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March 13, 2009

**Statement by Mr. Moser and Mr. Muradnazarov on Vietnam
(Preliminary)
Executive Board Meeting 09/26
March 16, 2009**

1. The staff report outlines a candid picture of recent developments in the Vietnamese economy and the challenges the authorities are facing. Overall, economic activity in recent years has been robust. However, with risks tilted to the downside, growth prospects are projected to dampen in the near-term. The large current account deficit, a widening fiscal deficit, and a low level of gross international reserves are sources of concern.
2. The State Bank of Vietnam (SBV) has been quick in reversing its monetary policy stance by lowering interest rates and reducing reserve requirements sharply. Looking ahead, caution is warranted with respect to further monetary easing, as Vietnam remains vulnerable to inflationary pressures arising from further currency depreciation and wage growth. Exchange rate policy needs to be consistent with ensuring sufficient liquidity in the system. In light of the continuing depreciation pressure of the dong, greater exchange rate flexibility might be warranted, which in turn will facilitate adjustment to recent external shocks and enhance monetary policy effectiveness.
3. The fiscal stimulus plan needs to be carefully designed and focus on well-targeted and temporary measures. Moreover, in light of the limited fiscal space, we share staff's view that the stimulus plan should be primarily financed by reprioritizing existing spending and mobilizing additional concessional external financing. In this light, *we would be particularly interested to know more about the details of the authorities' fiscal response to the slowing economy.*
4. We regret that due to lack of information on the details of the stimulus plan the impact of additional government spending could not be included in the debt sustainability analysis. This is particularly worrisome, as due to deterioration in the overall fiscal balance - even under the baseline scenario without additional fiscal impetus - public debt management is shown to become more challenging in future years. To this end, *we are looking forward to the authorities' revised budget plan for 2009 and staff's projections based on updated data.*

5. We commend the authorities on the measures to promote a medium-term fiscal framework and propose to consider the implementation of a fiscal rule as an institutional anchor.
6. While the financial sector appears relatively resilient, vulnerabilities in the banking sector have lately increased owing to rising credit and solvency risks and continued weaknesses in the banking supervisory framework. The current downturn is likely to lead to a substantial increase in non-performing loans, and liquidity pressures could re-emerge. Furthermore, as the recent staff statement indicates, banks have started extending loans under the interest rate subsidy scheme, which began in early February, with the bulk of the loans channeled by state-owned commercial banks (SOCBs). In this regard, *we would appreciate the staff's comments on the potential implications of such lending for the SOCB's already difficult financial situation.*
7. We welcome the staff's simulation analysis according to which banks' strengthened capital base may help banks to dampen the impact from the economic slowdown. Nonetheless, the authorities need to monitor the conditions and act promptly to preserve financial stability, including by promoting reforms to improve the supervisory framework and to strengthen the SBV's autonomy. Transforming the SBV into a modern central bank empowered to adopt appropriate monetary policy, building the institutional capacity to implement such policy, enhancing the regulatory framework, and upgrading the ability of the banking sector to assess credit risk will be critical to make Vietnam less vulnerable going forward. *Could the staff comment on whether nonbank financial institutions have shown signs of stress?*
8. We continue to be concerned about the slow progress in reforming SOEs. Faster reforms are key to mitigate credit risk for the banking sector and to contribute to sustained economic expansion. Like the staff, we encourage the authorities to forcefully continue the equitization process for SOEs and SOCBs.
9. Finally, we believe that improving the quality and availability of data will be crucial for the Fund to offer adequate policy advice. We thus encourage the authorities to address the existing shortcomings and to enhance the reliability, transparency, and dissemination of economic data, especially in the fiscal, SOE, and banking sector.