Vietnam: Further Challenges in 2009

Sanchita Basu Das, Omkar Lal Shrestha

ASEAN Economic Bulletin, Volume 26, Number 1, April 2009, pp. 1-10
(Article)

Published by ISEAS–Yusof Ishak Institute

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Vietnam
Further Challenges in 2009

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This special issue of ASEAN Economic Bulletin zeroes in on the challenges faced by one of the emerging ASEAN economies, Vietnam. Vietnam, which was hailed as a miracle economy in the recent years, came under severe pressure in 2008. Inflation rose, real estate market crashed, and stock market burst. It was in the second half of 2008, as the central bank’s policy measures came into play and global economies slowed, Vietnam could rein in its macroeconomic meltdown. Going into 2009, with external demand still showing no signs of recovery, Vietnam will face a slower growth. The paper further gives some policy options for Vietnam to restructure its economy and deliver good quality growth. Finally, the paper previews the articles contained in this special issue on Vietnam.

Keywords: Vietnam, inflation, exports, investments.

I. Introduction

A couple of years ago, Vietnam was considered to be a miracle economy, matching the rise of Asian tigers of the 1990s. The success was hailed with its newfound standing in the World Trade Organization (WTO) and in the United Nations Security Council. The GDP growth target of 9 per cent, and the efforts to achieve a status of middle-income country governed most of the country’s economic policies. Such targets and determination were supported by international communities as foreign investors poured their capital into the country. Thus, along with an economic growth of 8.5 per cent in 2007 (Figure 1), housing price doubled and the nascent stock market experienced a sharp rally.

However, in 2008, Vietnam economy, besides the domestic challenges, was caught in the midst of a global financial crisis. While the havoc started in 2007 with the U.S. sub-prime mortgage crisis, it was exacerbated by the collapse of Lehman Brothers in September 2008 and led to a deep economic recession in the United States, Japan, United Kingdom and in many Euro Area countries. According to the International Monetary Fund (IMF), the world output slowed from 5.2 per cent in 2007 to 3.2 per cent in 2008. It further predicted that the global economy will be in recession in 2009 for the first time in sixty years. World growth is expected to contract by 0.5 per cent to 1 per cent in 2009, with gradual and modest recovery only in 2010. Given that, Vietnam’s manufacturing exports that head for
these advanced economies will suffer and policymakers will have a dilemma of managing slower growth without pushing the economy into recession or damaging the business environment for foreign direct investment (FDI).

In this context, this special issue of the ASEAN Economic Bulletin zeroes in on the domestic and external challenges for Vietnam. This introductory article provides an overview of the economy and sets the backdrop for the articles that follow. In the next section, we give an outline of challenges faced by Vietnam in 2008. The following section III deals with the economic outlook and summarizes the hindrances to growth. Some policy recommendations are narrated in section IV. Finally, we conclude this article and provide a preview of the articles ahead.

II. 2008: A Challenging Year for Vietnam

The year 2008 was a difficult one for Vietnam. Inflation crossed the 25 per cent mark as food prices doubled, cost of housing and construction materials rose, and prices of beverage and tobacco soared. All these neutralized most of the gains made by Vietnam over the last few years. The stock market collapsed, falling more than 55 per cent in the first half of the year. The Vietnamese dong fell to 17,485 in end-2008 (from 16,000 at the beginning of 2008) against the U.S. dollar, giving further indications of weakening economic conditions. Citing this macroeconomic instability, Moody’s lowered Vietnam’s ratings outlook from positive to negative.

Meanwhile, Vietnam also witnessed a restive workforce. Workers’ salaries could not keep pace...
with the rising cost of living. This resulted in a number of strikes, which affected the country’s image to international investors, especially to companies looking for alternatives in China. In the first half of 2008, there were more than 300 strikes throughout the country, with management generally agreeing to some pay increases. The number of poor increased in the country, with Prime Minister Nguyen Tan Dung acknowledging the pain imposed by inflation on the people and admitting the government’s responsibility to restore price stability.

In order to tackle inflation, State Bank of Vietnam (SBV) raised the benchmark interest rate by 575 bps (to 14 per cent) to increase savings and limit credit growth, while the government cut some public investment projects. The authorities faced a strong dilemma of managing slower growth without pushing the economy at the same time into recession or damaging the business environment for FDI. Nevertheless, as other external factors came into play, the authorities finally got some relief with inflation ebbing to less than 20 per cent in December 2008 (Figure 2).

Because of these administrative interventions, business activities were scaled down significantly. A large number of small- and medium-sized businesses who were not capable of overcoming the significant burdens posed by credit, interest rates, prices and market movements have gradually faded away.

That said, GDP grew by 6.2 per cent year-on-year (y/y) in 2008, below the rates recorded in recent years (7–8 per cent) and 8.5 per cent y/y in 2007. Except for the services sector which posted

![FIGURE 2](source: CEIC Database.)

Abating Inflationary Pressure since September 2008
an improvement in growth to 7.2 per cent y/y, all
other key sectors registered moderate growth. The
agriculture sector saw moderate growth of 3.8 per
cent y/y, as global food and commodity prices
softened along with decline in demand. Anti-
inflation measures taken by the Government
restrained growth in investment and halted
the expansion of the construction sector.
Manufacturing sector also suffered as industrial
production slowed to 5.5 per cent y/y in 4Q08,
vis-à-vis 14.1 per cent of expansion in the first
three quarters of last year.

III. Economic Outlook Remains Challenging

The economic prospects for 2009 will be even
more challenging than in 2008. With the current
global crisis, Vietnam is already experiencing
adverse impact in terms of export performance
and FDI. This is unfavourable for a country like
Vietnam, whose US$63 billion nominal exports is
about 80 per cent of nominal GDP. More than
50 per cent of these exports go to G3 economies
of the United States, EU, and Japan, which are all
now struggling with recession (Figure 3). The
regional economies in Southeast Asia, which
accounts for 18 per cent of total exports, are also
struggling against the global recession.

This is also supported by the monthly trade data
of Vietnam. In the first two months of 2009 both
imports and exports fell by 42.2 per cent and 0.5
per cent y/y respectively (Figure 4). This is against
a growth of 5.6 per cent y/y in exports and a
contraction of 9.0 per cent y/y in imports during
the last quarter of 2008. However, the trade
balance registered a surplus of US$390 million in
January 2009, its first since January 2006. This
could be due to sharp fall in oil prices, as the oil
trade balance has narrowed, it narrowed the
overall trade deficit. The central bank has also

FIGURE 3

Around 50 per cent of Total Exports Goes to the U.S. and Europe

NOTE: Data for 2005.
SOURCE: CEIC Database.
allowed the currency to depreciate and it has widened the trading band to accommodate higher fluctuations. Finally, the decline in production activities as a result of a slowdown in export demand could have caused import demand to cool.

The coming quarters will witness a fall in the value of export goods owing to weak global demand. The fall in crude oil prices suggest that Vietnam’s oil exports will fall in 2009. For imports, given the uncertainty in the global economy and the fact that foreign investors will face difficulties acquiring financing in the next two years, capital goods imports will fall from their high levels in recent years. The slowdown in consumption growth will also curtail growth in imports of consumer goods in next two years. This will result in a major reduction in the merchandise trade deficit.

The current account deficit will also narrow in 2009. Tourism receipts will decline, with other imports of trade-related services. The upward trend in the repatriation of foreign investors’ income and profits will temporarily reverse, in line with a slowdown in the operations of foreign enterprises. Inflows of current transfers will be affected by recessionary conditions in the United States and the EU, which are home to large numbers of Vietnamese.

Going forward, weak external demand will likely to take its toll on the export-oriented manufacturing sector and thus on overall GDP growth. FDI, which was an important driver for

FIGURE 4
Uncertain External Sector due to Weak Oil and Textile Demand Overseas

SOURCE: CEIC Database.
growth of the Vietnam economy, will be severely curtailed on lack of available financing. Liquidity for banks is also expected to dry up, partly because banks are refusing to lend to other financial institutions that may not be able to pay back loans. This, in turn, will adversely affect the overall investment growth in the economy. On the supply side, in addition to weakness in the industrial sector, services growth will also suffer as a result of the global financial crisis and recessionary conditions in many developed countries. Hence, the overall economic growth for Vietnam is expected to further moderate to around 5.5 per cent in 2009, the weakest pace since 1999.

Inflation growth in 2009 will be sagging on lower crude oil and food prices and on high base effect of last year. Crude oil prices have already plummeted about 72 per cent from a peak of US$145 per barrel in July 2008 (Figure 5). Given this, analysts expect Vietnam’s inflation to fall to a single digit of 8–9 per cent for the full year of 2009 (vis-à-vis 23 per cent in 2008).

Nevertheless, some of the social problems will continue, and maintaining workers’ employment and income will be difficult. As exports decline due to ongoing global meltdown, many businesses have to reduce the number of employees, operating hours and production. This will result in higher unemployment and increased poverty.

IV. Policy Recommendation

Most of the economic problems in Vietnam are due to low economic and investment efficiency. The Government pursued measures and projects...
that would achieve its growth targets. It created an investor-friendly environment that would draw on massive capital flows and distributed them to provincial government agencies. It also distributed land and developed new industrial areas. All this led to overlaps and wastage of scarce resources. This was reflected in the construction of too many projects such as golf courses, real estate developments, steel factories, as well as large and small-scale oil refineries.

State-owned enterprises took advantage of the laxity of the government, and they diversified themselves to "high-end" sectors such as stocks, financial investment, real estate, and even participating in the establishment of commercial banks. Eventually, credit levels rose above 50 per cent in 2008, inflation shot up to 28 per cent, and trade deficit surpassed its acceptable benchmark.

In 2009, with gloomy global environment, higher unemployment and declining investments, the Vietnamese Government has to take measures to contain economic recession. It should restructure the economy, make it more competitive and also explore new export markets.

The government is undertaking stimulus measures to boost the economic growth around 6 per cent, while capping inflation at 8–9 per cent. The government is also engaged in public investment, with focus on short-term and small projects, particularly those that require large quantities of materials and labour. Better management and supervision of public investment along with increased transparency and openness will be critically important.

Recognizing that the downside risk to growth is more externally driven, the government is appropriately loosening its monetary policy. SBV has cut its base rate by a total of 550 bps, to 8.5 per cent in October 2008 and further down to 7 per cent in February 2009 from 14 per cent previously. Going forward, on weaker growth profile for 2009, the SBV is likely to lower the rate further during the year and keep it low in 2010 to support credit expansion.

Against such a background, Vietnam may need to stimulate both investment and consumption to compensate for the falling exports. In this regard, monetary policy alone is not enough. Fiscal policy also needs to be implemented in order to obtain better results. While the Vietnamese Government has pledged a US$6 billion fiscal stimulus package to boost growth, it has not specified how much of this represents new spending in addition to what had been allocated in the original budget for 2009. The original budget (excluding stimulus plan) estimated a deficit of 8.3 per cent of GDP vis-à-vis 4.8 per cent of GDP in 2008. In view of this, it is important that the stimulus measures being planned are better defined, effectively implemented and fiscally sustainable. This is particularly in view of the country’s slower revenue growth from declining oil prices (which accounts for 30 per cent of total government revenue), relatively low tax base (since tax reform has been deferred) and weak cash reserves.

In Vietnam, the Government recognizes small and medium-sized enterprises (SMEs) as an engine for economic growth and job creation. It has encouraged commercial banks to increase lending to SMEs with subsidized interest rates programme. Incentives should also be given to labour-intensive projects.

On the trade deficit side, it reached US$17 billion in 2008, up from US$12.5 billion in the preceding year. Since early 2007 when Vietnam joined the WTO, it has been difficult to control trade deficit as the country can no longer impose import quotas. Moreover, strong growth and other development activity increased the demand for imports. This trade deficit has to be reduced, as it will put severe pressure on the balance of payments. In 2009, with the recession in the developed countries, international companies will rethink on expansion plans, and remittances from overseas Vietnamese are also expected to contract. On the other hand, 2009 is also expected to witness a sharp fall in oil prices, thus narrowing the oil trade balance and the overall trade deficit (Figure 6). Moreover, the central bank increased the width of the dong’s trading band from 2 to 3 per cent, so as “to ensure reasonable and stable
economic growth”. In late December the SBV devalued the dong by 2.9 per cent, which reflects the central bank’s strategy of employing the exchange rate as a tool to boost exports. However, the central bank’s strategy of adopting the exchange rate as a tool to boost exports may or may not work at a time of economic recession in Vietnam’s trading countries.

Lastly, the Government should create confidence among the people that the economy will be stable, thereby avoiding its dollarization. This is necessary especially because, at the fixed exchange rate, as real interest rates fall below the international rate, residents switch to assets denominated in foreign currencies, or they move into assets like gold and land. In such case, it becomes very difficult for the central back to mop up the excess liquidity in the system, which finally could result in inflation.

V. Concluding Remarks and Articles in this Issue

Just as the country was succeeding in stabilizing inflation in 2008, the global financial turmoil has left it with no option but to switch its policies towards promoting economic growth. As the government makes a commitment to pursue its stimulus programme of US$6 billion, it is confronted with relatively low cash reserves,
narrower tax base and reduced oil revenue, a major source of government revenue. The burgeoning fiscal deficit of around 8 per cent of GDP (without counting the stimulus package) offers its own limit to the Government. While the Government may pursue easy monetary policies, the commercial banks may still be wary and risk averse. The country’s policy of keeping the currency weak to gain export market access may not yield the desired result as its export partners continue to experience economic recession. Vietnam is thus passing through a critical phase where growth needs to be sustained against limited policy instruments at its hand and shrinking traditional export market abroad.

Looking ahead, the first article in this issue looks into the challenges faced by Vietnam. In this article, Jonathan Pincus first reviews the likely impact of the global recession on Vietnam, and suggests a set of policies to reduce the negative effects of slower export growth, falling export prices, and a reduction in FDI. The paper then examines the specific problems facing large state-owned enterprises, and argues that more rigorous disclosure requirements and separation between financial and industrial interests are needed to ensure that public investment is directed towards projects that create jobs, profits and foreign exchange.

In the second article, Kenichi Ohno provides an assessment of industrial policy formulation in Vietnam and how it can avoid the middle-income trap. According to him, as the global integration has deepened, Vietnam needs to create internal value to continue to grow and avoid the middle-income trap. The vision of industrialization and modernization to be achieved by 2020 must be backed by realistic industrial strategies and concrete action plans, which are currently lacking.

Suiwah Leung examines the banking and financial sector reforms in Vietnam. She discusses the asset price bubble and macroeconomic instability of mid-2008, and the extent to which these were directly and indirectly related to the unresolved problems in the financial sector. The article also points out the need for continued deep institutional reforms in order to take advantage of financial globalization whilst minimizing the risks of financial crises. It addresses the balance of interests in contemporary Vietnamese society which could affect the likelihood of such reforms being adopted.

There is no doubt that the main impetus for Vietnam’s high GDP growth came from large inflows of foreign funds mainly to manufacturing sector. Thus, the next three articles in this issue present pros and cons related to FDI in Vietnam.

In his article on “Managing Success in Vietnam: Macroeconomic Consequences of Large Capital Inflows with Limited Instruments”, Jayant Menon examines the trends, determinants, and impacts of FDI. He further looks into the macroeconomic consequences of capital inflow. According to him, in a dollarized economy like Vietnam, where the ability to conduct open market operations may be impaired, the result can be sharp rises in inflation. Jayant finally examines the policies that are available to Vietnam to manage macroeconomic imbalances as a result of inflows of FDI.

Tien Quang Tran’s article on “Sudden Surge in FDI and Infrastructure Bottlenecks” investigates the roots of sudden increase in FDI inflow and patterns of FDI in Vietnam. It reviews the impact of policy change on FDI inflows in Vietnam and discusses the changes in the form of investment and patterns of source country. The article further analyses FDI by investment area and assesses the geographical distribution of FDI in Vietnam.

Vietnam became a member of WTO in early 2007. The effect of WTO accession are diverse, ranging from direct effects such as expansion in market access and FDI, to more indirect ones such as competition and pressures to further reform. Keeping this in mind, the next two articles in the issue talk about the trade policy reforms in Vietnam.

In his article on “Economic Transition and Export Performance in Vietnam”, Prema-Chandra Athukorala examines Vietnam’s export performance in the reform era with a view to informing the policy debate on designing the future export development strategy. The key theme of analysis is the complementary role of domestic
policy shifts and the ongoing changes in world trade patterns in determining trends and patterns of exports.

Finally, in their article on “Vietnam after Two Years of WTO Accession”, Vo Tri Thanh and Nguyen Anh Duong examine the impact of the WTO accession on Vietnam’s economy. The authors subsequently summarize the main lessons for Vietnam as the first two-year period of WTO membership eventuates. They finally draw out some concluding remarks with respect to Vietnam’s experience in light of integration, including the WTO accession, and policy directions in the coming years.

NOTE


Sanchita Basu Das is Visiting Research Fellow and Lead Researcher for Economic Affairs in the ASEAN Studies Centre at the Institute of Southeast Asian Studies, Singapore.

Omkar Lal Shrestha is Senior Visiting Research Fellow at the Institute of Southeast Asian Studies, Singapore.