FOR INFORMATION

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From: The Acting Secretary

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***If the authorities consent to the publication of this assessment, it may be published by the World Bank.**

Vietnam—Assessment Letter for the World Bank

February 18, 2020

I. BACKGROUND AND RECENT DEVELOPMENTS

Vietnam's growth performance has been robust in recent years, underpinned by sustained reforms and prudent macroeconomic policies. GDP expanded on average 6.8 percent over 2014-18 and is estimated to grow around 7 percent in 2019.[1] The expansion was private sector-led and broad-based, fueled by growth in incomes and consumption and by strong trade, manufacturing, tourism, and remittances. Headline inflation increased to 5.2 percent at end-2019, driven by higher food prices, reflecting a sharp hike in pork prices, but annual average inflation (2.8 percent) remained below the 4 percent target. Credit growth is moderating, in line with the authorities' targets and modernization of the monetary framework is under way. Significant fiscal consolidation was carried out during 2016–2018, and the 2019 budget remains largely on track, but with infrastructure investment delays. Privatization of blocks of government-owned shares of companies in non-strategic sectors continues through the pace has slowed recently. There are 18 banks[2] officially meeting Basel II standards at end-2019 and the previous commitment of adoption by January 1, 2020 is likely to be extended. Efforts to recapitalize State Owned Commercial Banks (SOCBs) and enhance governance are on-going.

Vietnam remains resilient thus far to global trade tensions and elevated financial volatility. Export growth has moderated, with rising exports to the US offsetting lower demand from China and other partner countries. However, FDI remains strong and the rate of new business creation reached a six-year high. Non-FDI exports have outperformed FDI sector exports in 2019, suggesting encouraging signs of domestic firms participating more actively in the global value chain[3].

Vietnam's external position in at the time of the 2019 Article IV consultation was substantially stronger than warranted by fundamentals and desirable policies. International reserves amounted to 97 percent of the IMF's reserve adequacy metric at end-September 2019.

II. OUTLOOK AND RISKS

Growth is projected to ease to 6.6 percent in 2020, supported by solid domestic demand and favorable FDI prospects. Rising investment income payments (FDI repatriation), despite strong tourism and remittance inflows, are projected to lower the current account surplus to 1.0

[1] All economic indicators are calculated based on new GDP numbers that are revised upwards by 25.4 percent on average over 2010-17 largely owing to better measurement (coverage of businesses), following IMF technical support. Resulting changes to economic indicators mostly reflect changes in measurement rather than policies.

[2] Some banks, that account for around 40 percent share of total banking assets, are facing difficulties in adopting Basel II due to thin capital ratios.

[3] CT-TPP and other FTAs have increased opportunities for domestic firms to participate in global value chains and boosted exports to new markets.

percent of GDP in 2020. Inflation is projected to remain within the target band. Over the medium-term ongoing structural reforms should further lower the current account surplus.

Large downside risks. Vietnam's highly open economy is vulnerable to rising trade tensions, growing protectionism, and weaker-than-expected global growth, including on account of the negative impacts of the recent nCoV virus outbreak. Vietnam has also been placed on the US Treasury watchlist of currency manipulators which could weigh on the bilateral trade relationship. Domestically, regulatory barriers and overlapping laws and regulations constrain needed infrastructure investments in the energy transmission and transportation sectors, threatening to slow the medium-term growth momentum. Ample liquidity in the banking system, and still high domestic credit targets could encourage excessive risk taking in a banking system which still needs further strengthening. On the upside, newly-signed FTAs could spur productivity gains and support reforms; Vietnam could also further benefit from trade diversion and investment relocation.

III. ASSESSMENT

Vietnam has made impressive strides in maintaining macroeconomic stability and private sector-led growth. But the window to address long-term challenges—including rapid prospective population aging, climate change and digitalization—is narrowing. Fiscal consolidation must become of higher quality; macroeconomic institutions modernized; and governance strengthened.

Fiscal policy should emphasize high-quality consolidation to meet large development needs. On-going fiscal consolidation has contained public and publicly guaranteed debt (PPG) to 43.4 percent of GDP in 2019, well below the statutory limit of 65 percent of GDP. Efforts need to be made to widen tax bases; improve public investment management and adopt an appropriate and feasible PPP law with a strong gatekeeper role for the Ministry of Finance to safeguard fiscal sustainability. Tackling regulatory and other barriers (e.g., land clearance, coordination between ministries, regions and cities, procurement) would help avoid excessive investment delays in both public and private investment. Vietnam should ensure that there is adequate fiscal space to meet longer term challenges arising from aging and climate change.

The banking system continues to be strengthened but fragilities remain. Bank profits are rising, boosted by the strong economy and a shift to retail lending with higher net interest rate margins. Strengthening the legal framework for NPL trading, collateralization of debts, and protecting the third-party asset buyer would help facilitate resolution efforts. Bank balance sheets remain vulnerable to shocks, with attendant macro financial risks. Continued efforts to strengthen the capital of systemically important state banks is critical for bolstering banking system resilience. Over the medium-term, prudently moving away from credit growth ceilings (both aggregate and bank-by-bank) towards price-based monetary policy will improve the allocation of credit in the economy and allow for greater exchange rate flexibility to better navigate external shocks. Developing capital markets, including corporate bond markets, is important for long-term investment funding.

Structural reform agenda needs to be broadened and accelerated to tackle the remaining barriers to investment and raise labor productivity. Continued efforts to remove economic distortions and improve the business climate, and ongoing SOE reforms, are steps in the right direction but need to be accelerated. Further reductions in regulatory barriers and transitioning to international standards for regulatory excellences, transparency and data quality to aid investment. Reducing high levels of informality and raising productivity in the still sizeable agricultural sector to facilitate structural transformation remains a priority. Recent efforts to strengthen tertiary education and upgrade training and curricula will help reduce skill matches in the labor market and aid the economic transition from labor-intensive to high-tech goods.

Structural reforms and modernization of policy frameworks will assist with lowering external imbalances and strengthening policy making. More ambitious reforms to strengthen private investment and improve the efficiency of public investment will help reduce current account imbalances. Greater two-way exchange rate flexibility would reduce the need to build policy buffers and better navigate external shocks.

Vietnam needs to strengthen its governance and reduce corruption vulnerabilities.
The 2018 anti-corruption law strengthened the system for the declaration of income and wealth. Additional efforts should prioritize: control of corruption; greater fiscal transparency and public investment management; stronger rule of law and AML/CFT framework and execution.

Table 1. Vietnam: Selected Economic Indicator 2014–2020 1/

	2014	2015	2016	2017	Est 2018	Projections 2019	2020
Output							
Real GDP (percent change)	6.4	7.0	6.7	6.9	7.1	7.0	6.6
Prices (percent change)							
CPI (period average)	4.1	0.6	2.7	3.5	3.5	2.8	3.0
CPI (end of period)	1.8	0.6	4.7	2.6	3.0	5.2	3.2
Core inflation (end of period)	2.7	1.7	1.9	1.3	1.7	2.8	2.1
Saving and investment (in percent of GDP)							
Gross national saving	34.6	32.0	33.2	32.6	35.3	35.0	34.5
Gross investment	30.9	32.9	33.0	33.2	33.3	33.7	33.5
Private	18.6	20.4	20.6	21.3	22.2	22.8	22.9
Public	12.3	12.5	12.4	11.8	11.1	10.9	10.6
State budget finances (in percent of GDP) 2/							
Revenue and grants	17.7	19.2	19.1	19.5	19.5	19.1	18.8
Of which: Oil revenue	2.0	1.3	0.7	0.8	0.8	0.7	0.7
Expenditure	22.8	24.4	22.2	23.2	22.9	22.5	22.0
Expense	16.3	17.2	16.3	16.9	16.6	16.3	16.1
Net acquisition of nonfinancial assets	6.5	7.1	5.9	6.3	6.4	6.1	5.9
Net lending (+)/borrowing(-) 3/	-5.0	-5.2	-3.1	-3.8	-3.5	-3.4	-3.2
Net lending /borrowing including EBFs	…	…	…	-2.9	-2.9	-2.5	-2.4
Public and publicly guaranteed debt (end of period)	43.6	46.1	47.6	46.3	44.2	43.4	42.6
Money and credit (percent change, end of period)							
Broad money (M2)	17.7	16.2	18.4	15.0	12.4	11.4	11.0
Credit to the economy	13.8	18.8	18.8	17.4	12.7	13.0	13.0
Interest rates (in percent, end of period)							
Nominal three-month deposit rate (households)	5.0	4.8	4.9	5.9	5.9	…	…
Nominal short-term lending rate (less than one year)	8.5	7.2	7.2	8.7	8.7	…	…
Balance of payments (in percent of GDP, unless otherwise indicated)							
Current account balance (including official transfers)	3.7	-0.9	0.2	-0.6	2.0	1.3	1.0
Exports f.o.b.	64.5	68.4	70.0	77.6	80.6	80.5	81.2
Imports f.o.b.	59.3	65.3	65.7	73.7	75.1	75.7	76.3
Capital and financial account 4/	2.4	0.4	4.3	7.2	2.8	4.7	3.0
Gross international reserves (in billions of U.S. dollars) 5/	34.3	28.3	36.7	49.2	55.3	74.9	89.3
In months of prospective GNFS imports	2.4	1.9	2.0	2.4	2.5	3.1	3.3
Total external debt (end of period)	30.6	33.9	35.8	38.9	36.6	38.1	38.5
Nominal exchange rate (dong/U.S. dollar, end of period)	21,388	22,485	22,761	22,698	23,175	...	...
Memorandum items:							
GDP (in trillions of dong at current market prices)	4,937	5,191	5,639	6,294	6,959	7,591	8,309
GDP (in billions of U.S. dollars)	232.9	236.8	252.1	277.1	302.3	326.8	356.9
Per capita GDP (in U.S. dollars)	2,567	2,582	2,720	2,959	3,197	3,422	3,702

Sources: Vietnamese authorities; and IMF staff estimates and projections.
1/ The national accounts has been re-based to 2010 from 1994 by the authorities.
GDP numbers are revised upwards over 2010-17 largely owing to better measurement.
2/ Follows the format of the *Government Finance Statistics Manual 2001* . Large EBFs are outside the state budget but inside the general government (revenue amounting to 6-7 percent of GDP).
3/ Excludes net lending of Vietnam Development Bank and revenue and expenditure of Vietnam Social Security.
4/ Incorporates a projection for negative errors and omissions going forward (i.e. unrecorded imports and short-term capital outlfows).
5/ Excludes government deposits.