorities every success in their endeavors.

Mr. de Villeroché, Mr. Castets and Mr. Sode submitted the following statement:

We thank staff for the quality of their documents and Ms. Mahasandana and Mr. Abenoja for their informative buff Statement. While Vietnam economic performance has been particularly impressive since the early 1990s, it is still a lower middle-income country with significant development needs and several policy challenges ahead. Preserving sound macroeconomic policies, developing a modern social safety net and implementing ambitious structural reforms will be necessary to ensure a balanced, inclusive and sustainable growth trajectory. While we agree with the thrust of staff analysis and recommendations, we would like to highlight the following points for emphasis:

We agree with staff assessment that the external position is substantially stronger than warranted by fundamentals and desirable policies. While the excessive current account surplus is indeed the result of a dual and segmented economy, we agree with staff that this duality calls for further reforms to boost private and public investments. Reforms aiming at better allocating the significant profits generated by the FDI sector into the non-FDI part of the economy are crucial. In parallel, allowing greater exchange rate flexibility and limiting FX interventions to cases of excess volatility is also necessary to ensure Vietnam’s external rebalancing.

We commend the authorities for their fiscal consolidation efforts over the last years which helped to put the public debt on a downward path. Going forward, and against the background of reduced access to ODA, we think it is essential to further strengthen domestic revenue mobilization in order to finance the still significant development needs of the country. On the expenditure side, we welcome ongoing efforts to improve public financial management and notably public investment management. We commend staff for the excellent integration of capacity development strategy in this Article IV (as illustrated by Appendix VII) and we encourage this practice in all countries beneficiating for Fund CD activities.

We commend the authorities for their efforts to reduce credit growth, improve prudential measures and restructure non-performing loans. Going forward, we agree with staff that higher bank’s regulatory capital and a stronger macroprudential and supervisory frameworks are preconditions for a gradual liberalization of the banking sector. In parallel, the authorities should continue their efforts to modernize the monetary framework.

We commend staff for its excellent treatment of the governance challenges and fully support the recommendations of this part of the document. While we agree with Ms. Mahasandana and Mr. Abenoja that substantial efforts have been undertaken over the last years to tackle corruption, more reforms are needed to improve fiscal transparency and public investment management, to have a stronger judiciary and legal framework as well as to strengthen the AML/CFT framework. Reforming institutions to improve public accountability is key to ensure that Vietnam continue to grow over the medium term. As highlighted in the excellent analysis of Appendix VI, reforming SOEs will also be key to improve governance and the business climate.

As highlighted in the excellent Selected Issues Paper on sustainable welfare, Vietnam is heavily exposed to natural disasters and already suffers from high level of local air pollution. The overexploitation of natural resources such as forest and fisheries also pose problems for Vietnam medium term economic sustainability. These challenges call for higher investment in resilient infrastructures and disaster risk management as well as a in mitigation policies to reduce the use of polluting energy and ensure an environmentally sustainable exploitation of natural resources. Going forward, we encourage staff to further enrich the dialogue with the authorities on these issues. Could staff indicate if the authorities have expressed interested in having the Fund providing further advice on climate-related policies and whether staff feels sufficiently equipped to provide such assistance (both in surveillance and capacity development)?

Mr. Saraiva made the following statement:

We did not issue a gray statement, but we share the thrust of staff’s appraisal and policy recommendations but would like to make the following points.

First, the track record of strong economic performance established by Vietnam over time is remarkable. The country has consolidated a development path that brought the country from the condition of being one of the poorest nations in Asia to middle-income status. Last year, growth was 7.1 percent, a very strong pace and well sustained with inflation well behaved. In addition to that, the gains over time in terms of reducing extreme poverty, which has declined to below 3 percent, and the prospects of its middle class doubling in size in the next eight years, attest to the strong performance.

In particular, health and education are areas in which progress has been impressive, and we take note of the comment by the staff that the performance of Vietnamese students exceeds that of many OECD countries. This places the country in a favorable position to harness the opportunities from the frontier of technological development—including in the financial sector—and institutional modernization so as to support increased private sector-led growth.

I want to make a specific comment on the shifting of monetary policy toward inflation targeting. I read Appendix 5 on monetary policy and the exchange rate, and one of the takeaways is that the current framework works. It has been effective in stabilizing inflation, the exchange rate, and output growth. But gaining flexibility on the side of the exchange rate improves the framework and provides a shock absorber, which may be very useful for the country. What puzzled is the timeframe for the transition of six to eight years. I understand that the virtue of a gradual approach is that there is no pressure to move toward the new framework in a rush, but I would like to understand if there are structural developmental issues in terms of the functioning of the markets that are hampering this transition and that need to be addressed, which requires more time. If it is more a matter of fear of floating, then the development of our discussions here in terms of an Integrated Policy Framework (IPF) could be even helpful to give more comfort to the policymakers that even in an inflation-targeting regime, they can use other instruments to ensure that they can address the situation without disruptive market conditions.

Mr. Daïri made the following statement:

I would like to emphasize some of the points made in my gray statement.

First, the impressive growth achieved by Vietnam in recent years was the result of sound macroeconomic policies and far-reaching structural reforms. I commend the authorities for these remarkable achievements, and I encourage them to embark on a more ambitious reform agenda to tackle short-term risks, reinforce macroeconomic and financial stability, and address the challenges associated with further modernization of the economy, and boost potential growth.

Second, gradual fiscal consolidation has been helpful in reducing public and publicly guaranteed debt and should continue. In this regard, I welcome the staff's indication that the authorities share the staff's views regarding the benefit of lowering the debt limit to below 50 percent of GDP.

Third and finally, I commend the Fund for the extensive technical support being provided to Vietnam to strengthen capacity and welcome the confirmation that such support is consistent with the authorities' own strategy and priorities. As noted by Mr. de Villeroché and other Directors, Vietnam is subject to climate-related risks, and I welcome the indication that the staff is ready to support the authorities in addressing these risks. With these remarks, I wish the authorities continued success.

Mr. Trabinski made the following statement:

We thank the staff for their candid set of reports and Ms. Mahasandana and Mr. Abenoja for their informative buff statement. We broadly agree with the analysis, and we have issued a gray statement, so let me just stress three additional points.

First, we commend the authorities for their commitment to macroeconomic stability and a steadfast implementation of necessary structural reforms. However, further consolidation is needed to safeguard public finance and fiscal sustainability in light of prospective aging population. Therefore, more fundamental tax reform will be needed, especially to broaden the tax base and reduce informality.

Second, we commend the authorities' efforts to enhance the use of IT and digitalization in tax administration, which could help increase revenue further. It is not often when I can share my own country experience, but currently tax administration reform happens to be quite successful in Poland, and I thought that might be a relevant example to share with the Board. Complex reform equipped our administration with innovative analytical tools, and intense cooperation with the IT and banking sectors has supported tax officials in detecting irregularities. Moreover, big data analysis has proved to be an efficient tool for identifying VAT fraud, and that in effect led to a substantial reduction in the VAT gap and increased public revenues. We stand ready to share in detail our experience in this with other chairs.

Finally, we agree with the staff that the concentration of land ownership could pose a barrier to investment and growth in Vietnam. Hence, there is a need to reform land ownership and leasing. We take good note of the ongoing review of land use measures by the Central Institute of Economic Management, and we would have one additional question to the staff. We would appreciate if the staff could just provide an update on this review and the authorities' views in this regard.

Mr. Saito made the following statement:

We thank the staff for the informative paper and Ms. Mahasandana and Mr. Abenoja for their insightful statement. We commend the Vietnamese authorities for maintaining economic stability, resilient economic growth, and the low inflation. Leveraging these favorable conditions, we encourage the authorities to embark on ambitious structural reforms. As we have issued a gray statement, we would like to offer three comments for emphasis.

First, on the effect of rising trade tensions, while the staff estimates a small positive impact due to trade diversification, the negative impacts through the complex regional supply chain and also confidence effects should be monitored carefully. In case the uncertainty on trade issues proceeds for a longer-term, we are of the view that the investment relocation channel would have a larger impact on Vietnam. In this relation, we welcome the staff's analysis in the selected issues paper and encourage the staff to continue research on this issue, collaborating with the other country teams in the Asian region.

Second, regarding fiscal policy, we welcome the Vietnamese authorities' ongoing efforts on fiscal consolidation. That being said, Vietnam is expected to face aging pressures in the longer-term, and it is important to start addressing the fiscal issue caused by aging as early as possible. In this regard, we appreciate the staff's helpful analysis in Appendix 4 and detailed answers to technical questions. We encourage the staff to give further advice regarding the combination of policies and the sequencing for pension reforms to the authorities.

Finally, as for the monetary policy, we welcome the authorities' commitment to modernizing monetary policy and the gradual shift to the inflation-targeting framework. As preconditions of shifting to inflation targeting, we support the staff's view that the authorities need to allow greater exchange rate flexibility. In addition to that, as Mr. Saraiva mentioned, there are other policy areas to be addressed, such as de-dollarization or enhancing market functioning and removing credit growth targets. In order to achieve a well-sequenced and appropriately paced shift to inflation targeting, we encourage the staff to continue advice and engagement through technical assistance (TA) to provide an operational roadmap that would work as a useful benchmark for the authorities. While we appreciate the staff's detailed answer to our question regarding the sequence, we would like to clarify whether staff and the authorities share the necessary steps and timelines toward the introduction of inflation targeting.

Mr. Heo made the following statement:

I would like to join other Directors in thanking the staff for an insightful set of reports and selected issues analysis and thank Ms. Mahasandana and Mr. Abenoja for their informative buff statement. We have issued a gray statement and agree broadly with the thrust of the paper but want to highlight two points for emphasis.

First, as the staff elaborated in the answers to technical questions, the increase of FDI to Vietnam and elsewhere in Southeast Asia, reflecting a shifting global supply chain, provides good opportunities for many to jump up to upper middle-income countries in the near future. But in order to make the most of this favorable trend, authorities also need to continue to improve infrastructure, prepare a labor force demanded by the digital age, and provide a business-friendly environment.

Second, I do not think that there is a golden rule as to an appropriate debt ceiling, whether it is 65 percent or 50 percent of GDP, but it seems that most Directors agreed in their gray statements that further fiscal consolidation is needed not just to improve sustainability but also to create fiscal space for essential social spending, as well as for longer-term challenges, especially aging.

As we all know, issues related to pension reforms and health insurance are to become trickier along with the population aging if not addressed at an early stage. In this context, we welcome the authorities' continued commitment toward sound policies by reviewing tax laws on VAT, environment, and property tax, public-private partnership (PPP) law, and many other fiscal issues, as clearly articulated in the buff statement. With this, I wish the Vietnamese authorities every success in their future endeavors.

Mr. Castets made the following statement:

I would like to start by thanking the staff for the quality of this Article IV review and the insightful answers to our technical questions. In addition to a well-crafted main report, we found the several appendixes and selected issues papers particularly relevant and interesting. This Article IV notably illustrates that the staff can provide top-notch advice in its traditional macrofinancial field of expertise while tackling at the same time other macrocritical issues such as governance, inequality, and climate change.

We also would like to thank the staff for the excellent integration between surveillance and capacity development activities. This report can be a model for other Article IV reviews. We also thank Ms. Mahasandana and Mr. Abenoja for their useful buff statement. With this general comment in mind, I just would like to add a few points to our gray statement.

First, like many other Directors before me, I commend the authorities for the very strong and impressive economic performance, and notably the very rapid decline in the poverty rate, but as also recalled by Mr. Saraiva and Mr. Saito before me, Vietnam remains a lower middle-income economy, which is promising in a sense because it means much room for further development and diversification if the right policies are implemented, and we would also support the call for doing more in the infrastructure and education field.

Second, we support the staff's assessment that the external position is substantially stronger than warranted by fundamentals and desirable policies, so we are pleased to see that the staff refrained from ad hoc adjustment to the assessment and provided a candid policy recommendation to register the excessive current account surplus.

Third, while we commend the authorities for the measures recently taken to reduce corruption, we support the staff's call for more ambitious reform of state-owned enterprises (SOEs), of the legal system, of public finance transparency, and of the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework. We see those reforms as essential to ensure better integration between the FDI and the non-FDI sectors, and we know it will be a challenge for Vietnam moving forward, and it will also pave the way for a sustainable convergence path.

Finally, Mr. Daïri mentioned the point made in our gray statement on climate change, and on that, we would like to thank the staff for the detailed answer to our question, and for raising the issue during the policy dialogue with the authorities. It is often the case that the country team does not have the resources to address this issue with the authorities, so we are pleased to see that for Vietnam the authorities felt that it had the right tools to tackle that. Moving forward, we would see merit in having this mainstreaming of approach on climate change in other Article IV reviews.

Mr. Jin made the following statement:

We commend the authorities' efforts in recent years to further open up the Vietnamese economy and greatly reduce the trade barriers with the major economies. An open economy requires a more sophisticated macroeconomic management framework. The Vietnamese economy has remained resilient despite ongoing uncertainties surrounding the external environment. That being said, downside risks to the outlook call for continued strengthening of fiscal management and policy as well as steadfast implementation of financial and structural reforms to ensure sustainable and inclusive growth in the long run.

To fully reap Vietnam's potential capacity, increased investment in training and education would be needed to ensure that the labor force is equipped with the correct skills to meet the evolving business demands. In the meantime, adequate safeguards are needed to protect those being displaced by rapid technological developments. To ensure growth remains sustainable, a stronger effort to reduce pollution and enhance infrastructure would also be needed to help bolster the countries' resilience to climate change and natural disasters. I wish the authorities continued success in their future endeavors.

Ms. Freeman made the following statement:

We welcome the report, and we want to thank the staff for its comprehensiveness, and we note the helpful buff statement provided by Ms. Mahasandana and Mr. Abenoja.

In particular, we note the many concrete steps being taken by Vietnam to encourage inclusive and sustainable growth, and the positive steps taken on meeting Financial Action Task Force (FATF) standards, strengthening anti-corruption laws, sustaining GDP alongside contained inflation; the emphasis on public financial management, and the work on debt sustainability. We also, like Mr. Castets, welcome the selected issues annex, and we agree with the broad thrust of the staff's recommendations. We did not issue a gray statement but wanted to focus on three of the longer-term risks highlighted in the report: aging population, the risk of climate change, and a need to embrace digitalization.

On digitalization, this can be transformative, and we welcome the digital action plan, the new National Committee on Digital that has been established, and the focus on financial technology. However, the report rightly identifies the risks of digitalization, and we encourage the staff and the authorities to consider an additional growth plan that encourages inclusion of all, particularly women and those in rural areas, to ensure no one is left behind and that growth remains inclusive. And given Minister Dung's comments at the recent forum on the need to support data privacy, we encourage exploration with other multilateral development banks (MDBs) on how to provide support on important issues such as regulation, privacy, inclusive government technology, and the work to ensure open procurement and access to the market.

Second, on climate, we agree with the statements by Mr. de Villeroché and Mr. Castets. Given the economic risks presented by climate change, the risk of knocking 10 percent off economic growth, we welcome the deep dive into this issue in the accompanying selected issues paper but would have liked to have seen more mention of this in the main report and recommendations. In particular, we would appreciate detail on how climate risks are being understood, mainstreamed, and reported through financial systems. We encourage the staff to explore with other MDBs what further support can be provided to assist the authorities in this.

Lastly, we noted the aging population was a significant risk, but we did not see much in the report on this, and we look forward to the Fund's surveillance work to have a greater understanding of the impact of aging—as Mr. Saito said earlier, we need to move on this quickly—and also the impact of climate change on debt sustainability. With those three points, we wish successful implementation in the coming years.

The staff representative from the Asia and Pacific Department (Mr. Mourmouras), in response to questions and comments from Executive Directors, made the following statement:[1]

I thank Directors for their views as expressed in the gray statements and in their subsequent interventions. My colleague from the Strategy, Policy, and Review Department (SPR) and I will take up some of the issues regarding the external assessment and reserves that were raised in gray statements, and I will try also to deal with some of the issues that were raised in the Board.

On Vietnam-specific issues related to the external assessment, we acknowledge the uncertainty about data, about models, that underpins our judgment. At the end of the day, we decided on the basis of superior fit, to use the current account model of the External Balance Assessment (EBA) and not

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

to put any weight on the exchange rate model, which performs poorly in a statistical sense. What comes out of it is a substantial gap of around 6 to 6.5 percent of GDP, which conforms with what we view from a conceptual perspective to be the case in Vietnam—that there is this hypercompetitive FDI sector alongside the residual elements of economic dualism, meaning a more backward sector that is labor-intensive, that cannot absorb investment and use modern capital-intensive methods of production. The thrust of our advice when it comes to reducing the current account gap is to deal with these root causes, the barriers to accessing credit and land.

On the land issue, there is movement that we are happy to report. The government has proposed amendments to the current land law to the National Assembly to make land planning and zoning more transparent and follow streamlined procedures. The process to amend the land law will not begin until the end of 2019, so there is progress, but the Vietnamese are gradual, thoughtful, and we are looking forward to reporting more of this in the future.

Regarding the large errors and omissions, which Directors pointed out, part of it has to do with the substantial openness of the Vietnamese economy, and frankly, the balance of payments data could be better. We are working with the Vietnamese authorities very closely. A balance of payments TA mission from the Statistics Department (STA) was in the field alongside the Article IV mission, and there are new databases and better communication between the central bank and the statistical agency and the Ministry of Finance to use information. In particular, there will be better recording of repatriation of income by FDI companies in the balance of payments. Going forward, the revisions to the balance of payments will become operative in the next few months, and that will get the errors and omissions to come down.

The point about balance of payments data not being sharp is not an isolated one. We are working with the authorities to get better national income accounts, and so there will be more to report in months to come.

On the metric, let me just make this one last point. The metric is for a managed exchange rate regime, and to the extent that Vietnam will, over the next six, seven, eight years move toward a more flexible exchange rate regime, there will be a different metric that will show less need for additional reserve accumulation. But as far as the current managed exchange rate regime is concerned, they are still not close to 100 percent, so we do recommend gradual additional reserve accumulation and a little bit of appreciation.

Directors asked about the balance between appreciation and reserve accumulation. The issue is one of not doing too much, and we have in our medium-term framework numbers that indicate that they can go to 100 percent in the next five years. We think that is a reasonable recommendation.

The staff representative from Strategy, Policy, and Reform Department (Ms. Duttagupta), in response to questions and comments from Executive Directors, made the following statement:

I will just add one point on a question relating to reserve adequacy and how overstating of exports would impact reserve adequacy. The Fund uses its Assessing Reserve Adequacy (ARA) metric for making assessments on the adequacy of reserves for precautionary purposes for the entire membership. This metric captures multiple channels of potential market pressure, not just loss of export income, which is one of them, but also the risk of resident outflows, which would be captured by broad money, or non-resident outflows, which would be covered by other liabilities, or even short-term debt-related rollover risks, which is caused by short-term debt. Within all of these, the weight that is given to exports or loss of export income, as Mr. Mourmouras mentioned, in a managed non-independent floating regime is only 10 percent. Even if exports were overstated or there was some mismeasurement, it would not change the metric by too much. Obviously, further improvement on the data side to address the various errors and omissions would help in getting a better sense of reserves.

Mr. Lopetegui made the following statement:

I thank the staff for the answer to my questions. We issued a gray statement broadly supportive of the authorities' efforts over the recent years and highlighting our broad agreement with the staff appraisal the main challenges going forward.

I wanted to make a comment on the external sector assessment because basically we have seen in many staff reports that when the staff assesses the external position, at times the staff raises a word of caution regarding uncertainty surrounding the assessment. In the case of Vietnam, what caught our attention was that errors and omissions oftentimes are more than double in absolute terms the size of the current account surplus. As the staff recognizes in the footnotes, part of this could be unreported imports. There is uncertainty regarding the actual level of the current account in Vietnam. At the same time, the assessment is categorical, with substantial strength of the current account over the norm, so the data uncertainties are enough to qualify the assessment or at least mention that it is surrounded by certain elements of uncertainty.

Mr. Saito asked the staff whether the initial steps and the timeline for moving to inflation targeting would be shared by the authorities.

The staff representative from the Asia and Pacific Department (Mr. Mourmouras) made the following statement:

> We are at the early stages of Phase 1 of this three-phase envisaged modernization of the monetary framework, Phase 1 being getting the necessary human capital systems and organizational capital in the central bank ready for Phase 2, which would be gradual opening up of the width of the exchange rate band and operating an implicit inflation-targeting regime; to be followed by Phase 3, which would be no band whatsoever and the shift to an inflation targeting-like regime. But it is important not to jump the gun on this. The staff's information from the central bank meetings and with meetings of other authorities indicate that there is widespread consensus in Vietnam for moving along this three-phase blueprint that TA from the Monetary and Capital Markets Department (MCM) first drew up in a mission in 2017. But the political decision and the green light and the legal work has not been undertaken yet, so it is important to understand that the Vietnamese are concerned that the necessary market infrastructure is not in place. The transmission mechanism for monetary policy is not operative yet, so it will be important to get these things right. A moderate macroprudential framework is not in place. There is fiscal dominance. Many of the preconditions are not there yet, and it will take Vietnam several years before the modernization and the shift to anything like inflation targeting will happen, but there is widespread consensus to do that.
>
> On the fiscal questions, we appreciate the point made about the fiscal rule. They have moved in the last three years from a position where they had no fiscal room and there was concern about fiscal sustainability, to a steady downward trend in the public debt, very strict limits on government guarantees, reduction in the deficit—and that was a conscious political decision after 2016. In our medium-term DSA, we project that Public and Publicly Guaranteed (PPG) debt will continue to decline, so we want to have a formal fiscal rule, something like a 50 percent statutory limit, to help the authorities cement the hard-won gains in fiscal sustainability. The National Assembly is the stakeholder in all of this, and it pushes against forces that would want to have higher budget deficits in the future. The explicit fiscal debt rule would be important, as we analyzed in the 2018 staff report.

Regarding the aging issue, they are raising the retirement age, and they are doing the right things. Among the reform options for parametric pension reform, we would caution against further increases in contribution rates because those are already high for a country with Vietnam's per capita income, and it encourages informality. We would like to do more in terms of better collection of contributions and a better link between contributions and benefits to avoid disincentives.

Mr. Dairi made the following statement:

On the issue of reserve adequacy and in addition to the comment made by Mr. Lopetegui on errors and omissions, I see from the staff assessment that there are still high capital controls in Vietnam, but I do not see a reference to the adjusted ARA metric in the report. Is there a reason for that? Maybe if the ARA metric was used, the adequacy of reserves would be less of a problem.

The staff representative from the Asia and Pacific Department (Mr. Mourmouras) responded that the staff did not adjust for capital controls as it was not required.

Ms. Mahasandana made the following concluding statement:

We thank Mr. Mourmouras and the rest of the mission team for their constructive engagement during the Article IV consultations and for responding to the technical questions. We also thank Directors for their interest in the Vietnamese economy and the valuable comments and suggestions, including the offer from Mr. Trabinski to share Poland's experience in using IT and digitalization in the tax reform. We will convey these comments and suggestions to our authorities, who will be closely taking them into consideration.

The Vietnamese economy continues to experience robust growth, benign inflation, and improvement in its external and internal stability amid increased international trade tensions and heightened external risks. The significant fiscal consolidation has led to a decline in public debt. Credit growth has moderated while maintaining ample liquidity in the system. The NPL ratio has also gone down but remains at a relatively high level. The adoption of sound macroeconomic policy and the pursuit of structural reform have contributed in large part to this favorable outcome of private sector-led growth, the transformation of the economic structures, and important gains in total factor productivities. At the same time, our authorities recognize that shared interest remains in managing the possible impact of heightened external uncertainty and in continuing the momentum of the reform process.

On the fiscal front, our authorities remain committed to fiscal consolidation to build policy buffers and reduce public debt. They are focused on broadening the tax base and raising the quality of public expenditure while improving overall fiscal management. The objective is to help ensure that fiscal space is available to fill the infrastructure gap and support social spending in the short-term while having the flexibility to meet the challenges of aging, climate change, and achieving the Sustainable Development Goals over the medium to long term.

On external front, our authorities note that the external assessment model yields conflicting issues. The current account surplus in Vietnam is due in part to structural factors that are not adequately captured in the EBA-lite approach. In this regard, we encourage the staff to continue to work on these assessments and carefully take into account country-specific circumstances in interpreting the result.

On the authorities' front, they are also determined to complete the package of structural reforms to support expansions of domestic demand and promoting investment, which would help moderate the current account surplus in the future as well.

On the exchange rate policy, the authorities are strongly committed to having flexible exchange rates as a shock absorber against external shock. The State Bank of Vietnam has allowed greater two-way exchange rate movement within the band. Their operation in the foreign exchange market is aimed to ensure orderly market conditions and adequate market liquidity. This is to ensure that excessive exchange rate volatility does not harm macroeconomic and financial stability.

On the financial sector, the strengthening of the banking sector is the priority of our authority. They have formulated a bank-by-bank strategy to recapitalize state-owned commercial banks and have already initiated the introduction of Basel II requirement. The resolution of NPL is being pursued with vigor under close coordination between related government agencies. The authorities also plan to establish a high-level financial stability committee to monitor system-wide risks and formulate appropriate policy measures to ensure stability in their financial system.

As for monetary policy and modernization of the monetary policy framework that many Directors have raised and expressed interest, this issue has been addressed quite well already by Mr. Mourmouras. In this regard, I would want to emphasize only a few things. The improvements in the external and financial fronts are crucial steps for our authorities to modernize the monetary policy framework. This will be a gradual, carefully sequenced process, and will lay the preconditions for the modernization of monetary policy framework to be successful. Critical aspects of this upgraded policy framework would be having a more developed financial market to be able to use market-based instrument for monetary operations and flexible exchange rates. Adequate reserves also play a crucial role, especially during the transition period, to ensure market confidence to allow exchange rate to act as an automatic stabilizer.

Vietnam’s structural reform agenda is both broad and long. Our authorities would like to assure Directors that they will continue the initiatives to modernize the policy framework, regulatory regime, and public institutions. They are complemented by efforts to fight against corruption and improve governance, including the area of SOE oversight and AML/CFT. Moreover, the methodology for collecting and compiling data, particularly in the area of national income, balance of payments, financial data, are being improved with the help of the Fund.

To conclude, our authorities are committed and determined to pursue sound macroeconomic policies and implement a broad set of structural reforms to continue to transform the economy and realize its full potential. Our authorities would like to thank the Fund for valuable support in terms of policy advice and capacity development and look forward to a continued close productive engagement in the future.

The Acting Chair (Mr. Lipton) noted that Vietnam is an Article VIII member, and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the Vietnamese authorities for their prudent policies which have contributed to economic resilience and impressive growth amidst rising trade tensions and external uncertainties. Directors welcomed the authorities’ continued commitment to macroeconomic stability and wide-ranging reforms and agreed that policy priorities should continue to focus on building buffers, strengthening governance, and boosting productivity and private sector-led growth.

Directors welcomed the authorities' fiscal consolidation efforts, especially improvements in tax policy and administration, including higher environmental taxes, the tightening of government guarantees and lower current spending, which helped reduce public and publicly guaranteed debt. They noted that further consolidation should focus on the quality of adjustment so as to keep the public debt on a declining path and create room for priority infrastructure and social spending, prepare for rapid prospective population aging, and deal with the effects of climate change and digitalization. Revenue-enhancing measures should focus on broadening bases, including unifying VAT rates, a property tax, and reducing exemptions and improving tax administration. Directors noted the ongoing efforts to rationalize the public sector wage bill and underscored the need to improve public financial and investment management.

Directors welcomed the current monetary and credit policies stance, especially declining credit growth which is helping Vietnam cement macroeconomic stability. They encouraged the authorities to continue to limit interventions to maintaining orderly market conditions and maintain efforts towards greater exchange rate flexibility while gradually building reserves. Directors called for reforms to reduce remaining barriers to investment, including improving access to land and credit, that would boost private investment and raise worker productivity and growth. They looked forward to a well-sequenced modernization of the monetary framework with technical assistance from the Fund.

Directors noted ongoing reforms in the financial sector, including the shift of bank business models to lending to households and private firms, accompanied by more prudent aggregate credit growth limits and the deepening of bond and equity markets, which has reduced financial stability risks, improved the quality of financial intermediation and boosted economic growth. Directors welcomed the adoption of Basel II standards and encouraged swift recapitalization of the systemic state-owned banks and the construction of a modern macroprudential framework to replace quantitative credit limits and deal with potential financial stability risks.

Directors welcomed the reforms to modernize economic institutions and improve governance. They highlighted that priority needs to be given to strengthening anti-corruption legislation further, reforming and improving oversight of state-owned enterprises, implementing Public Investment

Management Assessment recommendations, and improving statistical systems and data provision and transparency. Directors welcomed the authorities' plan to strengthen the AML/CFT regime and address any related issues to be identified by the forthcoming peer review by the Financial Action Task Force's Asia Pacific Group.

It is expected that the next Article IV consultation with Vietnam will be held on the standard 12-month cycle.

APPROVAL: April 7, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook and Risks

1. ***We would welcome further elaboration from staff as to the longer-term policy implications for the authorities and potential regional spillovers of a shift in supply chain orientation.***

2. ***Noting the significant boom of FDI inflows in recent years, could staff comment on the absorptive capacity of Vietnam, especially given the already low unemployment rate which stood at around 2.2 percent in 2018?***

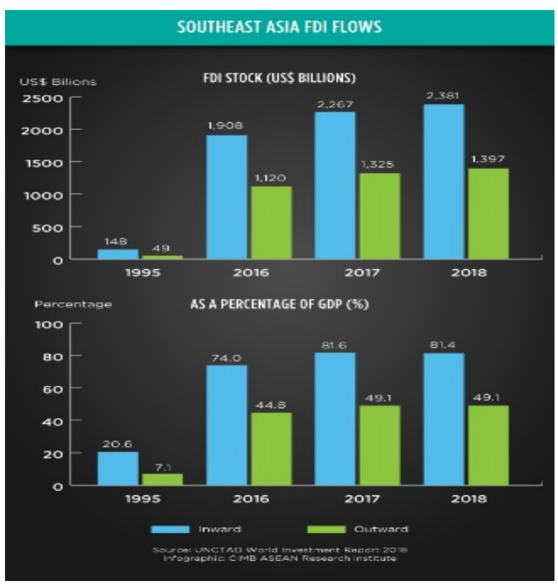
- FDI inflows to ASEAN countries were on the rise in 2018 even as FDI declined elsewhere: according to data from the United Nations Conference on Trade and Development's (UNCTAD) June 2019 World Investment Report, FDI inflows into South East Asia reached a record high of US$149 billion in 2018. By comparison, global FDI fell by 13 percent to US$1.3 trillion in 2018 as uncertainties lingered in the global economic environment due to the escalation of trade tensions. Inflows into ASEAN surpassed FDI into mainland China. Singapore was the top FDI destination in ASEAN, with Vietnam, Indonesia, Thailand also recording significant increases.

- Taking a longer-term perspective, the shift of FDI to Vietnam and elsewhere in South East Asia reflects a shift in the supply chain that has been years in the making, driven by economic fundamentals. Multinational firms have been attracted to South East Asia's rapidly growing middle classes, quality and attractively priced labor, and tax incentives offered. More recently trade tensions and rising economic policy volatility have also led investors to diversifying production locations. The reorientation toward Vietnam is expected to continue over the medium-term as reforms, including under the impetus of recently agreed free trade agreements, including the EU-Vietnam FTA, CP-TPP and others, kick in.

- Rapid digital technological progress is also expected to cause profound shifts in the regional supply chain. Improvements in the capabilities of robots—such three D printing driven by lower computing costs, AI and big data—and reductions in cost, are changing the cost-benefit calculus of multinationals and making them reconsider their supply chains for labor intensive manufactures. This is bound to affect Vietnam and the rest of ASEAN. A 2016 ILO study projects that more that more than 50 percent of manufacturing jobs in ASEAN could be at risk, with women being more at risk than men.

- In staff's view, Vietnam has not yet reached its absorptive capacity limits when it comes to receiving FDI inflows. Vietnam's labor force is large, well-educated and internet-savvy, with Vietnamese PISA scores surpassing those of some OECD countries and wireless internet penetration and speeds rising fast (see Staff Report, text Chart 1). Vietnam's capital-to-labor ratio is still and FDI would bring about capital deepening in the economy by raising the quality and quantity of capital in the economy. In addition, structural transformation is far from being complete: 38 percent of the labor force is still employed in the agricultural sector, and more than half of the rest are employed in the informal sector. It will take another 10-15 years for Vietnam to reduce the share of labor in agriculture to that of upper middle-income ASEAN countries. Land is another potentially scarce resource: but while land prices and wages are increasing near the largest cities and industrial poles, other regions haven't experienced the same phenomenon yet, although there is anecdotal evidence that foreign direct investors are now radiating out of major FDI centers to outlying areas.

- But there is no doubt that Vietnam needs to invest more in improving its infrastructure and connectivity, both hard and soft, and prepare its labor force with skills that will be demanded in the new digital information age. Financial market development and private-public partnerships will be needed for Vietnam to close its substantial infrastructure gas and improve its connectivity. It will also need to revamp its education system, especially vocational and tertiary education to ensure graduates have the skills demanded by business. Vietnam also needs to increase its ecological absorptive capacity by reducing urban and rural pollution of ground, water and air, and by making its infrastructure more resilient to climate change and natural disasters.



Fiscal policy

Limit on Public Debt

3. ***Could staff elaborate on the authorities' views regarding the proposal to lower the fiscal anchor (the statutory PPG debt limit) from 65 to 50 percent of GDP?***

- Based on the 2016-20 Financial Plan (Resolution 25), the statutory limit on public and publicly guaranteed debt (PPG) is 65 percent of GDP. This is according to the Vietnamese classification, which translates to about 62-63 percent of GDP in the GFS classification. The 65 percent limit is applicable annually until 2020 and fiscal adjustment and robust growth in recent years have made it not binding, with PPG debt slated to decline further in the staff's medium term DSA baseline.
- In part prompted by IMF risk analysis (see 2018 staff report and selected issues paper), the authorities have recognized that a lower debt level should be targeted to increase fiscal space and deal with a host of contingencies and risks, including prospective aging, climate change, shifts to the supply chain and other disruptions associated with the spread of the digital economy. While a specific discussion to lower the statutory debt limit has not yet occurred in Vietnam, the authorities are eager to reduce public debt to below 50 percent. The 2021-25 five year plan will be a good opportunity for the authorities to delineate their medium term fiscal strategy and priorities.

4. ***We note staff advice to lower the statutory debt ceiling to 50 percent of GDP as this will create additional fiscal space. We are interested in how lowering the statutory ceiling, in and of itself, helps to create fiscal space. Can staff elaborate on the mechanics of this? Are staff expecting that the ceiling would be breached (and the consequences of this would be minimal) should shocks materialize in future***

- In the absence of larger shocks, once a debt level below 50 percent is reached, a breach of the 65 percent statutory limit is deemed unlikely in the medium term. However, a lower debt ratio is needed, as in the medium- to long run spending for SDGs and pensions will have to increase, and therefore some buffers should be provisioned for. This should go in line with revenue increases and spending efficiency gains, to keep the increase in the deficit to a minimum.

5. ***We agree with staff that public debt management requires further improvement and flexibility. Can staff comment on specific measures that the authorities will take in this regard in the medium term?***

- The authorities are currently reviewing tax policy and administration in their effort to increase revenue, with specific goals to increase property and environmental taxes and apply risk-based tax administration. A new PPP law, which will include better monitoring and management of PPPs is, is equally being drafted and will be discussed in the National Assembly later in 2019. In addition, the authorities are working to raise the capacity of the Vietnam State Treasury to manage the government's cash and debt issuance. Fund capacity development to Vietnam on fiscal issues is ongoing and strategic, including in tax administration, complementing the World Bank's large ongoing program in this area, and in modernizing the State Treasury. More fiscal TA to improve fiscal accounting and reporting is contemplated.

Aging

6. ***We also note that it is essential for the authorities to prepare for aging. In this regard, we appreciate staff's detailed analysis on some possible reform plans for current pension system in Appendix IV such as inflation indexation, increase in retirement age, reduction in benefits, etc., and would appreciate it if staff could elaborate on their view on appropriate combinations and sequencing of those measures.***

7. ***As for changes in the pension system, we understand that high informality makes expansion of coverage difficult, but even more so we see the need to ensure that vulnerable groups are adequately protected in old age. In this context, we are skeptical that basing pension calculation on the five years before retirement instead of lifetime employment would address this challenge sufficiently, given the limited coverage. Staff comments are welcome.***

- ***Menu of parametric pension reforms***: IMF staff has supported reforms to raise the retirement ages and the base for benefit calculation as soon as possible, and soon after to increase coverage and change indexation to inflation. An increase in the coverage of the system will delay the impact of aging on the finances of the pension system and will give more time over which to phase in reforms. As explained in the staff report (paragraph 15), the finances of the health insurance fund are of more immediate concern following the recent expansion of medical care coverage.

- ***Indexation of pensions***: Staff agrees that high levels of informality makes it difficult to expand coverage and that it is important to protect vulnerable groups. In the view of staff, mandatory contribution rates are relatively high in Vietnam (32 percent of payroll for workers and employers) and could contribute to informality incentives. The priority on the contribution side is to improve enforcement of payment, by unifying the system of collecting payroll contributions and that of income tax. The digital economy makes it easier to enforce payment discipline by cross-checking tax and payroll contribution data bases. It would also be good to create a system of individual retirement accounts that would allow contributors to make a close link between contributions and benefits they expect to receive when they retire. Staff has therefore suggested to the Vietnamese authorities to introduce a combination of measures, including an increase in retirement ages (already planned), an increase in coverage and contribution rates, and a change to inflation indexing (from current wage indexation). Ultimately, a further broadening of base rate calculation from 5 years before retirement to lifetime employment will equally become necessary, however at the current time more than an extension from one year to 5 years will be politically infeasible. Staff supports current planned steps and urges for continuing reforms to improve the situation further.

8. ***Can staff explain in more detail the practice of carry forward revenue and spending as it applies in Vietnam and their associated concerns?***

- The practice of revenue carry forward is highly unusual. It refers to revenue that is collected and kept by the localities and spent in future years. The size of revenue carry-forward is often very large (up to 20 percent of total revenue), making budget predictions and planning difficult. This practice also complicates monitoring of local activities' spending. It equally adds to the proliferation of projects, spreading budgets for investment spending too thinly.

- Therefore, improvements in the management, accounting and reporting of carryover budget provisions in a more transparent and consistent way are needed to help strengthen budget credibility and fiscal discipline. Budget accounting must follow the principle that revenue and expenditure incurred in one year must be accounted for in that year to truly reflect the fiscal balance. TA in this area is a priority.

9. ***The resulting fiscal space can be effectively used for public investments, protecting social spending and filling the spending gap created by declining official development assistance. In this context, could staff elaborate on the areas and the scale of financing impacted by the altered ODA levels?***

- The reduction of ODA has been gradual. Some USD 22 billion have already been committed and will be disbursed over the coming years. A gradual shift towards domestic financing and alternative external financing is perceived as appropriate and feasible. The current DSA's reduction in foreign financing describes the gradual reduction of foreign financing, driven by ODA, about 1-2 percent of GDP per year. The organic emergence of capital markets has helped to make financing available for large, creditworthy state and private enterprises, and the corporate bond market is fast growing.

10. ***To successfully tackle the development issues, the authorities may need multi-annual technical assistance in public finance management from the international***

institutions and development partners, in addition to the Fund TA on fiscal data and statistics. Staff comments are welcome.

- We agree with this assessment. The authorities have already indicated the desire for follow-up TA, and TA on treasury reform, debt management, and GFSM conforming fiscal accounts are already ongoing. FAD also continues support on laws from IMF HQ, with the clear option for further TA if the authorities were to request. Private funding via PPPs is already receiving priority in infrastructure spending, and the currently drafted new PPP law will further help with monitoring and management of PPPs.

Monetary Policy and External Sector

Reserve Adequacy

11. ***We have some reservations regarding staff's assessment of the country's external sector… We would appreciate staff's comments on all these issues.***

- Staff will respond to this question during the Board meeting.

Monetary modernization

12. ***Noting that the authorities see the shift to IT will take between six and eight years, we welcome staff's views on timeframe suggested by the authorities and more detailed explanation on necessary reforms and their sequencing before shifting to IT.***

13. ***Given that there is an ongoing TA, is staff supportive of this time line to shift to inflation targeting?***

14. ***We would welcome staff elaboration on the planned intermediate steps before switching to inflation targeting (IT), which is expected to take several years.***

15. ***Can staff comment if the authorities have a specific timeline for the modernization of the framework and how it would be sequenced?***

16. ***What key steps or milestones do staff envisage in the transition to inflation targeting and a fully flexible exchange rate regime over the next few years?***

17. ***Given the current exchange rate regime, staff recommend both nominal appreciation of the currency and the further accumulation of international reserves. How should the authorities strike the right balance between these objectives?***

- The authorities' blueprint for modernizing their monetary framework is in line with the recommendations of a 2017 MCM technical assistance mission. There are three stages, one focusing on human and institutional capital development; followed by gradual widening of the exchange rate band, followed by its eventual abolishment. The feasibility of achieving this timeline depends on the speed with which the authorities can shift away from the current system involving multiple directed policy tools (such as credit ceilings and a stabilized exchange rate) to allow market forces to operate through modern monetary policy tools such as using interbank market rates as the main operational target. While the current system of credit growth ceilings and exchange rate stability could be maintained in the interim, the central bank will need to gradually phase out the credit growth ceilings and introduce FX flexibility to complete the transition to inflation targeting. The length of this transition period will also depend on the speed with which the banking system is strengthened and recapitalized to facilitate the monetary transmission mechanism; macro prudential tools are introduced to limit excessive financial risks; and, carefully calibrated with the liberalization and development of the equity and bond markets.

- On privatization of the SOCBs in longer term, the government plans to reduce its state ownership further to 51 percent by 2025, and targets to have at least 2-3 commercial banks to be in the list of top 100 banks (in term of total assets) in Asia. Given the current relatively sizeable of SOCBs, and a few of them are strong banks, so they would be the first candidates for the target. The government, however, will not privatize the SOCBs but continue to probably hold a dominant share at least 51 percent even over the long term.

Financial Sector

18. ***At the same time, as staff rightly point out, it is necessary to monitor the risk caused by Vietnamese banks' shift to retail lending. In this regard, we would like to know staff's view on the needed response by the authorities to address the risk.***

- The authorities should carefully assess the current growth of retail loans, especially consumer loans which have seen double digit growth in recent years. Loan to SMEs may need to closely watched since many of the loans are non-secured loans, and credit risk could be high due to the poor quality of SME financial statements.

- To address these risks, banks should be recapitalized, non-performing loans should be transparently recognized on the books of the banking sector, and macroprudential policy, such as LTV ratios and debt to income ratios, should be instituted as soon as possible. For this to happen, data quality on balance sheets and real estate prices should be improved as a matter of priority.

19. ***We take note of staff's recommendation that fresh capital should be injected by government funds to recapitalize SOCBs. We would like to know budgetary implication of the recapitalization through injection of government funds.***

- Rough estimates for recapitalizing 3 of the 4 remaining SOCBs that have not met Basel II standards is about two percent of GDP, including retained earnings, and injections from the budget and private bank owners. Staff assesses that recapitalization can be done without having a significant adverse effect on debt sustainability. First, the capital injection would be a one-shot policy action to deal with the adoption of Basel II and the legacy NPL problem. Also, thanks to the recent year banks' high profits and the foreign investor's interest in the Vietnamese banking sector, part of capital shortage of SOCBs will be covered by divestment (from investment in other private banks and corporates), private money and retained earnings. Hence, the capital shortage which should be eventually covered by fresh government funds will probably not be large. In the meantime, the government has very significant buffer (9 percent of GDP).

20. ***Could staff offer more insights on strategy and sequencing planned for the recapitalization of banks?***

- As described in para 32, the authorities urge SOCBs to recapitalize using private money as much as possible, and if this is not sufficient, allowing them to use retained earnings while also allowing the option of injecting government funds. Our view on their strategy is in para 35. To make private investment in weak banks attractive, they have limited issuance of new bank charters, which makes it attractive for some investors to acquire weak banks—they are attracted by the prospect of entering a dynamic growing market. The banks will also be permitted to use retained earnings from previous years for recapitalization. This is a departure from past practice where they had been required to transfer all/most of their earnings as dividends to the Treasury. Relaxing foreign ownership limits is a third option, followed by access to privatization receipts and government cash injections being the last.

21. ***In this context, we note that dollarization appears to be a widespread phenomenon in Vietnam and wonder whether this relates only to the liabilities side or also to the assets side, including lending to households, and whether appropriate limits on net foreign currency positions are in place. Staff comments are welcome.***

- Dollarization in the banking system has come down significantly in the last 10 years to 8.2 and 6.3 percent in 2018 for deposits and lending, respectively. There is some uncertainty about cash holdings of U.S. dollars and hard currencies with U.S. $60 billion being a reasonable estimate. Thanks to de-dollarization policies, including zero USD interest rate cap on foreign currency deposits; limitations on foreign exchange loans; and tighter control over gold market. The authorities believe that the stable exchange rate and stable and low inflation and macroeconomic stability have also contributed to de-dollarization. Net open positions in the banking sector are regulated at +/- 20 percent of capital.

Structural policies

22. ***We note that privatization of SOEs has been on the reform agenda and would appreciate staff's view on the progress.***

23. ***We value the informative Appendix VI on Priorities for Improving the Business Climate, and we would appreciate additional information on the progress achieved with the privatization of SOEs.***

24. ***Vietnam's domestic sector lags behind the highly integrated FDI sector. Could staff elaborate on the authorities' strategy, in particular with regard to SOEs' reform and privatization?***

- The authorities are trying to encourage the domestic sector by reducing administrative barriers and red tape for businesses, encouraging banks to lend to the SME sector and agriculture, and revamping the FDI strategy to facilitate foreign investment with greater linkages with the domestic sector. Various legal revisions underway should facilitate domestic corporate borrowing and foreign investment in sectors hitherto reserved for state investment only.

- At the same time, the authorities are trying to reduce the footprint of state-owned enterprises (SOEs). The legal framework for SOEs was revamped with the creation of an independent State Capital Management Committee (SCMC) to oversee all large SOEs to improve accountability and efficiency, while leaving management and regulation with line ministries and regulatory bodies. A revised Securities Law is expected to allow 100 percent foreign ownership in all non-strategic sectors.

- SOE privatization is ongoing and following equitization of large SOEs in 2017, the pace slowed down in 2018, with 37 out of the 113 SOEs originally planned have completed the initial implementation schedule for IPO. The government plans to complete the equitization of 103 additional SOEs are over 2019-2020. The slow progress in 2018 was partly due to difficulties following requirements of the recently implemented regulatory framework when assessing SOEs' share market values.

25. ***Can staff comment about the prospects for privatization of state-owned banks over the longer term?***

- The banking sector is deemed to be a strategic sector by the government and therefore there are restrictions on private and foreign ownership. Over the longer term, the government plans to reduce its ownership of SOCBs from the current 70 percent or more to 51 percent by 2025. It plans to have at least 2-3 commercial banks to be in the list of top 100 banks (in term of total assets) in Asia.

26. ***Could staff provide more context on the status of operations and effectiveness of the State Capital Management Committee?***

- The SCMC has recently commenced its operations of providing oversight of all 19 State Economic Groups and General Corporations on behalf of the state. As it was recently established in late 2018, it may be too early to assess the effectiveness of its operations. The SCMC has started revamping the management of SOEs, addressing bottlenecks in the restructuring/equitization process and in facilitating investment decision issues pertaining to SOEs.

Fund Related Issues

27. ***We welcome staff comment on the extent to which the CD strategy takes into account the authorities' own strategy and priorities, a point emphasized by the Executive Board during the last review of the Fund's CD strategy.***

- Fund CD priorities focus on modernizing the monetary and financial sectors, strengthening fiscal systems and institutions, improving data quality, and improving the anti-money laundering frameworks. These priorities are in line with the authorities' own strategy and should help lay the foundation for sustainable and inclusive development in Vietnam. Staff and the authorities participate in frequent seminars, courses and other face to face meetings, in the context of Article IV and CD missions originating at HQ, CDOT, OAP and STI. This is a truly collaborative ongoing endeavor that also involves consultations with the World Bank and other multilateral and bilateral donors. Finally, staff has demonstrated its agility in recent months by quickly responding to recent high-level requests from the authorities to assist with revisions to national income accounts and balance of payments statistics.

28. ***Could staff indicate if the authorities have expressed interested in having the Fund providing further advice on climate-related policies and whether staff feels sufficiently equipped to provide such assistance (both in surveillance and capacity development)?***

- Staff has discussed with the authorities issues of climate change and resource sustainability and policy responses, including the Ministries of Finance, Planning and Industry and Environment and Natural Resources. It has also engaged the World Bank and representatives of the international community in Vietnam as it considers the issue to be macro-critical. Staff is of the view that the authorities would be open to further exchange of views and expertise, including from FAD, on climate change and mitigation strategies. The CD would fit in the authorities' planned broad-based of tax policy priorities and implementation-cum-quantification of their National Action Plan to meet obligations under the Paris Climate Agreement. Staff has the necessary expertise, including projections of fuel use and carbon emissions in Vietnam and estimates of the emissions and the fiscal and economic impact of carbon taxes and other mitigation policies. FAD also has estimates of efficient fossil fuel prices to reflect supply costs and the full range of environmental costs, including local air pollution costs. Our engagement in Vietnam would follow the approach taken in selected countries in Asia (China, India, Thailand), where staff completed Selected Issues Papers on carbon taxation and mitigation policy options. This is of course subject to the usual caveat about staff resources being limited.