FOR INFORMATION

FO/DIS/20/178

August 27, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **Vietnam—Assessment Letter for the World Bank**

Board Action:	Executive Directors' **information**
Publication:	Not yet decided*
Questions:	Ms. Dabla-Norris, APD (ext. 37118)

***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

August 27, 2020

This note provides the IMF staff's assessment of Vietnam's macroeconomic conditions, prospects, and policies, based on available information as of August 24, 2020. The assessment has been requested in relation to a development loan for Ho Chi Minh City by the World Bank.

Recent Developments, Outlook, and Risks

The near-term growth outlook for Vietnam is significantly impacted by COVID-19. Prior to the pandemic, growth had remained robust at 7 percent in 2018-19,[1] driven by strong trade, manufacturing, tourism, and buoyant domestic demand. Vietnam's growth is projected to decline to 2.7 percent in 2020, reflecting weak external demand and the impact of strict domestic containment measures, amidst considerable uncertainties. A gradual recovery is expected in 2021 (7 percent growth), supported by monetary and fiscal easing and relatively strong macroeconomic fundamentals. Headline inflation is projected to decline to 2 percent at end-2020. The current account surplus projected to narrow sharply to 0.7 percent of GDP (from 4 percent of GDP in 2019) given the sharp contraction in trade and tourism. FDI inflows slowed moderately by 6 percent (year over year) in the first half of 2020, and portfolio investments registered a small outflow. Vietnam's external position was assessed to be substantially stronger than warranted by fundamentals in 2019.

Given pervasive uncertainties, the balance of risks is sharply tilted to the downside. Early implementation of stringent containment measures limited propagation in the first half of the year, but the recent rise in infections will likely prolong the social-distancing period. Economic impacts under an adverse scenario of a longer and more widespread global or domestic outbreak with sustained mobility restrictions could be more severe. Vietnam's highly open economy is vulnerable to a sharp slowdown in trading partners and growing protectionism. While the health of the banking sector has improved in recent years, a more protracted shock could materially impact asset quality.

Policy Response and Settings

Fiscal policy

The government introduced a fiscal support package valued at approximately VND 279 trillion (3.7 percent of GDP) to support the economy. Key elements of the package include increased state budget for healthcare and containment, temporary tax and land rental payment

[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.

deferrals for affected firms, lower corporate income taxes for SMEs and micro firms, and cash transfers for the poor, workers without unemployment insurance, the self-employed, and vulnerable households, although the speed of implementation of measures could be improved. In addition, steps have been taken to speed-up public investment carried over from previous years, cut electricity price and increase unemployment benefits.

Given the extraordinary circumstances, additional support may be necessary particularly if downside risks materialize. Vietnam's public and publicly guaranteed debt (42.9 percent of GDP in 2019) is well below the statutory limit of 65 percent of GDP. This combined with sizeable government deposits with the banking system of over 6-7 percent of GDP, and curtailment of current spending, provides welcome fiscal space. Mitigating factors include a large domestic investor base, long tenor of domestic debt, and low levels of external indebtedness. Given significant uncertainties, the authorities will need to remain agile and respond proactively to the evolution of the economy and the pandemic, quickly adjusting the size and composition of the fiscal response as both economic and public health conditions change. The authorities have indicated their commitment to maintaining fiscal discipline, managing expenditure closely to keep the deficit in check and to ensure that debt levels remain prudent. As the economy reopens, fiscal measures should shift from liquidity support to productive infrastructure investment while mobilizing domestic revenue, including through broadening the tax base as suggested by recent IMF TA. The large envisaged increase in the capital budget calls for concomitant steps to improve public financial management and public investment spending efficiency.

Monetary Policy

The State Bank of Vietnam (SBV) has eased monetary policy to support a slowing economy amid the COVID-19 shock. Benchmark policy rates were cut twice by 50-100 bps. The State Bank of Vietnam (SBV) also cut the short-term deposit rates cap and the short-term lending rates cap for priority sectors to priority sectors, including small and mid-size enterprises affected by the pandemic. After the second wave of outbreak, remuneration rates on required reserves and government deposits were further lowered to stimulate credit.

Easing monetary bias should continue in order to mitigate a more severe economic slump and support the recovery, given moderating inflation amid a wide negative output gap, and lower commodity prices. However, given weak monetary transmission, fiscal policy will have to play a prominent role in supporting the economy. SBV should continue to ensure an adequate supply of liquidity to financial institutions to support market functioning. Greater exchange rate flexibility could be allowed and FXI utilized in a temporary and transparent manner to limit excessive volatility. Over the medium-term, the SBV needs to continue to modernize the monetary policy framework.

Financial Policy

The SBV has introduced guidelines to ease the economic fallout of the pandemic on affected firms and household businesses. The SBV encouraged commercial banks to provide new loans, restructure existing loans, waive and lower interest rates and fees, and keep loan classification unchanged. Many banks have registered to participate in preferential credit packages to assist borrowers to the tune of VND 285 trillion (3.8 percent of GDP). The SBV has also instructed commercial banks to reduce bonuses and salaries, cut other operating costs, and use the resources saved to reduce lending interest rates.

Banking system vulnerabilities arising from COVID-19 should be closely monitored. Prior to the pandemic, the financial system has been strengthened but fragilities remained. Weakening bank profitability and limited options for raising capital will make system-wide Basel II adoption more challenging than originally envisaged, particularly for the systemically important state-owned commercial banks. Targeted and temporary supervisory actions such as capital forbearance could be contemplated in these exceptional cases and any temporary decline in capital ratios accompanied with a credible capital restoration plan. Relaxation of prudential and accounting requirements should not be encouraged.

Macrostructural Issues

Structural reforms are essential to ensure robust and inclusive growth and improve economic resilience. Long-standing priorities, such as higher infrastructure investments, banking, land, and SOE reforms, and efforts to improve governance and productivity, are critical to support economic recovery at this juncture. Modernizing policy frameworks will help boost economic resilience and the ability to cope with future shocks. Reductions in regulatory barriers and transitioning to international standards for regulatory excellence, transparency and data quality can help boost private investment.

IMF Relations

Vietnam is on a standard 12-month Article IV consultation cycle. The 2019 Article IV consultation was concluded by the IMF’s Executive Board on June 19, 2019.

Table 1. Vietnam: Selected Economic Indicators, 2016–21 1/

	2016	2017	2018	2019	Projections 2020	2021
Output						
Real GDP (percent change)	6.7	6.9	7.1	7.0	2.7	7.0
Prices						
CPI (period average)	2.7	3.5	3.5	2.8	3.2	3.9
State budget finances 2/						
Revenue and grants (in percent of GDP)	19.1	19.6	19.5	19.0	18.1	18.5
Expenditure (in percent of GDP)	22.2	21.5	22.9	22.3	23.3	22.6
Fiscal balance (in percent of GDP) 3/	-3.1	-2.0	-3.5	-3.3	-5.2	-4.1
Gross financing needs (in percent of GDP)	5.1	3.8	5.5	6.0	7.8	7.1
Public debt (end of period, in percent of GDP)	47.6	46.3	44.2	42.9	45.7	45.5
Money and credit						
Broad money (percent change, end of period)	18.4	15.0	12.4	14.8	7.4	12.4
Credit to the economy (percent change, end of perioc	18.8	17.4	12.7	12.8	6.9	14.0
Balance of payments						
Current account balance (in percent of GDP)	0.2	-0.6	1.9	4.0	0.7	1.0
FDI, net inflow	4.3	7.2	2.8	5.9	0.4	2.4
Reserves (in months of imports)	2.0	2.4	2.5	3.5	3.4	3.6
Total external debt (end of period)	35.8	38.9	36.6	37.4	38.3	39.1
Exchange Rate						
Nominal exchange rate (dong/U.S. dollar, end of peric	22,761	22,698	23,175	...	...	...
Memorandum items:						
Per capita GDP (in U.S. dollars)	2,720	2,959	3,197	3,422	3,595	3,897

Sources: Vietnamese authorities; and IMF staff estimate

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 bı 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.